A Framework for the Quality of Corporate Risk Disclosure

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Abstract

Corporate risk disclosure (CRD) has gained considerable attention particularly after the US accounting scandals and corporate failures of the early 2000s and the global financial crisis of 2007-8. These crises served as a wakeup call for companies, investors, policy makers, capital market authorities and other stakeholder groups to pay more attention to risk management and risk reporting. Consequently, there has been a growing demand for companies to provide more, and better, risk information (RI). Professional bodies have proposed guidelines encouraging companies to provide more information on their risk exposure. Furthermore, there have been regulatory responses with different countries issuing regulations that oblige companies to report RI. Previous studies have focused on examining CRD quantity and its determinants. While some studies suggest companies have increased their risk disclosures, others highlight that companies are not necessarily reporting more informative RI. Concerns have been raised about CRD quality and usefulness, and yet CRD quality is still an under-researched area.

This study departs from the mainstream literature in that it develops an in-depth understanding of and a framework for CRD quality. This is the first study to investigate the perspectives of the different stakeholder groups on various aspects of CRD quality using semi-structured interviews. The findings reveal a lack of a common definition of risk among the interviewees and highlight the importance of CRD to information users and companies. The results indicate that CRD has improved, yet there is considerable room for improvement. The findings also demonstrate a number of incentives and disincentives for risk reporting that could help explain managers' CRD decisions. The FASB's qualitative characteristics have been operationalised in the context of CRD and a number of characteristics have been developed that could help improve and assess CRD quality. This study has important implications for CRD policy, practice and future research.

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Dedication

This thesis is dedicated to my dearly loved parents, my beautiful and beloved wife Aseel, “The love of My Life” and our lovely son, Omar, as well as to my beloved brothers and sisters.

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Author’s Declaration

I declare that this thesis is a presentation of original work and I am the sole author. This work has not previously been presented for an award at this, or any other, University. All sources are acknowledged as References.

Mahmoud Marzouk

York, September 2017

Chapter 1: Introduction

1.1. Background and overview

Today's business environment is often perceived as beset with risks and uncertainties with companies exposed to a wide range of internal and external risks. Thus, in this constantly changing business environment it is generally acknowledged that companies face many threats, challenges and uncertainties including, but not limited to, economic, political and social risks. Operating in a volatile and unpredictable business environment requires companies and other organisations to have an effective risk management system and strategies to contend with risks. These challenges may not only affect company performance but also endanger a company's survival. Therefore, as a part of good governance, firms should develop strategies to respond to such challenges and mitigate or take advantage of their potential impacts and outcomes. In this way they can protect and create wealth for shareholders.

It is also argued that it is incumbent upon companies to keep shareholders and other information users informed about their risk exposures and their risk management strategies, and that companies should also justify to investors in particular the rationale for their taking particular risks. Accordingly, corporate risk disclosure (or risk reporting) is a means for investors and stakeholders to be better informed about the risks a firm faces and how these are being managed. It is generally assumed that corporate risk disclosure (CRD) is important as it aids stakeholders in assessing management performance by providing a picture of how well managers manage risks and aids stakeholders in their decision-making by facilitating an assessment of the risk profile of the company.

1.1.1. Proposals for improved risk disclosure

Corporate risk disclosure (CRD) has been the focus of considerable attention over the last two decades within the accounting literature and as a topic under debate by regulators and professional bodies (Dobler, 2005, 2008), "yet the topic is still very much in its infancy" (Abraham and Shrives, 2014, p. 91). In part, this recent interest in CRD is related to increased demands for companies to provide more risk information following the corporate failures and accounting scandals in the early 2000s at a number of US companies such as Enron, HealthSouth, Tyco, Morgan Stanley, J. P. Morgan, and WorldCom. These demands have been given further impetus by the global financial crisis of 2007-09 after which it has been suggested that banks need to improve their risk disclosures (ICAEW, 2011; Lajtha, 2005).

The attention placed on CRD is not solely attributable to prior accounting scandals and the global financial crisis. Linsley and Shrives (2006) suggest that the Institute of Chartered Accountants in England and Wales (ICAEW) were one of the first bodies to identify a potential

deficit in the provision of risk information by companies. In its 1997 report on CRD, the ICAEW placed a considerable emphasis on the importance of risk reporting (RR) and attempted to motivate companies to voluntarily provide more risk information (RI) through suggesting there were benefits for companies in providing enhanced CRD. ICAEW (1997) identifies seven key benefits of improved RR for companies and investors (pp. 5-8).

First, providing forward-looking RI enables investors to make better decisions through enhancing their ability to predict the company's future cash flows and assess its future performance. Second, the report makes the claim that companies can lower the cost of capital through improving their RR practices, suggesting investors would require a higher risk premium (higher rate of return) for the uncertainty associated with their investments when there is a lack of RI. Third, the report argues that better CRD should enhance corporate risk management and increase the company's cash flows and, thereby, create greater value for shareholders. Fourth, RR improves corporate image and reputation demonstrating to investors the company's managers are risk aware. Fifth, the report encourages companies to ensure that the same information is made available to all investors and, therefore, overcome information asymmetry problems. Sixth, it asserts investors can evaluate management performance based on its risk management (RM) and RR practices. Lastly, appropriate CRD protects investors through keeping them informed about the company's risk exposure (RE).

Subsequently, accounting researchers have undertaken CRD studies that highlight the importance of risk-related information for investors and other users of corporate information, and argue the need for improved RR (see, for example, Beretta and Bozzolan, 2004a; Cabedo and Tirado, 2004; Deumes, 2008; Hassan, 2009; Linsley and Shrives, 2006; Mousa and Elamir, 2013; Rajab and Handley-Schachler, 2009). Similar to the ICAEW, this previous research suggests additional benefits will arise from increased CRD. Deumes (2008) argues that investors can use RI to assess a company's future prospects and, relatedly, it has also been argued that RI is useful to investors in assessing a company's RE (Cabedo and Tirado, 2004; Campbell et al., 2014; Linsley and Shrives, 2000). Furthermore, Solomon et al. (2000) report that institutional investors revealed that improved RR helps them make better portfolio investment decisions, as existing and potential investors can then make their decisions based on both potential returns and expected risks (Cabedo and Tirado, 2004).

Moreover, Beretta and Bozzolan (2004a) argue that CRD enables investors to better predict stock returns and changes in stock prices (see also, Deumes, 2008) whilst Campbell et al. (2014), Lajili and Zeghal (2005), Linsley and Shrives (2000), Neri (2010) and Rajab and Handley-Schachler (2009) discuss a major benefit of increased CRD is protecting investors through overcoming the information asymmetry problem and ensuring that all investors receive the same information at the same time. Therefore, a key argument proposed is investors can exploit RI to make informed decisions through enhancing their ability to identify the different

risks facing the company, assess its level of risk and potential returns and estimate the amount and timing of future cash flows (Abraham, Marston and Darby, 2012; Cabedo and Tirado, 2004; Linsley and Shrives, 2005b).

A broader argument concerning the benefits of CRD is that corporate disclosure in general aids the capital market to function more efficiently. Therefore, improved CRD could potentially contribute to the enhancement of capital market efficiency through promoting transparency and, which in turn, stimulates economic development (Abraham, Marston and Darby, 2012; Deumes, 2008; Linsley and Shrives, 2005b; Mousa and Elamir, 2013). In this argument increased CRD is considered important to the overall investment climate and to national economic growth as it contributes to the improvement and stability of the investment environment and capital accumulation (Rajab and Handley-Schachler, 2009).

1.1.2. Regulating risk disclosure

Given the above arguments regarding the potential benefits of CRD it is understandable that CRD has drawn the attention of professional and regulatory bodies in different countries and resulted in the introduction of CRD requirements and/or the improvement of existing regulations. These regulations are intended to oblige companies to provide more RI and enrich the content of risk disclosures in corporate reports in order to better meet the information needs of investors. For example, companies in the USA are required to disclose RI within Item 1A of their 10-K forms and German companies must now comply with German Accounting Standard (GAS) 20 which details what is required in respect of disclosures of risks and opportunities.

In addition, some of the pronouncements by professional and regulatory bodies regarding CRD are connected with restoring confidence particularly after the recent global financial crisis. An example of this is the Walker review of corporate governance (CG) in UK banks (2009). This review suggests banks prepare a separate report in the annual report that addresses the company's risk profile (RP), appetite, exposure and overall risk governance. The Walker review highlights the significance of such a report to investors stating that "the principal purpose of the risk report will be to assist shareholders through improving their understanding of the governance of risk-taking and of the risk appetite and performance of their investee company which is a consequence of the business strategy being pursued" (p. 104). It is important to state that CRD in banks is a highly complex matter as they are required to make very detailed and specific risk disclosures under the Basel Pillar III regulations.

In the UK companies are required by the CG Code and Companies Act 2006 to report on their principal risks and uncertainties, and explain how the risks are being managed and mitigated. The UK CG Code sets out that "the board should present a fair, balanced and understandable assessment of the company's position and prospects" (p. 5) (FRC, 2016). A company's financial position and prospects cannot be properly assessed separately from its RE and position.

Provision C.2.1 of the UK CG Code highlights the importance of RR and RM and the role of directors in fulfilling this responsibility, and states that "the directors should confirm in the annual report (AR) that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity" (p. 17). Additionally, the directors should "describe those risks and explain how they are being managed or mitigated" (FRC, 2016, p. 17). Likewise, the UK Companies Act 2006 requires companies to provide risk-related information in their strategic report. According to section 414C of the Companies Act 2006, "the strategic report must contain a description of the principal risks and uncertainties facing the company" (Strategic Report and Directors' Report Regulations, 2013, p. 2).

1.1.3. Risk disclosure and the issue of quality

Whether CRD regulation results in improved risk disclosures is subject to debate. Dobler (2008) emphasises the role of CRD incentives and concludes that "my main results confirm that regulation cannot overcome incentives in risk reporting at each level of analysis" (p. 186). Linsley and Shrives (2005a) explain the lack of RI being provided by proposing managers' unwillingness to disclose commercially sensitive information which is associated with the costs of CRD outweighing the benefits. This lends support to the notion that regulations alone cannot guarantee higher CRD quality.

Generally, there has been a growing interest in researching CRD within the accounting literature. Previous CRD studies have mainly focused on investigating CRD attributes (for example, whether risk information provided in annual reports is quantified or not), and examining the relationship between CRD quantity and a number of firm-specific and CG characteristics such as company size, industry type, company risk level, profitability, corporate reserves, cross listing, board size, board independence, CEO duality, ownership structure (see, for example, Abraham and Cox, 2007; Cabedo and Tirado, 2004; Elshandidy and Neri, 2015; Linsley and Shrives, 2006; Marzouk, 2016). Some prior CRD studies have concluded that CRD has improved over time (Konishi and Ali, 2007; Neri, 2010; Rajab and Handley-Schachler, 2009; Deumes, 2008); whereas other studies have raised concerns about the usefulness of the RI being provided (see, for example, Beretta and Bozzolan 2004a; Dobler, 2005; Dobler, 2008; Lajili and Zéghal, 2005; Linsley and Lawrence, 2007). However, these studies do not study the quality of the risk disclosures directly. Some of the prior studies fail to capture the essence of quality as they use inappropriate measurements of RI quality such as value relevance (see, for example, Moumen, Ben Othman and Hussainey, 2015), and some studies use the quantity of RI disclosed as a proxy for quality (see, for example, Mousa and Elamir, 2014; Leitner-Hanetseder, 2012).

Consequently, there is a need for further research that directly addresses CRD quality. The concepts of risk and quality are both inherently complex and this may explain why prior CRD research has considered CRD quality only indirectly. However, investigating CRD quality is important for understanding how to improve CRD practices and, therefore, CRD quality is the focus of the research within this thesis.

The remainder of this chapter is structured as follows. After a brief description of the scope of research in Section 1.2, I introduce in Section 1.3 the research aims and objectives. Section 1.4 presents the research questions. Section 1.5 addresses the research contribution. Section 1.6 concludes the chapter with a summary of the thesis structure.

1.2. Scope of research

This study focuses on investigating quality in the context of RR and proposes how to improve its usefulness for information users. Many previous CRD studies focus on counting the number of words and/or sentences disclosing RI in corporate reports regardless of how informative it is for information users (see, for example, Linsley and Shrives, 2006; Marzouk, 2016). The primary purpose of corporate reporting is to enhance information users' decisions by providing useful information (FASB, 2010). Therefore, it is imperative to examine CRD quality and usefulness, and this can be achieved by understanding stakeholders' perspectives on CRD quality and, in particular, information users and information providers' perspectives.

As noted above, prior CRD studies do not address CRD quality adequately. A number of previous CRD studies attempt to examine CRD quality by focusing on identifying different RI characteristics of risk sentences including quantitative/qualitative, time orientation and between good-bad news characteristics (Beretta and Bozzolan, 2004a; Dobler, Lajili and Zéghal, 2011; Linsley and Shrives, 2006). Abraham and Shrives (2014) adopt a different approach and propose a model for assessing and enhancing CRD quality. However, the study is very limited as they investigate only three criteria; disclosure of company-specific risk information; providing up-to-date information and reporting key risks and uncertainties. Campbell and Slack (2008) investigate the usefulness of narrative reporting from investment analysts' perspective, whereas Slack and Campbell (2016) conduct semi-structured interviews to identify the needs and use of investment analysts in terms of integrated reporting, and explore its usefulness. Consequently, whilst their studies include important discussions relating to CRD quality, their research does not have a primary focus on examining CRD or CRD quality. Therefore, there is a CRD quality research gap and, it can be argued that an effective analysis of CRD quality and usefulness can be achieved through investigating information users' perspectives on the subject.

Accordingly, this study develops an initial CRD quality framework based on the qualitative characteristics in the Financial Accounting Standards Board (FASB) conceptual framework, which was developed jointly with the International Accounting Standards Board (IASB) to

converge both FASB and IASB frameworks, in chapter 3, and drawing on the prior corporate disclosure literature and CRD literature in particular as reviewed in chapter 2. Semi-structured interviews were conducted with a range of stakeholders in order to assess, further develop and inform the initial framework. The analysis of the interview data focuses on gaining an in-depth understanding of the different quality-related aspects of CRD that have not been examined in previous studies and are relevant to understanding quality in this context. First, this study examines the differences among the different stakeholders in their perceptions of the concept of risk rather than assuming or adopting a particular definition of risk (see, for example, Linsley and Shrives, 2006) as taken for granted. Second, the interviews investigate existing RR practices and the relevance of CRD from the perspective of information users and other relevant stakeholders. Third, the study explores the issue of management discretion in respect of the amount, timing and quality of CRD. Understanding management behaviours and managers' incentives and disincentives for CRD is essential for suggesting the quality of CRD practices might be improved. Fourth, the interviews are undertaken so as to define quality in the context of CRD. Fifth, through employing the interview data, this study operationalises the FASB qualitative characteristics through identifying the quality-related characteristics of RI that are most useful for information users, and assesses how companies can meet each characteristic. The study then proposes a method for evaluating these quality characteristics. Accordingly, this study seeks to advance knowledge and practice as further discussed in Section 1.5.

It is worth mentioning that, although all the research participants are UK-based, the study provides an overarching understanding of risk reporting that is not restricted to a particular country or context, and the application of the proposed CRD quality framework extends beyond national or UK boundaries.

1.3. Research aims and objectives

This study represents a challenging departure from the mainstream focus on examining the quantity of CRD rather than its quality and usefulness. The main aim of the study is to develop an in-depth understanding of RR quality from the perspectives of different stakeholders interviewed in order to propose a way forward for enhancing CRD quality characteristics. The intention of the study is also to provide greater insights into fundamental aspects of CRD quality that have not been explored in the previous CRD literature. These insights incorporate examining aspects such as the concept of risk, defining quality in the context of CRD, and identifying quality characteristics of RI. This study shifts the focus from prior CRD studies that use quantity as a proxy for quality to directly examining the quality characteristics and informativeness of RI.

Accordingly, this study seeks to achieve the following research objectives:

1- To explore how risk is defined from a multi-stakeholder perspective.

2- To investigate stakeholders' perspectives on current CRD practices and on their relevance and adequacy for information users.
3- To identify the RI needs of users, and examine management incentives and disincentives for CRD.
4- To define quality, identify the key characteristics of CRD quality, and operationalise the FASB qualitative characteristics within the context of RR quality.
5- To make recommendations with regards to how to improve and measure CRD quality.

1.4. Research questions

In order to achieve the above objectives, the present study examines the questions below from the perspective of the different stakeholder groups on CRD quality.

1- How do different CRD-related stakeholders comprehend the concept of risk?
2- What are the perceptions of information users, and other stakeholders, of the relevance of RR and of current CRD practices?
3- What are the management incentives and disincentives for RR?
4- What is quality and what are the characteristics associated with good quality CRD?
5- How can the FASB qualitative characteristics be operationalised to create a CRD quality framework and how can CRD quality be further improved to correspond with the framework?

1.5. Contribution

This study seeks to contribute to knowledge in a number of ways. The study contributes to the existing CRD literature by advancing understanding in respect of CRD quality and usefulness. This study, to the best of my knowledge, is the first study that examines CRD quality in depth from the perspective of the different stakeholder groups and addresses CRD-related aspects that have not been examined in the prior literature drawing on FASB characteristics. Abraham, Marston and Slack (2014) unpublished study is the only CRD study to date, to the best of my knowledge, that adopts an interview-based approach. However, Abraham, Marston and Slack (2014) focus on only one stakeholder group which is institutional investors/investment analysts and emphasise only one aspect of CRD by investigating the usefulness of RI from the perspective of institutional investors. Likewise, Campbell and Slack (2008) and Slack and Campbell (2016) conducted interviews with one user group only (investment analysts) and, as explained above, CRD is not the main focus of their studies.

As discussed above, previous studies have frequently indicated that RR by companies lacks quality and informativeness. Hence, there is a need for research that is focused on CRD quality. The present study develops an overarching understanding of CRD by investigating key aspects including the concept of risk, the needs of information users to identify the information gap

between their needs and the risk information disclosed, management's attitude toward CRD, and the quality characteristics of RI.

Unlike the prior CRD literature that has predominantly focused on measuring the quantity of CRD and examining its determinants, this study explores the quality and usefulness of RI and how it can be assessed and improved. This study provides novel insights into RR quality and suggests a new method to enhance and evaluate the quality of risk-related information by developing a framework for CRD quality.

This study adopts a qualitative approach for gaining understanding of and developing a framework for CRD quality from the perspective of information users and AR preparers as well as other relevant stakeholder groups. The study adopts a multi-stakeholder perspective and uses interview-based research. Overall, 28 semi-structured interviews were conducted. This study investigates the views of information users including information user groups such as retail investors, institutional investors and investment analysts. The views of AR preparers are also considered to explore their incentives and disincentives for CRD through interviews with risk directors and chief finance officers. This study also considers the perspective of the members of regulatory and professional bodies such as the FRC, International Financial Reporting Standards (IFRS) and ICAEW, auditors in big four audit firms, and academics with relevant experience and interest in CRD.

Additionally, the study contributes to informing and improving CRD policy and practice. A best-practice framework for CRD quality is developed that identifies users' information needs and CRD quality characteristics and suggests a way of meeting these needs and characteristics. The framework has been developed in light of the interview data, the FASB qualitative characteristics and prior disclosure literature.

The framework is intended for different stakeholder groups. Researchers can potentially adopt the framework to measure CRD quality and usefulness. The framework could also be employed by regulators and standard setters to inform the introduction of new regulations and/or guidelines. It may also be helpful to external auditors in reviewing CRD and assuring its quality, and to companies seeking to improve their RR practices.

1.6. Structure of the thesis

This thesis is structured into nine chapters. Following the introduction chapter, chapter 2 gives an overview of the prior CRD literature as well as other relevant disclosure studies. The chapter discusses CRD studies undertaken in different countries and different contexts. The chapter also addresses prior research on CRD quality. Likewise, chapter 2 discusses quality in more detail in the context of corporate disclosure literature in general and CRD literature in particular. The chapter explores how the concept of quality is addressed in the prior disclosure literature, the methods used to assess quality and the association between disclosure quality and regulations.

The chapter explains the impact of management incentives on CRD quality. Finally, the chapter highlights the research gap that this study fills.

Chapter 3 develops the initial framework based on the FASB qualitative characteristics. Thus, in this chapter the FASB qualitative characteristics including the fundamental characteristics; relevance and faithful representation, and the enhancing characteristics; comparability, verifiability, timeliness and understandability are operationalised in the context of CRD considering the nature of risk. The characteristics are further developed in Chapter 7 based on the interview data and the relevant literature.

Chapter 4 describes the research methodology adopted in this research. The chapter explains the underlying philosophical assumptions that informed the choice of semi-structured interviews as the appropriate research method and thematic analysis as a method for analysing the data and answering the research questions. The chapter concludes with discussing the challenges of the qualitative research approach.

Chapter 5 is the first data analysis chapter. The chapter discusses how the different stakeholder groups perceive the concept of risk and explores their views on the relevance of RI and on existing CRD practices.

Chapter 6 investigates the incentives and disincentives for management to disclose and withhold RI respectively. The chapter focuses more on the role CRD incentives could play in encouraging companies to provide more and meaningful RI primarily on a voluntary basis.

Chapter 7 explores the views of the participants on the concept of quality in the context of CRD. The chapter identifies the quality characteristics of CRD. The chapter also operationalises the FASB qualitative characteristics based on the perspective of stakeholders and considering the uncertainty inherent in risk to improve RR practices.

Chapter 8 summarises, highlights and interprets the most important research findings. The chapter explains the theoretical linkage of the findings to the existing research.

Chapter 9 concludes with briefly presenting a summary of the previous chapters, answering the research questions, drawing conclusions and highlighting the contribution of this study. The chapter also indicates the implications for theory, research and practice. The chapter discusses the limitations of this study and suggests venues for future research on CRD.

Chapter 2: Literature review

2.1. Introduction

This chapter reviews prior CRD literature. As the thesis is focused on investigating the issue of quality in the context of risk reporting (RR) the chapter discusses in what ways, and to what extent, prior CRD studies have studied CRD quality. The central argument in this chapter is that whilst there has been a growing number of CRD studies undertaken by accounting academics these studies only partially address CRD quality. Therefore, the review and analysis of the literature establishes there is a need for CRD-quality research to be undertaken. The chapter also reviews literature that is relevant to the thesis but is not typically classified as CRD literature such as Campbell and Slack (2008).

This chapter is structured as follows. Section 2.2 presents early studies that have a relation to CRD. Section 2.3 discusses the two foundational CRD studies that have influenced subsequent CRD studies. CRD literature published subsequent to these two foundational studies is then reviewed in summary and by country in Section 2.4 whilst section 2.5 summarises the reports published by professional bodies on RR. Section 2.6 then discusses how the few CRD studies that purport to study CRD quality are, in fact, different in respect of addressing the issue of CRD quality. This then leads to identification, and discussion, of the research gap which is highlighted in section 2.7. Section 2.8 concludes the chapter.

2.2. Early studies related to risk disclosure

In section 2.3 below it is argued that the CRD studies undertaken by Beretta and Bozzolan (2004a) and Linsley and Shrives (2006) were primarily responsible for initiating research in this area. Further, it is argued in section 2.3 that a large number of subsequent CRD studies have been influenced in how they approach CRD research by the Beretta and Bozzolan (2004a) and Linsley and Shrives (2006) studies. However, it is important to recognise that there have been studies published prior to these two articles that can be described as CRD studies and this section reviews these papers.

Meier, Tomaszewski and Tobing (1995) is the earliest of these studies and analyses the disclosure of political risks resulting from the Gulf War of 1990-91 in the annual reports of US companies operating in Kuwait. The key finding is companies provided inadequate disclosures of the impacts of the war on their exposure to political risks. This leads Meier, Tomaszewski and Tobing (1995) to conclude that the existing disclosure regulations did not provide sufficient guidance on the assessment and reporting of political risks.

The other early studies related to CRD are similarly focused on examining the disclosure of very specific categories of risk. However, whilst Meier, Tomaszewski and Tobing (1995) have a specific focus on political risks the other early studies explore the disclosure of financial risks.

In particular they analyse market risk disclosures associated with the use of derivative financial instruments. These studies are largely concerned with investigating the impact of introducing a new disclosure regulation/requirement, Financial Reporting Release (FRR) 48 (Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments, and Disclosure of Quantitative and Qualitative Information About Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments and Derivative Commodity Instruments). This regulation was issued by the Securities Exchange Commission (SEC) in 1997 and the research focused on the relationship between market risk disclosures and the volatility of interest rates, exchange rates, commodity prices, trading volumes and equity prices (Abdelghany, 2005; Blankley, Lamb and Schroeder, 2002; Linsmeier et al., 2002; Rajgopal, 1999; Roulstone, 1999).

These studies conclude that companies tend to disclose more information on market risks in response to the newly adopted disclosure requirements. However, Roulstone (1999) find that market risk disclosures lack quality and clarity in terms of lack of information on market risk assessment methods and management actions and companies do not fully comply with disclosure requirements. Roulstone (1999) examines market risk information (RI)) quality in the narrow sense.

In the UK, there has also been a considerable amount of professional body CRD literature published in the late 1990s and early 2000s, particularly by the Institute of Chartered Accountants in England and Wales (ICAEW) which has highlighted the benefits of CRD to investors and companies as noted in chapter 1. These early ICAEW reports (ICAEW, 1997; 1999; 2002) are primarily seeking to encourage companies to provide more useful RI.

In 2000, Linsley and Shrives published an article in the Journal of Risk. This article is not a study of risk disclosures but provides a critical discussion in respect of the ICAEW (1997) proposals. Linsley and Shrives (2000) set out the benefits of reporting on risk, discuss potential problems associated with the ICAEW proposal that listed companies provide a 'Statement of Business Risk' in their annual report (AR), and briefly discuss four theories (agency, signalling, political costs and legitimacy theory) that might explain why companies would voluntarily provide such a statement. Whilst this article does not study specific risk disclosures it is of note that, by drawing on the ICAEW (1997) report, it reiterates a key argument that has subsequently become a central tenet in CRD research. This is the argument, which is rarely examined in any depth, that it is essential that companies provide RI in the AR as it enables the reader to make an assessment of how these risks might impact on the company in the future.

The two further ICAEW reports (1999, 2002) again highlight the importance of RR and encourage companies to provide more disclosures regarding their principal risks and to explain how the principal risks are being managed and mitigated. In these early reports the ICAEW emphasises a belief that better RR leads to lower cost of equity capital and also highlights the

importance of CRD to investors in assessing a company's risk exposure (RE) and predict its future cash flows as well as hold managers to account for their risk management (RM) practices.

2.3. The two foundational CRD studies

Beretta and Bozzolan (2004a) and Linsley and Shrives (2006) are the first two academic studies examining CRD in a comprehensive manner. Both studies examine the attributes and determinants of RR in the annual reports of non-financial companies in Italy and the UK respectively, using the content analysis method to identify and measure risk disclosures by counting numbers of risk sentences. To identify the risk sentences the two studies also adopt a broad definition of risk either implicitly (Beretta and Bozzolan, 2004a) or explicitly (Linsley and Shrives, 2006) that encompasses both downside risks (threats) and upside risks (opportunities).

The two studies investigate the association between CRD and a number of company-specific characteristics such as company size, industry type and company level of risk. Beretta and Bozzolan (2004a) find that there is a lack of forward-looking RI in the Management's Discussion and Analysis (MD&A) section of the AR of Italian listed companies which is contradictory to the findings of Linsley and Shrives. Beretta and Bozzolan also indicate that company size and industry sector have no impact on the amount of RI disclosed, whilst Linsley and Shrives (2006) report the result that the quantity of CRD is positively associated with company size. Linsley and Shrives also find that RR in the UK AR sample is predominantly qualitative and they conclude that current CRD practices are insufficient to meet the information needs of users.

Although Beretta and Bozzolan (2004a) claim to be measuring quality through a proposed model, they are not actually doing so. They only examine certain attributes of RI including the types of risk disclosed, the tone of CRD (good, bad, or neutral information), quantification of CRD (monetary vs nonmonetary information) and time orientation of RI (past vs future) and RM actions in place. They then attempt to measure the quality of risk disclosures based on the quantity of RI and the richness of information content. They refer to the richness of information content as the "semantic properties" of information disclosed and propose a four-dimensional framework that takes into account the risk factors (risk categories); the *economic sign* of the potential impacts (the tone of CRD; positive, negative or neutral), the measurement of potential impacts (monetary or nonmonetary), and the *outlook orientation* (the management risk mitigation strategy). Then they develop a measurement method for each of the four dimensions. However, the authors revert to using the number of CRD sentences to measure each of the above dimensions which contradicts their argument that they are measuring quality rather than quantity of CRD. Shevlin (2004) criticises the proposes model stating "I could envision nearly every sentence in a company`s MD&A section…as being concerned with some element of the

above three categories and dimensions" (p. 299). Beretta and Bozzolan (2004b) also argue that CRD quality should be examined from information users' perspectives and based on their needs.

The above two studies are highly cited in the RR literature and have greatly influenced subsequent CRD studies. Their subsequent influence is also evident in that these two studies have informed the research design and approach of the majority of subsequent studies. Thus, whilst these two studies paved the way for the evolution of the subsequent RR literature they have, in some respects, lead to these later studies being constrained in how they approach researching CRD.

2.4. CRD literature

2.4.1. Introduction

Following Beretta and Bozzolan (2004a) and Linsley and Shrives (2006) CRD has grown as a topic of importance in accounting research and there is a burgeoning literature. Whilst it is a distinct area of research it is also allied to other types of disclosure studies within the accounting domain including narrative disclosure studies. Extant research investigating RR practices and potential determinants of CRD is more prevalent in respect of developed countries; however, there is also a growing body of research on CRD in emerging economies. This section provides a summary of the results of prior CRD research and is organised according to the country/region that forms the basis for the different studies. Before presenting this research, there are some general comments that can be usefully made in respect of these prior studies.

First, it is of note that the primary research methodology adopted in these prior studies is content analysis to identify and categorise the risk disclosures and the vast majority of the studies have focused on measuring the amount of CRD by counting the number of risk sentences/words/lines within annual reports. The approach to undertaking the content analysis is either manual (see, for example, Linsley and Shrives, 2006; Marzouk, 2016) or computerised/automated (see, for example, Elshandidy, Fraser and Hussainey, 2013, 2015; Elshandidy and Shrives, 2016). The former is time-consuming; however, computerised textual analysis is problematic. Computerised textual analysis in CRD studies relies on searching for key words such as 'risk', 'risky, 'uncertainty' but there is a difficulty in knowing whether risk discussions have been fully identified. This is particularly so as 'risk' is a difficult concept to define. Second, the studies tend to attempt to identify the key characteristics of the RI or to identify any associations between the risk disclosures and a range of company-specific characteristics and corporate governance (CG) mechanisms (Abraham and Cox, 2007; Beretta and Bozzolan, 2004a; Elshandidy and Neri, 2015; Linsley and Shrives, 2006; Mokhtar and Mellett, 2013). Typically, the types of characteristics being identified are whether the risk disclosures are: (i) forward-looking or backward-looking, (ii) quantified (or monetary) or not,

and (iii) providing good (or positive) news or bad (or negative) news. The rationale for examining these characteristics is that it is more useful if risk disclosures are forward-looking and quantified, and that managers may provide more good news RI. When looking to test for associations between amounts of CRD (often measured by the number of CRD sentences provided in the AR) and CG mechanisms, it is common to use some form of regression analysis. For example, a study might test for an association between the size of the board of directors and amounts of CRD. Third, it can be observed that studies of non-financial firms are more prevalent than studies of financial firms. This is likely to have arisen because of the difficulties inherent in analysing the risk disclosures of financial firms which are far more extensive and far more complex. Therefore, it is understandable that some of these financial firm CRD studies choose not to examine the entire set of risk disclosures but instead look at only one sub-set of risk disclosures; for example, Barakat and Hussainey (2013) examine operational risk disclosures.

The largest body of CRD research has been particularly conducted in the UK and the USA. In some countries: USA, Germany, Italy and Finland, CRD has also received more regulatory attention through the introduction of more detailed and specific CRD regulations. For example, US companies are required to disclose both quantitative and qualitative information on their risk exposure within the form 10-K as Risk Factors under Item 1A. Likewise, the German Accounting Standard (GAS) 5 was introduced in 2001 to address CRD, and has been replaced by GAS 20 that requires companies to provide quantitative RI.

In recent years, there has been an increasing interest in CRD in other developed and emerging countries. There have been an increasing number of studies that examine RR practices and determinants particularly in Asian countries. For example, Japan (Kim and Yasuda, 2013, 2017; Fukukawa and Kim, 2017; Konishi and Ali, 2007; Ali, 2005), China (Tan, Zeng and Elshandidy, 2017), Indonesia (Achmad, Faisal and Oktarina, 2017; Aryani and Hussainey, 2017), Malaysia (Amran, Bin and Hassan, 2009; Arshad and Ismail, 2011; Ismail, Arshad and Othman, 2012; Othman and Ameer, 2009; Zadeh and Eskandari (2012a, 2012b), Hong Kong (Chan and Welford, 2005; Tong, 2013), United Arab Emirates (UAE) (ElKelish and Hassan, 2014; Halbouni and Yasin, 2016; Hassan (2009, 2011, 2014); Uddin and Hassan, 2011), Saudi Arabia (Al-Maghzom, Hussainey and Aly (2016a, 2016b); Alzead and Hussainey, 2017), Qatar (Elgammal, Hussainey and Zaki, 2017), Kuwait (Al-Shammari, 2014), Bahrain (Mousa and Elamir (2013, 2014), Jordan (Tahat, 2014), Pakistan (Abid and Shaiq, 2015), Bangladesh (Kabir and Sobhani, 2017), Iran (Ramezani et al., 2013).

Other studies have been undertaken in other countries including Australia, Europe and Africa. For example, Australia (Buckby, Gallery and Ma, 2015; Carlon, Loftus and Miller, 2003; Taylor, Tower and Neilson, 2009; Zhang et al., 2013), France (Combes-Thue´lin, Henneron and Touron,2006), the Netherlands (Deumes, 2008),Sweden (Jankensgård, Hoffmann and Rahmat,

2014), Belgium (Vandemaele, Vergauwen and Michiels, 2009), Switzerland (Hunziker, 2013), Bosnia and Herzegovina (Grbavac, Klepić and Papac, 2015), Romania (Bonaci, Strouhal and Mustata, 2013; Nichita and Țurlea, 2015), Poland (Wieczorek-Kosmala, Błach and Gorczyńska, 2014), Egypt (Baroma, 2014; Marzouk, 2016; Mokhtar and Mellett, 2013), Tunisia (Hemrit and Ben Arab, 2011), Malawi (Lipunga, 2014; Tauringana and Chithambo , 2016), Nigeria (Adamu, 2013a, 2013b) and South Africa (Ntim, Lindop and Thomas, 2013). Some of the key studies are discussed in the following sections.

2.4.2. CRD quality and usefulness

There has been little research on the concept of quality and usefulness in the context of corporate disclosure and CRD in particular. Previous studies have focused on measuring CRD quality using a number of proxies that may not necessarily capture its essence as discussed later in the chapter. Furthermore, there is no common definition or measure of CRD quality. The lack of research on CRD quality could be attributed to the particular nature of risk in terms of its inherent uncertainty and hence difficulty of assessing risk information quality. Ryan (2012) acknowledges the nature of risk in terms of its potential impact, probability of occurrence and the effectiveness of risk management policies, which might affect CRD practices. Beest, Braam and Boelens (2009) argue that measuring and defining disclosure quality has always been a challenge to researchers. Beattie, McInnes and Fearnley (2004) highlight the absence of a measure of disclosure quality stating "no definite set of quality attributes and weightings of those attributes exists, since quality is subjective and context-dependent" (p. 230).

Furthermore, different studies have used different terms to assess and reflect how CRD informs investors' decisions and describe CRD practices; for example, quality (Abraham and Shrives, 2014; Miihkinen, 2012; Mousa and Elamir, 2014; Ryan, 2012), relevance (Abraham and Shrives, 2014; Campbell and Slack, 2008), usefulness (Elshandidy and Shrives, 2016; Maffei et al., 2014; Miihkinen, 2013), and informativeness (Dobler, 2005). Likewise, professional and regulatory bodies have used both terms quality and usefulness. Whereas ICAS utilises the term usefulness (Abraham, Marston and Darby; 2012), Airmic (2014) uses quality. The ICAEW (2011, 2014), and the ACCA (Campbell and Slack, 2008; Slack and Campbell, 2016) use both quality and usefulness interchangeably. The FASB uses decision-usefulness while the FRC utilises quality. Nevertheless, these studies and reports do not attempt to define quality or usefulness of CRD in an in-depth and comprehensive manner or suggest an appropriate measure for CRD quality. Likewise, Jonas and Blanchet (2008) and Botosan (2004) define disclosure quality in terms of the decision-usefulness of information, but the question remains: useful to whom?

Disclosure is primarily intended for investors, and therefore its quality should be investigated from their perspective regarding its relevance for their decision-making. Information will always be of good quality and useful to investors if it enhances their investment decisions. Jonas and Blanchet (2000) state that "as the customers of financial reporting, the users should define reporting quality" (p. 358). The ICAEW (2011) also emphasises that companies should identify and satisfy users' risk information to help them properly assess a company's risk exposure and profile. Likewise, Botosan (2004) and Beretta and Bozzolan (2004b) argue that quality should be addressed from the viewpoint of information users, and Greco (2012) recommends that companies should attempt to meet users' risk information needs.

Abraham and Shrives (2014) shed light on the roles different stakeholders; namely users of information, annual report preparers and auditors, can play to enhance the quality of risk disclosures. Similarly, Breen, Clearfield and Klimczak (2011) and International Corporate Governance Network (ICGN) (2010) refer to the notion of getting investors in particular involved in risk communication and management. It is also important to consider management risk reporting incentives and disincentives. Moreover, Mokhtar and Mellett (2013) also highlight the role external auditor can play to assure the quality of CRD.

Nevertheless, many prior studies examine CRD by counting CRD sentences or words. Furthermore, the problem is that prior studies that seek to address CRD quality and/or usefulness apply the same research method (content analysis) used in the mainstream CRD literature and the result is their assessment of CRD quality is ultimately resting on numbers of words or sentences (for example, Jia, Munro and Buckby, 2016; Mousa and Elamir, 2014). Likewise, Maffei et al. (2014) use content analysis to measure the number of CRD sentences and use it as a proxy for the usefulness of risk information. Other studies used CRD index to investigate the existence of risk information and/or the type of RI disclosed and how it is presented regardless of its quality/usefulness (Hassan, 2009; Leitner-Hanetseder, 2012; Uddin and Hassan, 2011).

Beretta and Bozzolan (2004a) and Hussainey and Mouselli (2010) rightly argue that CRD quantity is not an appropriate proxy for its quality. Information quality is not solely about how much a company discloses, but also about the informativeness of disclosures to information users. This implies that qualitative characteristics of information quality such as accuracy, completeness, comparability, relevance are pertinent to enhancing and assessing the quality of CRD as discussed in chapter 3. Furthermore, previous studies seem to have not considered stakeholders and particularly information users' needs and views on the extent of quality and usefulness of risk information.

In addition, pervious disclosure studies have placed a particular emphasis on how corporate disclosure influences information users and particularly investors' behaviours, actions and

decisions to assess its usefulness and/or quality. There are a number of approaches that have been used in the accounting literature to assess the quality of financial reporting and CRD including earnings management (Lobo and Zhou, 2001), information quantity (Hussainey and Mouselli, 2010, Mousa and Elamir, 2014), accruals quality (Biddle, Hilary and Verdi, 2009; Mouselli, Jaafar and Hussainey, 2012) and value relevance (Müller, 2014). Likewise, Call et al. (2017) find that employees' quality measured by their education level is positively related to disclosure quality measured by accruals quality, internal control violations, and restatements. A few studies have used qualitative characteristics to examine the informativeness of disclosure (Beest, Braam and Boelens 2009; Schipper and Vincent, 2003).

Other studies have used the value relevance of risk information to examine the quality and/or usefulness of risk disclosures by examining the association between the level of CRD and some financial indicators such as company market value. They primarily focus on accounting numbers particularly studies that use earnings management and value relevance approaches to investigate the relationship between financial information and stock prices and employ this relationship to assess information quality (Müller, 2014). However, changes in share prices could be attributed to different factors other than corporate disclosure. It might also be difficult to attribute share price volatility to the disclosure of particular information, for example, risk information.

Value relevance studies explore the market reaction to the disclosure of risk information and the impact of CRD quantity on assisting investors' ability to predict future earnings and cash flows (see, for example, Moumen, Othman and Hussainey, 2015; Moumen, Othman and Hussainey, 2016). It could be argued that these studies fail to sufficiently and properly address quality as they use inappropriate measurements of RI quality. For example, Elshandidy and Shrives (2016) examine the impact of CRD on stock market liquidity and investors' perceived risk measured by the volatility of market returns as an indicator of the usefulness of risk information measured by risk disclosure sentences and tone of CRD and based on a number of key words. None of these studies seem to have investigated the characteristics of useful information using, for example, the FASB qualitative characteristics of relevance, materiality, faithful representation, comparability, verifiability, timeliness and understandability taking into account the qualitative nature of CRD.

The FASB (2010) also highlights that the ultimate purpose of corporate reporting is enhancing information users' decisions by providing useful information. It further emphasises the significance of the concept of 'usefulness' in corporate reporting stating that "usefulness in making decisions is the objective of financial reporting" (p.12). This principle is also of importance in the context of CRD and applies to the risk disclosures made by companies. Accordingly, risk disclosure should be deemed useful, and of good quality, if it

meets the decision-making needs of information users. Therefore, companies should aim at satisfying this criteria by providing decision-useful risk information to help investors assess company risk exposure and make informed decisions.

However, defining and assessing CRD quality/usefulness is problematic. Shrives and Brennan state that "quality of reporting is difficult to determine but that does not undermine its importance" (2015, p. 98). Different users have different interests in the company, and hence have different information needs. The vast majority of prior CRD literature in various jurisdictions has predominantly used content analysis to measure the amount of risk information and then use it as a proxy for quality. This is likely to be difficult and may require re-thinking whether content analysis is an appropriate methodology to adopt for such studies. It also implies that, in advance, there is a great need for work to be done that grapples with the concept of quality/usefulness in the context of CRD and in a fundamental way. This is likely to require discussions that err towards the philosophical but would be invaluable in forming a base for future CRD quality-focused studies.

Stanton (2009) suggests answering six questions prior to an effective and successful communication concerning why, who, where, when, how and what? Accordingly, managers should consider the following questions when reporting risks: Who is our main audience? What are users' background and prior knowledge? How are users likely to react to CRD? What is the purpose of disclosure and communication? What message do we exactly want to send to our investors and stakeholders? What are the appropriate disclosure channel, timing and context (where and when)? What disclosure tone should be used? How the message should be organised? Answering these questions is essential for improving CRD quality and meeting information users' needs.

CRD quality is discussed in more detail later in this chapter and in chapter 3.

2.4.3. The nature and determinants of CRD

A larger body of literature has focused on examining some attributes of RI and the factors influencing CRD practices including company-specific characteristics (eg, company size) in particular and corporate governance characteristics (for example, Abraham and Cox, 2007; Abraham, Solomon and Stevenson, 2007; Elshandidy, Fraser and Hussainy, 2013; Elzahar and Hussainey, 2012; Lajili and Zeghal, 2005; Linsley and Lawrence, 2007; Linsley and Shrives, 2005a, 2005b, 2006). Some studies have, however, argued that the current risk disclosures provided are still insufficient and too vague (Linsley and Shrives, 2005a, 2006). They have also highlighted the lack of quantified RI and raised concerns about the relevance and quality of RI provided to shareholders and other stakeholders (for example, Lajili and Zeghal, 2005). Hence, they call for improving RR practices so that the same RI is made available to all shareholders and other stakeholders at the same time to overcome the information asymmetry problem.

Likewise, they recommend that regulatory bodies act to stimulate companies to disclose more and higher quality RI. This draws attention not only to the quantity of CRD but also to its quality and usefulness.

There have been an increasing number of studies investigating the determinants of CRD and are briefly discussed as follows. Research undertaken in Asia on CRD has predominantly focused on Japan and Malaysia. In Japan, Ali (2005) examines the annual reports of 90 non-financial Japanese listed companies and finds that companies tend to voluntarily disclose RI. He demonstrates the companies disclose more qualitative and historical RI. The empirical findings also reveal that company size is the key determinant of the level of CRD, and no relationships exist between the level of CRD and company level of risk, profitability and ownership structure.

Konishi and Ali (2007) examine the annual reports of 100 non-financial Japanese listed companies identifying that companies display a high level of compliance with recent disclosure requirements by disclosing more RI. They also indicate that companies tend to provide more non-monetary RI, and that larger companies disclose more RI. However, they find that other firm characteristics including company level of risk, industry type, ownership structure and cross-holding structure are not correlated with CRD quantity.

Vandemele, Vergauwen and Michiels (2009) identify the factors influencing the volume of narrative RR within the annual reports of Belgian listed firms and find that CRD volume is significantly positively associated with company size and level of risk. However, profitability is negatively associated with CRD level. Moreover, none of CG mechanisms such as audit quality, the existence of risk committee or manager, CEO duality and board composition, is related to the amount of RI.

Studies undertaken in the Arab world include Hassan (2009) who examines companies listed on the Dubai Financial Market and Abu Dubai Security Market. A significant relationship is seen to exist between the number of risk disclosures and both the firm level of risk and industry type, whereas company size and amount of reserves are insignificantly correlated with the extent of CRD. In a later study, Uddin and Hassan (2011) examine UAE listed companies on the assumption that an increased level of CRD should minimise share variances and hence reduces investors' potential losses and exposure to market risks. However, they find that enhanced CRD cannot aid investors in predicting the changes in share prices, but it can assist them in building better investment portfolios to avoid/reduce potential risks and losses.

Arshad and Ismail (2011) explore CRD from a different perspective, from the managers' viewpoint, to identify their behaviour towards risk and CRD practices in the annual reports of Malaysian listed companies. A survey questionnaire distributed to managers and accountants who engage in preparing annual reports suggests that the better the managers' understanding of risks and CRD, the higher the level of CRD.

Zadeh and Eskandari (2012a) highlight the particular importance of company size as a key determinant of CRD quantity and in a subsequent study (2012b) assess the degree compliance by Malaysian listed firms with additional disclosure regulations and examine the extent of financial risk disclosure. They conclude that the majority of companies respond positively to the implementation of disclosure regulations by reporting more RI.

Ismail, Arshad, Othman (2012) examine the effect of the quantity of voluntary CRD on firm market value in the annual reports of Malaysian companies in two years, 2006 and 2009. Therefore, the study considers new disclosure requirements issued in 2007. The empirical findings reveal little change in the quantity and quality of voluntary risk disclosure but does find a positive relationship between the amount of voluntary CRD and company's market value.

Zhang et al. (2013) is a more specific study in that it examines narrative CRD by Australian listed companies and their relationship to institutional shareholders and audit committee finding that CRD is significantly positively associated with both transient-type institutional block shareholders (and not with dedicated-type institutional block shareholders) and audit committee independence (and not the financial expertise of its members).

In the Egyptian context, Mokhtar and Mellett's (2013) results reveal that companies show a low level of compliance with the mandatory CRD requirements and, at the same time, voluntarily disclose little RI. The study finds that companies disclose more information on financial risks and demonstrates that CRD is qualitative in nature with more emphasis on historical and good RI. The study also shows a positive association between the level of CRD and auditor type, board size and competition.

Likewise, Mousa and Elamir (2013) have investigated companies listed on Bahrain Bourse (BHB) and examine the impact of some corporate characteristics on CRD practices. They indicate that companies provide little information on risks in annual reports and that the major determinants of CRD are company size, level of risk, firm listing, issuance of shares, profitability and percentage of free float.

Another study conducted by Kim and Fukukawa in 2013 investigates the impact a company's auditor may have on its RR practices. The results show the auditor plays an important role in determining the company level of CRD with a positive association between the level of CRD and auditor size being reported. Nevertheless, they find that companies that have been audited by the same auditor for a long period of time disclose less RI.

2.4.4. The impact of regulations on CRD practices

Some previous studies have paid particular attention to the impact of introducing new regulations on CRD practices. These are longitudinal studies that investigate CRD over an extended period of time to examine the change in risk reporting over time considering some

factors particularly the introduction of new regulation on CRD in different jurisdictions. The vast majority of these studies as discussed below reveal that regulations have contributed to better risk reporting in terms of its quantity/find an increasing level of CRD following the introduction of new regulations, yet the impact on CRD quality is questionable.

Longitudinal studies have been conducted to explore the changes in the volume and attributes of RR over time considering the implementation of additional disclosure regulations (for example, Hill and Short, 2009; Rajab and Handley-Schachler, 2009). Overall, the results of these studies show that there is a trend of increasing RR by UK companies. The findings also show that the introduction of more CRD requirements have contributed to improving overall CRD practices. Moreover, the results indicate that company size, US dual listing and industry type are the most important factors influencing the level of CRD.

Berger and Gleißner (2006) analyse the annual reports of a sample of 92 German non-financial listed companies over the period 2000-2005. They examine the impact of implementing GAS 5 (the German Accounting Standard that governs disclosure of risks) and find an increase in the total number of risk disclosures, but with little improvement in the CRD quality.

Taylor, Tower and Neilson (2009) investigate financial risk disclosure in the annual reports of Australian listed companies over a consecutive five-year period. They find that the adoption of the IFRSs has improved the level of financial risk disclosure and this level is positively correlated with both CG mechanisms and corporate capital raising. Their findings reveal a negative association between CRD and cross-listing.

Neri (2010) explores the annual reports of Italian listed companies over a four-year period from 2005 to 2008 to examine the impact of implementing the International Accounting Standards in 2005 on CRD. He concludes there has been an increased level of CRD by companies that is positively associated with company size and finds a negative correlation between the level of CRD and both company risk profile and profitability. Likewise, Greco (2012) conducts a longitudinal content analysis of the management commentary section of Italian listed companies. Contrary to the findings of Neri (2010) and other CRD studies in developed and highly regulated countries, Greco finds that even with the introduction of mandatory CRD regulations, CRD level and practices have not changed, and argues that managers are unwilling to provide more RI. This is attributed to either management reluctance to provide commercially sensitive information that may affect the company's competitive position and overall performance or the desire of managers to avoid potential legal claims. Greco (2012) demonstrates that mandatory disclosure requirements could increase CRD quantity but may have little impact on its quality.

Oliveira, Rodrigues and Craig (2011) undertake a content analysis of 81 annual reports of Portuguese non-financial companies. They also consider the implementation of IASs/IFRSs and

the European Union's Modernisation Directive in 2005 on CRD. They conclude that CRD of the Portuguese companies is vague and more past and qualitative RI is disclosed. They also indicate that company size and leverage are the key determinants of the level of CRD. Moreover, they find that the existence of independent directors on the board of listed companies increases the amount of CRD provided by these companies. Overall, this implies that neither the level nor the quality of CRD was improved by the newly adopted disclosure regulations.

Miihkinen (2012) explores the impact of applying a new national accounting standard on the quality of RR by Finnish listed companies and demonstrates that the introduction of the accounting standard has improved both the quantity and quality of RI disclosed. He further finds that less profitable companies tend to disclose better quality RI, and that large firms and firms cross-listed in the US provide more quantitative RI. In a later study Miihkinen (2013) demonstrates a lack of quantitative RI being disclosed by companies as they focus on reporting their RM strategies rather than the potential economic impacts of risks.

Hunziker (2013) conducts an investigation of the level of market risk disclosure of 116 non-financial Swiss companies considering the introduction of IFRS 7 that governs the disclosure of market risks associated with the financial statements. He argues that market RI provided within annual reports should help investors assess the potential risks associated with the use of financial derivatives. The findings reveal that larger companies provide more information on market risks than smaller ones and that the level of CRD and company level of risk measured by the gearing ratio, are significantly correlated. However, the amount of RI is not affected by company performance.

A ten-year longitudinal Iranian study by Ramezani et al., (2013) finds that company size, financial leverage and co-variability earnings significantly positively correlated with the level of market risk disclosure, whilst a significant negative relationship is found between the level of market risk disclosure and current ratio, dividend per share and profit growth.

USA studies (Campbell et al., 2014; Kravet and Muslu, 2013; Mirakhur, 2011) that examine the impact of additional mandatory CRD requirements under the SEC disclosure requirement to provide quantitative and qualitative RI within the form 10-K find that the level of CRD has improved over the years following the introduction of the mandatory disclosure requirements.

Campbell et al. (2014) conclude that CRD helps investors assess company risk profile and predict stock prices as well as reduce the information asymmetry problem by ensuring the availability of RI to all interested parties. However, Kravet and Muslu (2013) argue that although risk communication can reduce investors' uncertainty companies tend to provide boilerplate CRD arguing that companies can technically comply with regulations without providing useful information through the disclosure of general disclosure statements rather than company-specific disclosures. In this respect, they underline that management incentives are a

major determinant of CRD policy and decision. Mirakhur (2011) primary result is that a company's future performance cannot be measured based on the current level of CRD. In contrast, Kravet and Muslu (2013) investigate the changes in CRD practices of US companies over a fourteen-year period and their results show that RI provided over time is informative to investors in the sense that increases in CRD volumes are significantly positively associated with increases in stock return volatility and trading volume before and after issuing the annual reports.

2.4.5. CRD practices during crisis

A number of studies examine CRD practices during crisis including financial and political crises and instability to explore the impact of crisis on the amount and attributes of risk information disclosed by companies. An early study by Meier, Tomaszewski and Tobing (1995) examines the disclosure of political risks resulting from the 1990-91 Gulf War. The study analyses annual reports of US companies operating in Kuwait before and during the war and the overall findings establish there is a low level of risk disclosure.

Meijer (2011) undertook a study that covers the period 2005 to 2008 revealing there has been an increase in both the quantity and quality of CRD in the annual reports of a sample of Dutch listed companies after the 2007–2008 global financial crisis. Meijer uses content analysis and a disclosure index to measure CRD quantity and quality respectively and finds that CRD both quantity and quality are significantly positively associated with company size.

In a South African context, Ntim, Lindop and Thomas (2013) investigate the nature of RI disclosed by non-financial companies and examine the influence of the level and quality of CG on CRD quantity and quality. They find that companies disclose more information on non-financial risks, which is qualitative in nature. The results also show a positive association between the extent of CRD and board diversity, board size and independent non-executive directors, while an insignificant relationship is found between dual board leadership structure and CRD quantity.

More recently, Marzouk (2016) provides new empirical evidence on the nature and determinants of CRD practices of Egyptian non-financial listed companies during the 2011 Egyptian uprising. The study finds that companies provided more monetary, forward-looking and good news risk information. The results also reveal a significant positive association between CRD quantity and firm size, a positive but insignificant relationship between the amount of CRD and industry type, profitability and cross-listing, and a negative but insignificant relationship between CRD quantity and the amount of reserves. The results of the previous studies generally show that companies tend to disclose more RI following crisis.

2.4.6. Cross-country studies

There have been a number of studies that examine the differences in RR practices among firms across different countries, particularly developed countries, considering the institutional setting and disclosure regulations in each country (Dobler, Lajili and Zeghal, 2011; Horing and Grundl, 2011; Elshandidy, 2011; Elshandidy, Fraser and Hussainey, 2015; Elshandidy and Neri, 2015; Linsley, Shrives and Crumpton, 2006; Probohudono, Tower and Rusmin, 2013; Woods and Reber, 2003).

The results of these studies generally reveal that there are no significant differences across the different countries in terms of CRD patterns and attributes. This may be due to the similarities among the countries covered by the studies; USA, UK, Germany and Canada, in terms of the reinforcement of regulations where there are strict disclosure regulations and requirements that companies should comply with. Moreover, the findings demonstrate that there is an increasing trend of CRD amongst companies across countries.

The results also show some driving factors of CRD that are common among these countries such as company size and cross-listing. However, there are other influencing factors and motives for CRD that differ from one context to another. For example, Elshandidy, Fraser and Hussainey (2015) find that German companies disclose greater amounts of both voluntary and mandatory RI than UK and US companies. They attribute these variances to the different regulatory frameworks and cultural contexts. In another context, Abdallah, Hassan, and McClelland (2015) find differences in CRD practices among Islamic financial institutions in the Gulf countries regardless of the similarities between these countries in terms of culture and regulations. They also demonstrate that CG contributes to more CRD.

The tables below present summary of studies that have been undertaken on CRD practices in different countries. Table 2.1 shows CRD studies for non-financial companies and Table 2.2 summarises CRD studies for financial firms.

Table 2.1: Summary of prior annual report-based risk disclosure studies: non-financial firms

Author(s)	Year	Country(ies)	Period	Summary of key findings/comments on paper (RD = risk disclosures)
Beretta and Bozzolan	2004a	Italy	2001	• Sentence counting to identify the characteristics and determinants of CRD • Non-monetary RD significantly greater than monetary RD • Past RD significantly greater than forward-looking RD • Firm industry does not explain level of RD • Constructs an index to attempt to measure RD quality (but this index is, ultimately, quantity-based)
Berger and Gleißner	2006	Germany	2000 to 2005	• Counting risk quotes (sentences) • Analysing CRD quality in terms of information content measured by readability (length of description and quantification), reported risk management system (risk analysis, assessment and management) and reported risks (risks that are frequently disclosed) • CRD quality has slightly improved over time by disclosing quantitative information in particular • Slight improvement in the quality of the reported risk management system • The number and proportion of risks reported have also changed

Linsley and Shrives	2006	UK	2000	• Sentence counting to identify the characteristics and determinants of CRD • Positive association between company size and RD • No association between company risk level and RD • Non-monetary RD significantly greater than monetary RD • RD dominated by general statements of risk management policy
Abraham and Cox	2007	UK	2002	• Counting words within risk-related sentences to identify the determinants of CRD • Firm industry does not explain level of RD • No association between RD and (i) number of executive directors, (ii) ownership by outside managed pensions plans • Positive association between RD and (i) number of non-executive directors, (ii) ownership by life assurance funds, (iii) dual US listing • Negative association between RD and ownership by in-house managed funds
Hassan	2009	UAE (financial and non-financial companies)	2005	• CRD index to identify the determinants of CRD • Corporate size is not significantly associated with the level of CRD • Corporate level of risk and corporate industry type are significant in explaining the variation of CRD • Corporate reserve is insignificant and negatively associated with level of CRD

Dobler, Lajili and Zeghal	2011	USA, Canada, UK and Germany	2005	• Sentence counting to identify the characteristics and determinants of CRD across four countries • USA firms provide greater RD • Predominant RD characteristics are historic/non-time specific and qualitative • Positive association between company size and RD • Mixed evidence regarding any association between company risk level and RD
Johansson and Thörnberg	2011	Sweden	2010	• An index to measure quantity based on the presence of some information as required by regulations, and quality based on how the information is presented • Lack of quantity and quality measured against the requirements
Oliveira, Rodrigues and Craig	2011	Portugal	2006	• Sentence counting to identify the characteristics and determinants of CRD • Predominant RD characteristics are backward looking, generalised and qualitative • Positive association between (i) size and (ii) environmental sensitivity
Uddin and Hassan	2011	UAE (financial and nonfinancial)	2005	• CRD index • To examine the impact of CRD on stock price volatility and investors' market risk • Findings tend to suggest that more disclosure of corporate risk information may indeed increase uncertainty of investment in UAE market, but more information allows the investors to diversity their portfolio and minimize the market risk

Lajili, Dobler and Zeghal	2012	USA	2006-9	• Sentence counting to identify the characteristics and determinants of CRD • Predominant RD characteristics are forward looking, bad news, and qualitative • RD unaffected by global financial crisis 2007-8 • Negative association between RD and (i) board size, (ii) board independence • Positive association between RD and profitability
Miihkinen	2012	Finland	2005-6	• Sentence (coverage as an aspect of quality) and word (quantity) counting to measure CRD quantity and quality and identify its determinants • The paper examines the effect of introducing an RD standard in Finland in 2006 • Results suggest the introduction of the standard increased RD disclosure quality • Firm size, profitability and having a listing on NYSE are also determinants of RD quality
Hunziker	2013	Switzerland	2011	• Sentence counting to identify the determinants of CRD • Significant associations are found between the number/amount of market risk disclosures and company size • Significant association is found between the number/amount of risk disclosures and the company's risk proxied by the gearing ratio • No association is found between the number/amount of risk disclosures and the company's performance

Miihkinen	2013	Finland	2006-9	• Sentence (coverage as an aspect of quality) and word (quantity) counting to measure CRD quantity and quality and identify its determinants • RD quality has negative effect upon (i.e. reduces) information asymmetry • RD is more useful if provided by small firms, high tech firms and low analyst coverage firms
Elshandidy, Fraser and Hussainey	2013	UK	2005-9	• Using a number of key words to identify and count the number of risk statements and its determinants • Firms with higher levels of systematic, financing and risk-adjusted risk provide greater voluntary RD • Firms that are larger, have higher dividend yields, higher board independence, more effective audit environments provide greater RD • High risk firms display greater sensitivity to risk levels leading to higher RD disclosure
Mokhtar and Mellett	2013	Egypt	2007	• Sentence counting (voluntary CRD) and RD index (compulsory RD) to identify the characteristics of RD and the determinants of each type of disclosure • Predominant RD characteristics are backward looking, good news, and qualitative • Positive association between RD and (i) barriers to entry (voluntary RD), (ii) board size, (iii) auditor type (mandatory RD) • Negative association between RD and (i) ownership concentration (mandatory RD), (ii) role duality (mandatory RD) • No association between RD and (i) firm size, (ii) industrial sector

Kravet and Muslu	2013	USA	1994-2007	• Sentence counting based on a number of key words to examine the impact of RD as below • Positive association between yearly changes in RD and stock return volatility, filing volume, trading volume changes, volatility forecast revisions • Suggests RD increase risk perceptions of investors
Mousa and Elamir	2013	Bahrain (financial and nonfinancial)	2011	• Sentence counting to identify the determinants of CRD and the types of risks reported • significant associations between the quantity of SRD and firm size, Beta of the company and firm listing. • significant associations between the quantity of USRD and firm size, issuance of shares, firm profitability and percentage of free float). • Firm size is found as a significant determinant of all types of risk disclosures.
Ntim, Lindop and Thomas	2013	South Africa	2002-11	• Sentence counting to measurer RD quantity and RD index to assess its quality as well as identify the characteristics and determinants of CRD • Predominant RD characteristics are historic, good news, qualitative and non-financial • Trend is for increasing RD over the period but the financial crisis period 207-8 is not significantly different to other periods • Positive association between RD and (i) board size, (ii) board diversity, (iii) non-executive directorships • Negative association between RD and (i) block ownership, (ii) institutional ownership

Ramezani et al.,	2013	Iran	2001 to 2010	• company size, financial leverage and co-variability earnings are significantly positively correlated with the level of market risk disclosure • significant negative relationship is found between the level of market risk disclosure and current ratio, dividend per share and profit growth • insignificant relationship between earnings variability and the extent of market risk disclosure
AL-Shammari	2014	Kuwait		• Sentence counting to measurer RD quantity and its determinants • CRD is associated positively with size, liquidity, complexity and auditor type • CRD and leverage and profitability is insignificantly related
Campbell, Chen, Dhaliwal, Lu and Steele	2014	USA	2005-8	• Word counting to identify the determinants and impact of RD • Positive association between RD and firm risk as based on pre-disclosure measures • Positive association between that part of RD which is unexpected and investor assessment of firm risk as based on market beta and stock return volatility
Abraham and Shrives	2014	-	-	• This paper proposes a model for assessing RD quality on the premise that current RD practice is inadequate
Jankensgård, Hoffmann and Rahmat	2014	Sweden	2009	• A disclosure index to measure the level of foreign exchange risk disclosure and identify its determinants • FX risk disclosure index is negatively related to firm value

Khaledi	2014	Sweden Interim reports Longitudinal 10 years 2001- 2010		• Sentence counting to identify the determinants of the level of risk disclosure • Firm size and audit committee have a positive relationship with the level of corporate risk disclosure • A negative relationship between family ownership and the level of CRD • Insignificant relationship between leverage and the level of CRD.
Mousa and Elamir	2014	Bahrain (financial and nonfinancial)	2012	• Sentence counting to measure for CRD quality and identify its determinants • Institutional investors and major investors have a significant and positive effect on the quality of corporate risk disclosure • Board size is found to have a significant and negative effect on CRD • Foreign investors, board composition and debt ratio are insignificant in relation to CRD

Abid and Shaiq	2015	Pakistan	2013	• Sentence counting to identify CRD determinants and risks disclosed • Company size is significantly and positively related with risk disclosure • Leverage and profitability are not significant drivers • Large companies are politically sensitive and are likely to disclose more risk related information in explaining their level of return of corporate risk disclosure • Effective audit environment (Big 4) plays a significant role in enhancing corporate risk disclosure and firms operating in the same industry provide similar level of risk disclosure • Big 4 auditors are also positively and significantly associated with the extent of corporate risk disclosure • Financial risks are the most disclosed risks followed by strategic and operations risks
Elshandidy, Fraser and Hussainey	2015	Germany, UK and USA	2005-10	• Sentence counting using a number of key words to identify the determinants of RD • Mandatory and voluntary RD vary significantly across the three countries • Mandatory and voluntary RD significantly influenced by risk level, legal system and cultural values • Firm and country characteristics have greater explanatory power for variations in mandatory RD than voluntary RD

Elshandidy and Neri	2015	UK and Italy	2005-10	• Sentence counting using a number of key words to identify the determinants of RD • UK firms display higher levels of voluntary RD influenced by corporate governance factors of board size, non-executive directors, lower dividend yields and firm size • Italian firms display higher levels of mandatory RD influenced by board size, non-executive directors, audit quality and firm size • In UK context RD practices improve market liquidity • In Italy voluntary RD practices improve market liquidity for strongly governed firms
Marzouk	2016	Egypt	2011	• Sentence counting to identify the characteristics and determinants of CRD • Predominant RD characteristics are quantitative, forward-looking and good news • Positive and significant relationship between company size and RD • Positive but insignificant association between RD and (i) industry type, (ii) profitability, (iii) cross-listing • Negative but insignificant association between RD and corporate reserves
Achmad, Faisal and Oktarina	2017	Indonesia	2013	• A disclosure index to identify the determinants of CRD (corporate governance mechanisms and firm-specific characteristics) • Audit committee, size of the firm and the company's financial performance are factors that encourage/positively related companies to communicate risk information • The level of risk disclosure in Indonesia is still relatively low (32%) • Insignificant relationship between independent commissioners positive, institutional ownership positive, and managerial ownership negative and the extent of risk disclosure

Elgammal, Hussainey and Zaki	2017	Qatar (non-financial and financial firms)	2008 – 2014	• Sentence counting using a number of key words to identify the determinants of RD and forward-looking information • Computer-based content analysis using Nvivo • Significant negative relationships between RD and both the number of nonexecutive members in the board of directors and duality role of the CEO • Financial firms tend to disclose less information about their plans, however, they tend to disclose more information about their future plans after the last financial crisis

Table 2.2: Summary of prior annual report-based risk disclosure studies: financial firms

		Sample					
Author(s)	Year	Size	Country(ies)	Period	Method	Risk type(s) examined	Summary of key findings/comments on paper (RD = risk disclosures)
Linsley, Shrives and Crumpton	2006	18 banks	UK and Canada	2001	Manual content analysis	All risk types	• Predominant RD characteristics are forward looking, generalised and qualitative • No significant difference between UK and Canada RD • Positive association between RD and bank size • No association between RD and bank risk
Barakat and Hussainey	2013	85 banks	20 EU member countries	2008-10	Manual content analysis to create RD index	Operational risk	• Negative association between operational RD and (i) bank entry requirements, (ii) powers/independence of supervisor, (iii) proportion of voting rights held by largest shareholder • Positive association between operational RD and number of audit committee meetings per year
Maffei, Aria, Fiondella, Spanò and Zagaria	2014	66 banks	Italy	2011	Manual content analysis	All risk types	• Predominant RD characteristics are intertemporal, neither good news nor bad news and quantitative

Al-Hadi, Hasan and Habib	2016	677 financial firm-year observations	The 6 countries of the Gulf Co-operation Council	2007-11	Manual content analysis to create RD index	Market risk	• Examining the connection between risk committee (RC) characteristics and market RD • RC size and qualifications of RC members are positively associated with RD index • RC in mature firms significantly improve market RD

2.5. Professional body reports

It has been stated earlier that the ICAEW published a series of CRD reports in the late 1990s and early 2000s. In addition, the ICAEW published another report in 2011 reiterating its demands for better RR particularly following the 2007/8 financial crisis. The report emphasises a number of challenges of CRD including the inherent uncertainty and subjectivity of risk assessment, the costs companies may incur as a result of RR and superficial compliance by companies that are not providing informative CRD. The report also suggests seven general principles for companies to enhance their RR including identifying and meeting users' needs, disclosing more quantitative and forward-looking RI, linking CRD with other corporate disclosures and the business model, disclosing up-to-date RI through other disclosure channels such as corporate websites, focusing on principal risks, highlighting ongoing risks and issues, and discussing their risk experience in terms of the difference between the expected risks and their impact and the actual ones.

The ICAEW (2011) report argues that although it may not be possible for a company's CRD to be perfect it can be improved and it underlines the need for research on CRD that takes into account the information needs of users. The report is comprehensive in its discussions of CRD and it is valuable to give some detail.

The report recommends companies provide quantitative information; however, it further claims that the disclosure of the likelihood a particular risk will occur or its potential impact is impractical. The report also implicitly refers to providing timely RI, considering the changing nature of some risks, and considers whether reporting risk-related information on corporate websites because of the lack of timeliness of annual reports might be appropriate. The report also highlights a number of aspects related to the presentation of RI. First, reporting on risks in the context of other corporate information related to the company's operations, business model and prospects is suggested as this should give a clear picture of the risks a company is exposed to. The report points out that risk is inherent in the company business model and strategy and needs to be understood in this context. Thus, it recommends that understanding the company's business model is essential for assessing its RE. Accordingly, in this report the ICAEW does not seem to give exactly the same support for a separate statement for RR as previously suggested in 1997. Second, it favours a short list of risks in order to make it easy for investors to understand and focus their attention on key risks. This is also consistent with Lee's (2012) suggestion to rank risks and disclose the top five ranked ones. Finally, reporting on the RM process during the past year and discussing the successes and failures during this period as a possibility for improving CRD, which is supported by Ryan (2012).

The Association of Chartered Certified Accountants (ACCA) also issued a number of reports addressing RR either implicitly (Campbell and Slack, 2008; Slack and Campbell, 2016) or

explicitly (Souabni, 2011; ACCA, 2014). Campbell and Slack's (2008) report does not look directly at CRD but focuses instead on voluntary narrative reporting in the AR in general. However, it includes some discussion of RR. Nineteen semi-structured interviews with investment analysts specialising in the banking industry are used to investigate the usefulness of narrative reporting for their decision making. The report reveals that CRD was perceived by the interviewees to be generic/boilerplate which hinders its usefulness. In another ACCA report Souabni (2011) conducted a cross-country study to examine RR practices of companies across seven countries, jurisdictions and industry sectors. The key finding is that CRD practices vary across the different jurisdictions due to disclosure regulations and voluntary guidelines adopted in each country.

More recently and more significantly, the ACCA published another report on CRD in 2014. The report addresses a number of aspects of CRD from the perspective of investors, regulators and annual report preparers through a series of interviews with these stakeholders to identify users' needs, companies' concerns and challenges to higher CRD quality. The report highlights the importance of RR and calls for better CRD. It recognises that a key limitation of current CRD relates to the disclosure of generic and boilerplate RI as companies are concerned about the commercial sensitivity of information and the potential loss of competitive advantage. The findings also demonstrate the users' RI needs in terms of identifying and explaining a company's principal risks in plain English, and explaining how risks are continually being assessed and reassessed.

In addition, the Institute of Chartered Accountants of Scotland (ICAS) published a report which explores some facets of RR including the relevance of different disclosure channels, the influence of regulations on CRD practices, the RI currently being disclosed in annual reports, the relevance of CRD to investment analysts and managerial discretion over whether to reveal or withhold RI through conducting a number of interviews with investment analysts and AR preparers (Abraham, Marston and Darby, 2012). The interview questions appear broad and are not investigating CRD quality attributes. The findings of the ICAS report reveal that face-to-face/private meetings with management is a key and significant source of information on company's RE that investment analysts appreciate more than annual reports. The report indicates that managers are constrained by the sensitivity of information that competitors may exploit and show that another disincentive for RR is related to senior managers' personal interests and preferences. The report also examines CRD practices of some UK listed companies in the food and beverage sector applying the same method used in the mainstream literature; namely, content analysis to count the number of risk-related sentences. The report argues that the quantity of RI has improved over time, yet it questions its usefulness. The results show CRD is predominantly boilerplate and companies provide more qualitative and less forward-looking RI.

The Association of Insurance and Risk Managers in Industry and Commerce (airmic) and the Institute of Chartered Secretaries and Administrators (ICSA) produced a joint report on RR (Airmic, 2013). The report analyses the risk disclosures made by a sample of UK companies across eight industry sectors to highlight examples of higher quality CRD so that other companies can follow as a best practice. The report uses five criteria to assess CRD practices: risk agenda, risk assessment, risk response, risk communication, and risk governance. The results demonstrate significant variations in CRD practices across companies and sectors. The report also emphasises the benefits that companies can achieve from better RR including, among others, providing assurance to investors and enhancing their confidence, and improving the resilience of organisations.

The most recent report was jointly commissioned by the Association of Chartered Certified Accountants (ACCA), the International Integrated Reporting Council (IIRC) and the International Association for Accounting Education and Research (IAAER) (Slack and Campbell, 2016). The report addresses RR implicitly as it is specifically investigating integrated reporting. The report explores the views of investment analysts and capital providers such as investment bankers on the relevance of integrated reporting and its perceived benefit in terms of decision-usefulness. With regard to RR, the findings of the report conclude that it is generic in nature which is a similar finding to the other professional reports. The report also refers to the lack of forward-looking information and lack of linkage between the different types of narrative disclosure including RR, business model and strategy and calls for connectivity to enhance decision-usefulness to information users.

These reports are primarily concerned with analysing the current RR practices and the perception of information users of its relevance and are not directly addressing CRD quality in the manner of this thesis. Although, unlike previous CRD studies, some of these reports investigate CRD from the perspective of information users, they predominantly focus on investment analysts as a user group as these are (supposedly) experts in analysing a company's performance and RE. Typically, these reports only provide some general principles and guidelines for improving CRD quality/usefulness. There is also a lack of interest in investigating the challenges to RR from AR preparers' point of view.

2.6. The issue of prior research seeking, and failing, to address CRD quality

Based on the discussion above, it is evident there is a growing body of research in the past decade on CRD practices in different countries in the world. Previous studies have mainly focused on investigating the quantity and some attributes of RI and examining the determinants (firm-specific and CG characteristics) of CRD. On the whole, there seems relatively good agreement across previous studies that CRD lacks coherence, clarity and usefulness as companies tend to provide vague and generalised RI that could apply to different companies in

different industries (see, for example, Jia, Munro and Buckby, 2016). Prior literature also indicates that there is a lack of quantifiable and forward-looking RI. Longitudinal studies and studies that have been conducted in highly regulated countries do find an increasing trend of CRD but still argue that RI provided to investors and other stakeholders is insufficient and lacks quality.

In respect of how these studies have attempted to investigate CRD quality, it is evident that the majority of previous CRD studies in various jurisdictions have used content analysis to measure the amount of RI and then use it as a proxy for quality. In addition, some other studies have used the value relevance of RI to examine the quality and/or usefulness of CRD. These studies fundamentally investigate the association between the level of RI and some financial indicators such as company market value. They apply the value relevance approach in order to explore the market reaction to the disclosure of RI and the impact of CRD quantity on assisting investors in predicting future earnings and cash flows (see, for example, Moumen, Ben Othman and Hussainey, 2015, 2016).

Whether a study uses content analysis or value relevance approaches is problematic in that it is not examining CRD quality directly as quantity is being used as a proxy for quality. This issue, as initially outlined in chapter 1, will be returned to in the next section of this chapter where there is further discussion of the CRD quality research gap. However, before providing this research gap discussion it is important to state that there are a very small number of prior studies which contend they have addressed the issue of CRD quality in an alternative way to prior content analysis or value relevance studies. Therefore, the purpose of this section is to explain in what ways these studies have sought to address CRD quality and, importantly, why these studies are limited in how they have addressed CRD quality. In this way it is possible to highlight that there has, in fact, been little prior empirical work undertaken that fully addresses CRD quality. There are six key studies that fall into this category: Abraham, Solomon and Stevenson (2007), Leitner-Hanetseder (2012), Miihkinen (2012, 2013), Abraham and Shrives (2014) and Jia, Munro and Buckby (2016).

In an unpublished study, Abraham, Solomon and Stevenson (2007) suggest a method for examining CRD quality considering only four attributes; *Formulaic, Specificity, Capability of measurement and Evidence of measurement*, based on the Jenkins report (1994). The first theme examines whether or not companies provide up-to-date RI and discuss the changes in their RE over time instead of boilerplate RI. The second attribute concerns the disclosure of company-specific RI. The third characteristic focuses on the disclosure of quantitative RI, and the fourth theme addresses the disclosure of risk assessment methods. They then examine CRD quality in the annual reports of 14 non-financial UK FTSE 100 companies. Their findings reveal a lack of CRD quality suggesting that companies provide similar RI over time. Unlike the vast majority of the previous CRD studies, their study shows that companies provide specific RI. They

underline the importance of disclosing information that helps users assess the impact and probability of a risk occurring and find little information about the assessment of risks. They recommend issuing regulations that oblige companies to disclose their key risks and changes in their risk profile over time. However, they seem to have ignored other relevant characteristics of high quality CRD.

Leitner-Hanetseder (2012) proposes a model to assess the quality of risk disclosures by German and Austrian companies based on CRD quantity, company size and the index on which the company is listed. The researcher assumed that CRD quantity measured by the number of pages is an indicative of its quality, and that larger companies tend to disclose higher quality RI. However, using the number of pages could raise more concerns. The vast majority of previous studies have used the number of sentences which may arguably yield more accurate results as researchers read through risk disclosures to examine and identify CRD-related sentences instead of counting the number of pages. Leitner-Hanetseder develops a disclosure index (scoring model) that covers five aspects of CRD; *form, risk management, overall risk, individual risk and financial risks*, and formulated a number of questions that she sought to answer to measure CRD quality. The questions capture a number of important features such as risk rating, risk concentration and risk quantification. Nonetheless, they focus on what information is disclosed and how it is presented in annual reports rather than its quality and informativeness. The questions also appear to be too broad to capture the essence of CRD quality and achieve the research objective. Furthermore, the proposed model is not based on the qualitative characteristics of useful information suggested by regulatory bodies and does not consider stakeholders perspectives on CRD quality. She does, however, find a significant relationship between the quantity and the quality of risk disclosures.

Miihkinen (2012) evaluates CRD quality using content analysis to examine CRD quantity, coverage and attributes. He measures CRD quantity using the number of CRD-related words, whilst coverage is measured by the number of different risks disclosed. He also examines the number of sentences revealing quantitative or qualitative RI and the sentences disclosing risk management actions which is consistent with previous studies such as Linsley and Shrives (2006). In a subsequent study Miihkinen (2013) also utilises the quantity and coverage of RI to assess CRD quality. In addition to the subjectivity in identifying and measuring the quantity of risk disclosures, Miihkinen (2013) does not examine RI quality attributes depending on quantity as a proxy for quality. Moreover, CRD quality cannot only be measured by the amount of RI information disclosed, but also, more importantly, its usefulness to information users.

Abraham and Shrives (2014) also propose a model for measuring and enhancing CRD quality. They use proprietary costs theory and institutional theory to explain the lack of RR quality. The model they suggest is based on ensuring only three attributes of the RI disclosed by companies. Firstly, they underline the importance of providing company-specific risk disclosures rather

than generic and boilerplate RI that is not useful to information users. Secondly, they suggest that companies revisit their risk disclosures and provide up-to-date information on their risk exposure and profile. However, they seem to be more concerned about the disclosure of generic RI that does not change over time rather than timely RI information that is more useful. Thirdly, they recommend that companies focus on reporting material risks that could have serious impact on their performance in prior and subsequent annual reports. It seems that they are stating the obvious because UK companies are required by the Companies Act and CG Code to disclose their principal risks and uncertainties. Furthermore, it is not clear which definition of risk they have adopted to identify and examine CRD quality.

Abraham and Shrives (2014) applied their model to examine the risk disclosures made by four UK companies of the FTSE 100 in the Food Producers and Processors sector over a five-year time period. The results reveal that companies provide poor RI quality that is generic and qualitative in nature. The findings also show that companies do not disclose significant events in prior or subsequent annual reports to reflect the development of their RE and RR has not changed over time. However, the study focuses on a limited number of characteristics that do not reflect overall CRD quality. Moreover, although they highlight that different stakeholders can play a key part in enhancing CRD quality, they have not considered stakeholders' perspectives; for example, users' RI needs, in developing their model.

More recently, Jia, Munro and Buckby (2016) examine risk management disclosure quality of Australian companies using the same method utilised in previous CRD studies particularly Beretta and Bozzolan (2004a) and Linsley and Shrives (2006). They use quantity and richness of RI to evaluate CRD quality. Whereas quantity is measured by the number of disclosure sentences, richness is assessed by some characteristics including time orientation, quantitative/qualitative, disclosure tone, and types of risks disclosed. They find that companies provide poor quality CRD particularly in terms of disclosing insufficient and generic information. Hence, their study is a replication study in a different setting.

Based on the above discussion, these studies fail to examine CRD quality in a more comprehensive manner. They have not, for example, defined risk or examined other relevant RI quality characteristics such as relevance, faithful representation and timeliness. Likewise, they have not considered the nature of risk in terms of its inherent uncertainty and the qualitative nature of CRD. They also focus on quantitative RI assuming that it is more informative than qualitative RI which may not necessarily be true. Therefore, this study departs from the mainstream literature in that it develops an understanding of and a framework for CRD quality based on the FASB qualitative characteristics and considering the particular nature of risk. The study also investigates CRD quality by soliciting stakeholders' views on the different aspects of CRD quality including users' RI needs and incentives and disincentives for CRD. The research gap is discussed further in the following section.

2.7. Research gap

According to the FASB (2010), the ultimate purpose of corporate reporting is to enhance investors' ability to make informed decisions by providing useful information. This is of importance in the context of CRD as it should also be the purpose of RR that it satisfies this criterion of decision-usefulness which arguably may be the prime indicator of the quality of CRD provided in an AR. Therefore, useful RI should help information users assess a company's risk profile and prospects.

However, defining and assessing CRD quality/usefulness is problematic. This could be one reason why prior studies have focused on counting risk sentences or words. Shrives and Brennan (2015) state that "quality of reporting is difficult to determine but that does not undermine its importance" (p. 98). Likewise, different information users have different interests in the company and hence different information needs. However, Beretta and Bozzolan (2004a) rightly argue that CRD quantity cannot be used as a proxy for quality. Information quality is not solely about how much a company discloses, but also about the informativeness of disclosures to the users of information. This implies that characteristics of information quality such as relevance, accuracy, completeness, comparability, and timeliness are pertinent to assessing the quality of CRD.

It could be argued that some previous studies which have focused on examining the quantity of CRD have also addressed quality/usefulness but only to a limited extent (for example, Beretta and Bozzolan, 2004a; Dobler, Lajili and Zeghal, 2011; Linsley and Shrives, 2006). These studies examine some specific attributes of CRD particularly the disclosure of quantitative and forward-looking RI and CRD tone in terms of disclosing downside risks (bad news) and upside risk (good news). Cabedo and Tirado (2004) argue that reporting quantitative RI should enhance usefulness of CRD and help information users assess the company's profitability and RE. These three aspects do not necessarily reflect the quality of RI disclosed. Similarly, the ICAEW (1999) underlines the importance of disclosing forward-looking and quantified RI for improving CRD quality. The ICAEW (1999) also recommends providing information on the types of risks, risk assessment methods, and RM actions.

On the contrary, Lee (2012) states that "numbers are simply not enough" (p.325) and highlights the importance of discussing a company's RE in qualitative terms in addition to providing quantitative RI to explain the significance of numbers, enhance understandability and boost investors' confidence. Furthermore, Lee claims that investors greatly appreciate qualitative information.

Quality of risk disclosure is a more comprehensive concept. FASB (2010) emphasises the significance of the concept of 'usefulness' in corporate reporting stating that "usefulness in making decisions is the objective of financial reporting" (p.12). Therefore, CRD should be

deemed useful and of good quality if it meets the decision-making needs of information users. Previous studies and professional reports have raised major concerns about the quality/usefulness of CRD as discussed above. For example, Linsley and Lawrence (2007) call for improving clarity and readability of CRD to enhance its informativeness to information users rather than just increasing the quantity of RI provided.

However, none of the previous studies seem to have investigated in depth the attributes of good quality RI and neither have they sought to employ the qualitative characteristics set by the FASB including relevance, faithful representation, comparability, verifiability, timeliness and understandability. Prior CRD studies that attempt to address CRD quality and usefulness; for example, Mousa and Elamir (2014) and Maffei et al. (2014), apply the same research method; content analysis and the number of CRD sentences or words, used in the majority of previous CRD studies as discussed above and the result is their assessment of CRD quality is ultimately resting on numbers of sentences or words. Other studies use CRD index that examines the existence of particular RI regardless of its quality and usefulness (Hassan, 2009; Uddin and Hassan, 2011).

Although CRD quantity is not a valid and comprehensive proxy for its quality, yet it can be considered an aspect of quality. Shrives and Brennan (2015) argue that the amount of disclosure is an aspect of quality because it reflects the time and effort spent on producing and providing this information. Therefore, it could be argued that investors may appreciate the quantity of RI disclosed. Moreover, Miihkinen (2012) finds a positive association between CRD quantity and quality. Nevertheless, CRD quantity should not be the only or the key indicator of quality and other qualitative characteristics should be taken into account.

Previous studies have also addressed other aspects of CRD quality and usefulness. For example, Ryan (2012) suggests that companies use a tabular format to present RI and disclose their risk experience and changes in their RE, and their RM plans. However, he argues that information users should not have high expectation for CRD acknowledging the complexities of risk and risk assessment. Linsley and Shrives (2000) give particular attention to risk identification and ranking in terms of their impact on company performance and likelihood of occurrence. Abraham, Marston and Darby (2012) also indicate that companies do not rank the risks they are exposed to and support the provision of a separate statement for CRD. Similarly, Breen, Clearfield and Klimczak (2011) advocate a standalone statement for RR and highlight that RM actions and practices including risk assessment have developed after the financial crisis, which in turn should be reflected in CRD practices and accompanied by improvements in the quality and informativeness of RI released by companies.

While the vast majority of prior CRD studies have focused on examining the quantity of risk disclosures, Beretta and Bozzolan (2004a) indicate that more attention has to be paid to the quality of RI as well. Dobler (2005) also emphasises the lack of research conducted to address

the usefulness of risk disclosures. Furthermore, Linsley and Lawrence (2007) argue that increased risk disclosure is not a guarantee of high-quality or useful RI unless it is presented in a clear and readable manner, which is also considered one aspect of understandability (FASB, 2010). Yet there is little empirical or theoretical work that has addressed RR quality and usefulness. Prior literature has also focused on explaining the lack of CRD instead of suggesting a way forward for improving CRD quality.

One major aspect of CRD quality that previous studies seem to have not considered is the needs of information users and their views on the usefulness of RI disclosed by companies. Botosan (2004) and Beretta and Bozzolan (2004b) argue that CRD quality should be investigated from the perspectives of information users. Greco (2012) also recommends that companies should attempt to identify and meet the information needs of users. It can be argued that RI is of good quality and useful to investors if it enables them to make informed decisions. Likewise, understanding information users' views on CRD practices and quality can provide a better understanding of their information needs and expectations.

Furthermore, Abraham and Shrives (2014) highlight the role of different stakeholders, namely information users, AR preparers, regulators and auditors, in improving CRD quality. Similarly, Breen, Clearfield and Klimczak (2011) and International Corporate Governance Network (ICGN) (2010) encourage companies to engage stakeholders and investors in particular in CRD and RM. Moreover, Mokhtar and Mellett (2013) underline the critical role external auditors can play in assuring RR quality and find that companies audited by large auditing firms tend to comply with CRD requirements. It is also important to consider managers' perspectives on CRD and their incentives and disincentives to disclose RI.

In addition, Mousa and Elamir (2014) find that institutional and major investors are significantly positively related to the quality of RI disclosed. Botosan (2004) also underlines the importance of identifying the information needs of different user groups for measuring disclosure characteristics particularly understandability and relevance. This study responds to calls for considering stakeholders' perspectives on CRD by investigating CRD quality through the eyes of information users and AR preparers as well as other relevant stakeholders. The study also considers the different characteristics of useful information developed by the FASB and operationalises them to fit the context of CRD. Therefore, this study contributes to the existing body of literature by developing a framework to assess and enhance CRD quality. The study explores the concepts of risk and quality that have not been addressed in the prior literature and considers users' RI needs and management concerns about reporting risks. Likewise, the perspectives of regulators, auditors and academics are also taken into account.

CRD is primarily intended for investors, and therefore CRD quality should be investigated from their perspectives in terms of its relevance to making informed decisions. Jonas and Blanchet (2000) state that "as the customers of financial reporting, the users should define reporting

quality" (p. 358). The ICAEW (2011) also emphasises that companies should identify and meet users' RI needs to help them properly assess a company's risk exposure and profile. Considering the limitations of current CRD practices discussed above there is also a need for understanding managers' concerns about disclosing RI and how to mitigate these concerns. Other stakeholders including regulators and auditors can also play a key role in improving CRD quality and hence their views should be considered.

The research gap can be addressed in two main aspects. Firstly, the limitations of the research methods used in prior CRD studies by using CRD quantity as a proxy for quality or the value relevance approach which examines the relationship between CRD and stock market value and returns as indicative of RI quality. For example, Elshandidy and Shrives (2016) examine the impact of CRD on stock market liquidity and investors' perceived risk measured by the volatility of market returns to assess the usefulness of RI using the number of risk sentences and CRD tone based on a number of key words. However, it may be extremely difficult to attribute the volatility of market return or share prices to the disclosure of particular information.

Second, in terms of research methodology, previous CRD studies have mainly adopted a quantitative approach using content analysis or a disclosure index to examine RR practices. There have been very few studies that have examined stakeholders' perspectives on CRD. Solomon et al. (2000) use a survey questionnaire aimed at probing UK investment analysts/institutional investors' views of existing RR practices in terms of its level and relevance to their decision-making and indicate that RI provided by companies is insufficient. However, they do not particularly examine CRD quality and its characteristics. Likewise, a survey questionnaire cannot fully capture the different aspects of CRD quality or enable researchers to investigate it in more depth and detail. They also focused on one stakeholders group. In addition, there is very limited interview-based research. In an unpublished study, Abraham, Marston and Slack (2014) adopt an interview-based approach to investigate only one aspect of CRD; usefulness of RI, from the perspective of only one stakeholder group; institutional investors/investment analysts.

Some professional reports discussed above have also used a qualitative approach to explore the views of stakeholders on RR practices through interviews. Despite the limitations of these reports, they have attempted, to a certain extent, to develop an understanding of current CRD practices and the perceived relevance and benefits of RI, and provide some suggestions for improving CRD quality, which is missing in the extant CRD literature. However, they also focus on particular stakeholder groups (investment analysts) and do not fully examine CRD quality.

Therefore, it is important to examine CRD quality in a more comprehensive manner. This importance stems from the concerns raised about the quality and usefulness of RI provided by companies as discussed above and in chapter 1. While some studies find that CRD has

improved over time, particularly in terms of the quantity of RI (Deumes, 2008; Konishi and Ali, 2007; Neri, 2010; Rajab and Handley-Schachler, 2009), others have raised concerns about the quality and informativeness of risk disclosures provided to information users (Beretta and Bozzolan, 2004a; Dobler, 2008; Lajili and Zeghal 2005). Likewise, some studies have argued that the current CRD is insufficient and vague RI is provided by companies (Linsley and Shrives, 2005a; Linsley and Shrives, 2006). Likewise, Linsley and Lawrence (2007) have investigated the readability of CRD and find a low level of CRD readability implying that RI is difficult to read.

Likewise, previous studies and professional reports emphasise the benefits of better CRD for companies and investors as discussed in chapter 1. Some previous studies also address the problems and costs associated with non-disclosure to encourage companies to voluntarily disclose more RI. Cabedo and Tirado (2004), though they focus on CRD quantity, point out that the lack of CRD hinders investors' ability to make better decisions. Dobler (2008) also argues that managers could use RR, considering the discretion inherent in CRD, as a tool for RM through influencing information users` decisions, behaviours and reactions. Furthermore, Miihkinen (2013) suggests that higher CRD quality leads to lower information asymmetry.

The characteristics of useful information have already been developed by regulatory bodies such as the FASB and IASB, but these characteristics should be carefully defined and operationalised in the context of CRD to meet users' information needs considering the nature of risk**.** Generally, CRD quality depends on a number of factors including the information needs of users, the nature of risk, company-specific characteristics, the regulatory framework and managerial incentives for CRD. These aspects are discussed in the following chapters.

2.8. Conclusion

CRD has gained increasing attention from academics and professional and regulatory bodies particularly in developed and highly regulated countries. There has been a particular emphasis on examining CRD practices of non-financial companies. Financial companies are seen to be more complex in terms of the nature of their business activities, the type of risks they face, the regulations they are subject to and the risk disclosures they provide.

Previous studies have mainly focused on investigating the quantity of risk disclosures and its determinants. These studies generally highlight the lack of RR quality in terms of disclosing vague and generic RI and the lack of quantitative and forward-looking RI. Likewise, prior studies that find an increasing trend in the amount of CRD demonstrate that companies provide poor quality CRD. Therefore, it is surprising that empirical work has, to date, not fully addressed CRD quality.

There are a number of motives behind investigating CRD quality. First, there is a dearth of research on CRD quality that has arisen as most prior studies have focused on examining the

quantity rather than quality of risk disclosures. Moreover, CRD quality has not been adequately addressed in the current literature. Second, prior CRD studies have continually raised concerns about the relevance and usefulness of RI to information users and, therefore, it is important to undertake a research project which is wholly focused on CRD quality. Third, the particular importance of providing high quality RI to stakeholders (e.g. investors), companies, capital market and the economy has been emphasised in many studies and professional reports.

One major aspect regarding the assessment of CRD quality is that previous studies have not considered the views of users of information on the quality and usefulness of RI. Therefore, this study seeks to contribute to the existing body of literature and develops a framework for CRD quality. The next chapter develops this initial framework for the quality of RR through considering the FASB conceptual framework and qualitative characteristics.

Chapter 3: The initial CRD framework

3.1. Introduction

As discussed in the previous chapter, there is a need for research that examines the concept of quality in respect of the provision of risk-related information by companies in their annual reports. Risk reporting (RR) is a unique context where a number of complex aspects need to be defined including risk, risk information (RI) quality and users' information needs.

This chapter considers the concept of quality within the broader context of corporate disclosure and includes discussion of the assessment of disclosure quality and the factors affecting the quality of disclosures provided by companies such as management incentives and disclosure regulations. The chapter then explores the characteristics of quality RI in light of the prior disclosure literature as discussed in chapter 2 and the FASB (2010) conceptual framework considering the unique nature of risk.

Accordingly, the key purpose of this chapter is to develop an initial conceptual framework for CRD quality. The importance of the FASB conceptual framework is that it establishes the fundamental "qualitative characteristics of useful financial information…that are likely to be most useful to the existing and potential investors, lenders, and other creditors for making decisions about the reporting entity on the basis of information in its financial report" (FASB, 2010, Paragraph QC1). The idealised CRD conceptual framework developed in the chapter provides a structure for examining CRD quality in the interviews and is revisited and revised in chapter 7 in the light of the interview analysis.

3.2. The concept of quality

An initial discussion of quality is required if the thesis is to develop an appropriate framework for assessing and enhancing CRD quality. According to Oxford Dictionaries (n.d.), quality is generally defined as "the standard of something as measured against other things of a similar kind; the degree of excellence of something". Oxford Dictionaries also provide another definition of quality as "a distinctive attribute or characteristic possessed by someone or something". Consequently, the quality of something (e.g. information, product) can vary depending on the attributes it possesses.

These definitions are initially helpful as they implicitly identify that quality depends on context. For example, the quality of a product as being free of defects may be quite different from the quality of a piece of information as being useful and helpful in making informed decisions.

There seems to be a lack of consensus in the disclosure literature about the concept of quality particularly in terms of how it can be evaluated. Botosan (2004) discusses the concept of quality in the context of accounting disclosure and initially states "no universally accepted notion of

disclosure quality exists" (p. 289). This remains an accurate assessment as disclosure quality has often been described in the accounting literature as presenting a dilemma and being problematic. Hence, researchers who attempt to measure disclosure quality have always been presented with challenges. However, Botosan (2004) then usefully notes that quality of information in an accounting context is best understood as related to its decision usefulness, and she then defines quality as the function/combination of a number of characteristics including understandability, relevance, reliability and comparability.

Jonas and Blanchet (2000) also identify that defining disclosure quality is challenging and, like Botosan, address quality from the perspective of meeting information users' needs. Their perspective on quality is derived from the deliberations of professional and regulatory bodies including the FASB, Security Exchange Commission and the American Institute of Certified Public Accountants. These bodies define disclosure quality in terms of meeting the information needs of users to assist them in making informed investment decisions with regard to the allocation and valuation of capital and resources. Therefore, this thesis also argues that CRD quality should be defined and assessed by reference to information users' needs.

Consequently, in the context of CRD quality, the thesis is founded on the premise that the degree of CRD quality will depend on the risk disclosures satisfying a number of characteristics that ensure that disclosures meet users' information needs and expectations. This accords with the FASB's (2010) perspective that financial reporting information is considered useful as long as it meets the users' information needs and assists them in making informed decisions regarding their investment choices and allocation of capital. Further, as the FASB conceptual framework comprehensively establishes the fundamental "qualitative characteristics of useful financial information" (ibid) then it is considered appropriate in the thesis to employ the FASB characteristics as the foundation on which to build a CRD quality framework. The resulting CRD quality framework will then be consistent with the FASB's view of how the needs of information users can be met.

This approach of employing the FASB characteristics as the foundation on which to build a CRD framework avoids using disclosure quantity as a proxy for quality which could yield misleading implications for policy and practice. For example, Beattie, McInnes and Fearnley (2004) and Hussainey and Mouselli (2010) raise concerns about using mere quantity measured by the number of text units as a measure for disclosure quality. Likewise, using the value relevance approach to examine the association between corporate disclosure and stock market reaction (e.g. firm value or stock price volatility) fails to capture important dimensions and fails to develop a comprehensive view of disclosure quality and usefulness. Consequently, researchers and other stakeholders could end up drawing inaccurate conclusions.

Jonas and Blanchet (2000) argue that the FASB framework is the best available platform to build on for developing a framework for disclosure quality and, similarly, Braam and Beest

(2013) measure disclosure quality based on the qualitative characteristics (the enhancing and fundamental characteristics) developed in the FASB conceptual framework. Similarly, Beest, Braam and Boelens (2009) indicate that corporate disclosure should provide high quality information on company performance that is useful to information users in making informed decisions. This study, to the best of my knowledge, is the only study that attempts to develop a CRD quality framework with reference to the FASB characteristics from stakeholders' perspectives.

As noted above, the context within which quality is being addressed needs to be considered (Beattie, McInnes and Fearnley, 2004). For this thesis this is important to emphasise, as RR is a unique context where the nature of risk and RI should be taken into account. Beest, Braam and Boelens (2009) indicate that different user groups and individual users will perceive quality of disclosure differently considering the disclosure context, and users' information needs, decisions and amount of investment. Thus, when drawing on the FASB characteristics to create a CRD quality framework the perception(s) of a range of information users of the concept of risk and RI must be considered. The research methodology chapter discusses the wide range of different information user groups drawn on for this study and why it was judged important to draw on their different perceptions of risk and RI for the study.

Furthermore, Jonas and Blanchet (2000) indicate that "as the customers of financial reporting, the users define reporting quality" (p.358). They indicate that a disclosure quality framework should bring major benefits through familiarising managers, auditors and audit committee members with the concept of quality which should then facilitate benchmarking across companies and lead to improving the quality of financial reporting. Abraham, Solomon and Stevenson (2007) highlight the importance of stakeholders' engagement in identifying the relative importance of RI and evaluating current CRD quality from their perspective. Likewise, Abraham and Shrives (2014) underline the role different stakeholder groups particularly information users, AR preparers and auditors can play to enhance CRD quality.

The above studies demonstrate that disclosure quality should be defined and investigated from the perspective of information users in particular and other relevant stakeholders. It can be assumed that corporate disclosure is deemed to be useful if it enhances investors' decisions as the key user group. This study argues that CRD quality should also be defined and assessed through the eyes of information users and other relevant stakeholders.

Jonas and Blanchet (2000) indicate that disclosure quality involves the quality of the information production process including the selection and application of accounting policies and techniques and not only its ultimate outcome. Jonas and Blanchet (2000) also define disclosure quality as providing "full and fair disclosures" to protect investor without explaining what constitutes a full and fair disclosure. In the context of CRD, Dobler (2008, p. 187) demonstrates that RR "shall satisfy an information function and more specifically an early-

warning function for outsiders". Jonas and Blanchet (2000) and Dobler (2008) seem to focus mainly on one aspect of disclosure in terms of informing investors about what can go wrong. However, the purpose of disclosure is generally to meet investors' information needs and enhance their decision-making.

3.3. Measurement of CRD quality

This section explores how quality has been addressed and assessed in the prior disclosure literature and CRD literature. Defining disclosure quality and identifying its attributes is significantly important for developing a method for its assessment, and hence suggesting a way forward for improving the usefulness of disclosures made by companies. There is a need for a measure of CRD quality considering the nature of risk and the importance of RI in understanding a firm's financial position and future prospects based on its risk exposure and risk management (RM). The difficulty and subjectivity of risk assessment due to the inherent uncertainty of risk could be an obstacle to the production and dissemination of high-quality RI.

Measuring disclosure quality has been described in the accounting literature as a dilemma and has always represented a challenge for researchers who attempt to assess quality. Botosan (2004, p.289) raises the following substantial questions that summarise the key issues related to disclosure quality which are addressed in this study in the context of RR; "What defines disclosure quality? Is disclosure quality measurable? What information aids investors in their assessment of firm risk and how do investors use this information in developing their risk perceptions?" Botosan (2004) further highlights this challenge and provides an answer to the second question stating "disclosure quality is inherently immeasurable" (p.290). Yet, this challenge should not deter researchers from examining disclosure quality.

Moreover, Beattie, McInnes and Fearnley (2004) shed light on proper assessment of financial reporting quality as a necessary step to identify its drivers and impacts. There are a number of approaches that have been used in the accounting literature to assess the quality of financial reporting including earnings management (Lobo and Zhou, 2001), information quantity (Hussainey and Mouselli, 2010, Mousa and Elamir, 2014), accruals quality (Biddle, Hilary and Verdi, 2009; Mouselli, Jaafar and Hussainey, 2012) and value relevance (Müller, 2014). Likewise, Call et al. (2017) find that employees' quality measured by their education level is positively related to disclosure quality measured by accruals quality, internal control violations, and restatements. Other studies have used qualitative characteristics to examine the informativeness of disclosure (Abraham and Shrives, 2014; Beest, Braam and Boelens 2009; Schipper and Vincent, 2003; Linsley and Shrives, 2006).

Some studies examine particular disclosure attributes such as quantitative/qualitative, positive/negative and forward-looking/past information (Beattie, McInnes and Fearnley 2004; Linsley and Shrives, 2006). Beest, Braam and Boelens (2009) measure disclosure quality using

a weighted disclosure index including 21 items to capture a number of qualitative characteristics. They calculate a score for each characteristic and for all the characteristics to measure the overall disclosure quality. Whereas they attempt to develop a comprehensive measure of information quality disclosed in the AR, they focus on financial reporting. Likewise, the disclosure items they have developed are generic.

Beest, Braam and Boelens (2009) argue that qualitative characteristics represent a direct measure of disclosure quality, yet they highlight the problematic of operationalising these characteristics and the difficultly of assessing disclosure quality. Likewise, Beattie, McInnes and Fearnley (2004) state that "it must, however, be emphasized that no definite set of quality attributes and weightings of those attributes exists, since quality is subjective and context-dependent" (p. 230).

Moreover, Hussainey and Mouselli (2010) acknowledge the deficiency of using disclosure quantity as a proxy for quality. However, they assess quality using the amount of disclosure measured by the number of sentences and richness of forward-looking information within corporate narrative reporting. They also use the amount of good news disclosures to evaluate information richness.

In addition, Mousa and Elamir (2014) use the number of CRD sentences to measure CRD quality. Leitner-Hanetseder (2012) finds that CRD quantity measured by the number of pages is a key determinant of its quality. Nevertheless, Beretta and Bozzolan (2004a) argue that quantity of RI cannot be used as an indicator of its quality. Beattie, McInnes and Fearnley (2004) also assume that quantity and quality of disclosure are positively related and consider the amount of information a key driver of its quality. They further claim that companies that disclose more information are more likely to provide higher quality information.

Abayo, Adams and Roberts (1993) use the degree of compliance with disclosure requirements to evaluate financial reporting quality arguing that companies, under a mandatory disclosure regime, consider the cost of non-disclosure. Companies can, however, comply with regulations without providing informative disclosure. Moreover, compliance with disclosure regulations does not necessarily lead to high-quality disclosure considering the effectiveness of such regulations. Abayo, Adams and Roberts (1993) also consider how much information companies disclose voluntarily as one aspect of disclosure quality.

Some studies investigate the impact of the type of the external auditor's report on disclosure quality (Abayo, Adams and Roberts, 1993; Dobler, 2008). However, the type of audit report depends on a number of factors including auditor's independence who is mainly concerned with examining the degree of compliance with disclosure requirements through ensuring that the preparation of annual reports is in accordance with a particular disclosure framework.

Furthermore, Dobler (2008) argues that audit does not necessarily have a positive effect on the quality (credibility) of RI and may rather have a negative impact. But the questions that might arise regarding the role of the external auditor: are auditors really concerned with ensuring and assuring disclosure quality and RR quality in particular? What is the extent to which auditors can contribute to improving CRD quality?

The previous studies have focused on a number of measures and proxies that do not capture the essence of quality. They primarily focus on accounting numbers particularly those that use earnings management and value relevance. For example, value relevance literature investigates the relationship between financial information and stock prices, and employs this relationship to assess information quality (Müller, 2014). However, changes in share prices could be attributed to different factors other than corporate disclosure. They have also ignored the characteristics of high quality disclosure developed by the FASB including relevance, faithful representation, etc. This would then require developing an effective model to define and operationalise each characteristic.

3.4. Disclosure regulations, CRD quality framework, and management incentives for CRD

Disclosure regulations and requirements are primarily intended to improve the informativeness of financial reporting information. Regulations are intended to oblige companies to disclose certain information in order to protect investors and assist them in making informed decisions as well as ensure capital market efficiency. Abayo, Adams and Roberts (1993) have claimed that compliance with disclosure regulations should improve financial reporting quality. Brown and Tarca (2012) also argue that the adoption of IFRS will enhance reliability and transparency and consequently comparability of financial reporting amongst companies across the EU. They suggest a number of benefits of the production and dissemination of reliable, transparent and comparable financial disclosure resulting from the adoption of IFRS in the EU including lower cost of capital, more efficient capital market and enhanced economic growth.

Therefore, it could be assumed that regulations contribute to higher quality disclosure, yet this remains to be proven. Previous studies offer contradictory arguments regarding the impact of regulations on CRD practices and quality. Greco (2012) finds that existing regulations have not contributed to better CRD and therefore suggests introducing more and detailed CRD requirements. Ryan also (2012) recommends developing regulations to enhance the usefulness of RR. Conversely, Solomon et al (2000) report that institutional investors prefer a voluntary approach to RR. Kravet and Muslu (2013) caution against introducing more regulations and argue that companies may technically comply with regulations without providing useful information through disclosing general RI rather than company-specific RI. They also underline the major role management incentives paly in determining CRD practices.

Dobler (2005) argues that "even in a regulated accounting environment, the information value of risk reports must not be overestimated" (p. 1). Dobler (2008) also claims that whilst disclosure requirements could overcome the incentives and discretion exercised by managers to report on risks to a limited extent, regulations may not always be associated with a positive effect on the quality of RI released by companies.

Furthermore, Dobler (2008) refers to the herd behaviour in CRD that could drive the company to disclose more RI following other companies in the same industry or market, albeit with further reinforcement by regulations. The researcher further indicates that credibility of risk disclosures can be enhanced through regulations and enforcement. Overall, Dobler (2008) is not in favour of an obligatory disclosure of risk-related information and claims that companies and the economy as a whole could be negatively affected as a result of a mandatory disclosure system. Dobler, Lajili and Zeghal (2011) also raise concerns about the effectiveness of CRD regulations or risk-related accounting standards. Their argument is that risk regulation is demonstrably ineffective as they observe a lack of future and quantitative RI within the annual reports of a sample of manufacturing companies in the USA, Canada, UK and Germany, all of which have risk regulation. Similarly, the ICAEW supports a voluntary approach to RR and argues that it can be improved without further regulations. The absence of a comprehensive accounting standard tailored for RR is also worth highlighting.

Prior studies have also observed that regulations may contribute to increasing the quantity of information disclosed but not necessarily its quality. Therefore, management incentives and disincentives to comply with regulations and disclose particular information must be taken into account when studying CRD quality. This is because management can exercise discretion over the disclosure of financial reporting information in general and RI in particular. Managers can either disclose or withhold particular information in order to attain benefits for themselves and/or their companies or avoid potential costs associated with the disclosure of, for example, competitively sensitive information. Corporate disclosure in general is closely related to the cost-benefit analysis of the consequences of disclosure and/or nondisclosure.

Prior literature indicates that the role of disclosure incentives can surpass the effect of regulations on RR (Dobler, 2005; Dobler, 2008; Dobler, Lajili and Zeghal, 2011). This is particularly important considering the inherent nature of risk in terms of its uncertain and forward-looking nature, and hence the judgement and subjectivity of risk assessment and reporting. Consequently, Dobler, Lajili and Zeghal (2011) argue that "risk disclosure is a function of regulation and incentives with both factors linked to the institutional and cultural environment and the latter additionally depending on firm-specific factors" (p. 4).

Dobler (2005) demonstrates that managers are expected to report more on risks if they can achieve the benefits claimed in prior literature such as reducing the cost of capital. Dobler (2008) further stresses the role of disclosure incentives and states that "given its inherent discretion, risk reporting depends on disclosure incentives" (p. 184). He further asserts that disclosure requirements cannot eliminate the impact of management incentives. The subjectivity and non-verifiability inherent in RR place more emphasis on considering management incentives and discretionary risk disclosures (Dobler, 2008). Dobler (2005) indicates that management incentives will continue to play an important role even in the existence of mandatory CRD requirements because of the subjectivity and uncertainty inherent in risks.

Managers can use RI to their advantage to influence investors' behaviours and reactions. Therefore, Dobler (2005) proposes introducing regulations that require particular disclosures and presentation format of RI, risk measurement methods, risk categories to report on and RM actions. Dobler (2008) indicates that management discretion exists even in a mandatory disclosure framework, which can to some extent help companies overcome the commercial sensitivity of particular information. However, he argues that management discretion on reporting risks could be limited by regulations requiring particular risk disclosure formats and categories of risk factors.

Dobler (2008) identify three factors that could encourage managers to reveal more RI. First, companies are willing to provide more RI if they will incur no disclosure costs. Second, if stakeholders know that managers hold relevant information, then companies may have to respond by disclosing and sharing this information with stakeholders. Third, companies may attempt to disclose information that is verifiable. Dobler (2008) also indicates that "incentives for risk reporting depend on information already available to the outsiders" (p. 193). Management incentives to reveal or conceal RI should be considered when studying CRD and suggesting a way forward for improving its quality and especially when introducing new disclosure regulations to set reasonable expectations of the expected outcomes.

Dobler, Lajili and Zeghal (2011) indicate that management decisions or discretion to report on risk is triggered by the subjective, nonverifiable and uncertainty nature of risks. The uncertainty inherent to risks leads to management discretion in measuring risks, assessing their potential impact and choosing RM actions and disclosure policies. Dobler, Lajili and Zeghal (2011) explain the motives behind management discretion regarding disclosure or withholding of RI. They indicate that risky companies might provide more risk disclosure to justify the high-level of risk exposure and highlight risk management actions that might be affecting the company's performance. This could be an attempt to attribute risks or losses, poor company performance to other factors outside management control. With regard to disclosure disincentives, they indicate that management could withhold RI to avoid potential costs; competitive costs and litigation costs. However, the ICAEW (1999) states that "companies have no informational or commercial

barriers to enhanced risk disclosure, but simply do not provide as much useful information as they could" (p. 21).

It can be argued that disclosing higher-quality RI is beneficial to the company in the long-term for building and maintaining investor's confidence. Moreover, keeping investors informed and engaged in the RM and RR process could mitigate the impact of a particular risk. Otherwise, investors may take adverse actions leading to unfavourable consequences (Lundholm and Winkle, 2006), which could cause harm to the company and affect its performance. Furthermore, concealing RI could achieve some benefits in the short-term; yet companies should consider the market conditions and reaction which could lead investors to react in an unfavourable manner. Therefore, managers should consider the consequences of non-disclosure and the disclosure of misleading and generic RI.

3.5. CRD quality attributes

There have been attempts by professional and regulatory bodies as well as academic research to suggest ways to enhance the quality and improve the informativeness of RR. For example, the ICAEW (1997) and Cabedo and Tirado (2004) recommend a separate risk statement within corporate reporting to disclose the risks facing companies. However, in a recently published report, the ICAEW (2011) suggests incorporating RI within other corporate disclosures rather than reporting on risks in a standalone statement to ensure their integration with other corporate disclosures. Similarly, Solomon et al (2000) indicate that institutional investors do not appear to support an additional statement of business risk. In this section these different prior suggestions are drawn on when considering the FASB qualitative characteristics and creating the initial CRD framework.

The FASB has developed a number of qualitative characteristics for enhancing the usefulness of corporate financial reporting. The FASB divides these characteristics into two main categories: fundamental characteristics and enhancing characteristics. Fundamental characteristics include relevance and faithful representation whereas enhancing characteristics comprise comparability, verifiability, timeliness and understandability. The fundamental characteristics are related to the information content while the enhancing characteristics are more concerned with the presentation of information. It can be argued that qualitative characteristics are more appropriate for gaining a better and comprehensive understanding of the quality of information disclosed particularly in the context of RR.

The FASB also considers the impact of constraints, particularly cost constraints, on the production and communication of useful information. These characteristics apply to financial reporting information in general. Therefore, in order to use them in evaluating CRD quality they need careful definition and operationalisation considering the contextual nature of risk and RI.

3.5.1. Fundamental characteristics

The FASB places most emphasis on the fundamental characteristics to enhance the usefulness of financial reporting information. These comprise *Relevance* and *Faithful Representation*.

3.5.1.1. Relevance

The FASB (2010) defines *relevance* as the capability "of making difference in the decisions made by users" (p.17), and further explains this capability by the disclosure of "predictive value, confirmatory value, or both" (p. 17). Hence, relevant information helps users attach values (actual or expected) to various events. In the context of CRD, this is related to the quantification of risks in terms of their actual or potential impact, likelihood of occurrence and their ultimate impact on firm performance. However, providing quantitative information on risk and its potential impact, though it is possible for realised risks is difficult to achieve especially in case of significant uncertainty about the outcomes of particular risks.

Dobler (2008) attributes the lack of proper and useful CRD largely to the uncertainty inherent to risks that discourage managers from disclosure. He indicates that providing past risk information does not assure the usefulness of CRD. Moreover, measuring risks and their potential impact is problematic and subjective. However, predictive value is not necessarily related to the precise amount of risk, it could generally be a description of the trend in risk (increasing or decreasing) and its potential impact (positive or negative). Predictive value refers to providing information on potential risks a company might face including upside and downside risks that enables investors to gain an understanding of company future risk exposure (RE) and prospects.

According to Botosan (2004), relevance means providing information that meets users' information needs. Ryan (2012) argues that CRD quality can generally be improved through disclosing relevant information about company RE to help users assess its potential impact on company future performance. Jonas and Blanchet (2000) explain relevance with respect to reporting historical and forward-looking financial information that provides information users with a full and rich picture of past company performance and experience (what went right and what went wrong) and assists them in assessing company's potential respectively. Dobler (2008) highlights the particular importance of providing historical information and argues that "a manager can build reputation and trust by having past forecasts being classified ex post as truthful" (p. 195).

Likewise, Beest, Braam and Boelens (2009) emphasise the predictive value of disclosure and the extent to which information can help users predict company future performance, and use this value as a measure of information relevance. They employ three measures of relevance; the amount of forward-looking information, disclosure of risks and opportunities and the use of fair value. They also recognise historical information that could provide some confirmation and

reassurance, and enable information users to compare management expectations with actual performance.

In addition, Abraham, Solomon and Stevenson (2007) draw attention to the notion that information users need more forward-looking information and place more emphasis on future RI in conveying both business risks and opportunities. The ICAEW (1999) indicates that a key benefit of RR is providing investors with useful future RI. Likewise, Hussainey and Mouselli (2010) highlight the importance of forward-looking information and find that "future-oriented earnings statements in the annual report narratives increase the stock market's ability to anticipate future earnings change three years ahead" (p. 171).

Likewise, previous CRD studies attach particular importance to the disclosure of forward-looking RI and consider it a key aspect of CRD quality/usefulness (Linsley and Shrives, 2006; Linsley and Shrives, 2000). Abraham and Shrives (2014) propose a model for improving the relevance of CRD and focus on three elements including the disclosure of company-specific information, up-to-date RI, and information on key risks. Company-specific RI is also an important aspect of CRD as the prior CRD literature highlights the generic nature of CRD and the lack of company-specific RI as discussed in chapter 2.

Conversely, the FASB also encourages companies to disclose historical information that provides confirmatory value to help investors evaluate past estimates and compare them with actual outcomes. Likewise, Dobler (2008) contends the consensus in the prior literature on the usefulness of future RI due to concerns about information credibility and its inherent uncertainty. Future CRD ultimately represents management's view about future events which is subjective. Accordingly, it could be argued that a combination of both future and past RI is more appropriate to aid investors in assessing management stewardship and company future prospects.

Table 3.1 below presents an exhaustive list of all the sub-characteristics of relevance in terms of CRD. These sub-characteristics will be further developed in chapter 7 based on the interview data considering information users' needs and management concerns about proving future RI.

Table 3.1: Proposed comprehensive CRD framework: Relevance-based risk disclosures

Future risks	- Quantitative RI on company overall RE and each key risk. - A statement on the likelihood or probability range for each key risk and the assumptions used to assess risks. - Potential impact for each risk on company performance. - Providing information on the trend in future risks. - Providing information on short-term risks; "reasonably foreseeable material risks" (OECD, 2004, p.53).

	- Providing realistic risk estimates. - RM plans to mitigate threats and/or optimise opportunities. - Identification of controllable and uncontrollable risks. - Providing information on any uncertainty associated with the estimate and measurement of risks. - Reporting the amount and number of reserves and provisions the company establishes to meet its future risks.
Past Risks	- Providing information on the initial risk estimate. - Disclosing progression or evolution of risk over time. - Discussing variations in the company's RE (risk position). - RM actions taken to manage risk. - Providing quantitative information on each risk factor as well as the company aggregate RE. - Reporting the net/residual impact of risk. - Discussing the discrepancies between estimated and actual risk outcomes considering RM. - Reassessment of past risks to determine ongoing risks and remove risks that are no longer considered material.
Other sub-characteristics	- Disclosing new and emerging risks. - Providing company-specific; "Disclosure of risk is most effective when it is tailored to the particular industry in question" (OECD, 2004, p.53). - Reporting company business model and strategy. - Discussing the company's overall RM system and strategies.

3.5.1.2. Faithful representation

In order to be faithfully represented, information should be "complete, neutral, and free from error" (FASB, 2010, p. 17). According to Jonas and Blanchet (2000) disclosure is complete if "it tells the whole story" (p.361), and covers the material events either positive (opportunities) or negative (threats). Accordingly, completeness could be defined in the context of CRD in terms of disclosing all key risks and providing adequate information on each risk so that users can better understand and assess the company's RE. Therefore, companies should disclose information on the impact and probability of occurrence of each key risk that may have significant impact on company performance without any omission of relevant information. However, it is almost impossible for RI to be complete and error-free because of the uncertainty inherent in risk.

Likewise, considering the nature of risk and the above discussion *neutrality* may be difficult to achieve because CRD ultimately represents management's view of risks facing the company. Moreover, the FASB states that "because financial reporting is a tool to influence decision making, it cannot be neutral" (P. 28). The FASB provides further explanation for each of these three sub-characteristics. It explains completeness as providing sufficient information to assist information users in understanding a particular phenomenon.

It confines *neutral* to "bias in the selection or presentation of financial information" (p.18). But bias could also apply to the measurement of events and risks through the choice of particular accounting measures and techniques to assess and report on risks as well as the application of accounting standards and disclosure requirements, "which involves considerable judgment and the use of private information, and as a result, IFRS (like any other set of accounting standards) provide managers with substantial discretion" (Jeanjean and Stolowy, 2008, p.481). Neutrality refers to "objectivity and balance" in disclosure and presentation of financial reporting and means providing information honestly without bias (Jonas and Blanchet, 2000). Similarly, Beest, Braam and Boelens (2009) suggest managing the balance between positive and negative disclosures.

Neutrality is pertinent to RR with regard to disclosing upside and downside risks. However, this depends on the company's perception of risk in terms of risk being only downside or both upside and downside. For example, Linsley and Shrives (2006) adopt a broad definition of risk that encompasses both upside and downside and find that companies provide more information on upside risks. Considering the uncertainty of risk and volatility of its outcome, companies should disclose their upside and downside risks to present a neutral view of its risk profile. Beest, Braam and Boelens (2009) also call for reporting both good and bad news in a relatively balanced manner.

Beest, Braam and Boelens (2009) use another measure of faithful representation which is freedom from bias. They indicate that disclosure cannot be completely free from bias due to the uncertainty and subjectivity of measurement and prediction of future events. Therefore, they suggest reporting on the accounting assumptions and principles upon which estimates of future events are based. They state that "when the selected accounting principles are clearly described and well-founded, it increases the probability to reach consensus and to detect misstatements for the user of the financial report as well as for the auditor" (p. 12). With regard to CRD, managers may choose not to report certain RI to influence investors' decision and behaviours. This sub-characteristic could be further enhanced by disclosing how risks are being assessed.

Moreover, Beest, Braam and Boelens (2009) refer to two other measures that could assure faithful representation of financial reporting: the type of auditor's report and corporate governance. They consider an unqualified audit report a key aspect of faithful representation that lends credibility to the AR. Likewise, external auditors may play a part in terms of RR but

the extent to which auditors can contribute to enhancing neutrality of CRD is questionable. External auditors may not be in a position to evaluate the effectiveness of a company's risk management system. However, they can confirm that external CRD is consistent with internal documents.

In addition, the FASB addresses *materiality* which refers to significantly important information that could affect investors' decisions in case of non-disclosure or mis-diclosure. Breen, Clearfield and Klimczak (2011) also highlight the importance of reporting material risks. This leaves a great deal of judgment to company's management to determine material risks and information. In general, faithfully represented disclosure should portray the true financial performance and RE of a company. Table 3.2 presents the sub-characteristics of faithful representation in terms of CRD.

Table 3.2: Proposed comprehensive CRD framework: Faithful representation-based risk disclosures

Completeness	- Disclosing Key risks and uncertainties that have affected or could significantly affect company performance. - Disclosing company internal and external risk factors. - Providing sufficient quantitative and/or qualitative information on each key risk. - Explaining non-disclosure of particular risks. - Ranking key risks in terms of their impact and likelihood of occurrence.
Neutrality	- Providing information on the principles used to identify and measure key risks. - CRD should reflect the company's actual risk position. - Objectivity in presenting RI through disclosing risk assessment methods and risk management actions. - Non-omission of material risks. - Precluding any intentional removal or manipulation of RI. - Disclosing upside and downside risks.
Freedom from error	- Past risks can be verified and reported accurately. - Providing information on future risks including their likelihood, potential impact and RM plans. - Avoiding disclosing misleading RI or misstating risk disclosures. - Disclosing corporate governance mechanisms in place.

	- External auditor could provide further assurance that CRD is complete, neutral and free from error.

3.5.2. Enhancing characteristics

The enhancing characteristics (*Comparability, Verifiability, Timeliness, and Understandability*), as the name implies, are intended to further improve the quality of information that meets the above two fundamental characteristics. However, relevant and faithfully represented information might be useless or lose its significance if, for example, not provided in a timely and/or understandable manner. Therefore, these qualitative characteristics complement each other (Braam and Beest, 2013).

3.5.2.1. Comparability

Investors should be able to compare the performance of different companies and choose from the various investment options available. According to FASB (2010), comparable information is useful to investors as it enables them to evaluate a company's performance over time as well as compare it with other companies. Dobler (2005) states that "comparability is particularly important to estimate the plausibility of a manager`s assessment of economy-wide or industry-wide risks" (p.23). Beest, Braam and Boelens (2009) indicate that comparability requires that the information disclosed is comparable over the different accounting periods for a given company and across different companies, which is then considered of high quality (Botosan, 2004).

Whereas comparability over time seems reasonable and achievable, comparability across different entities may be difficult considering company characteristics and circumstances. Comparability may also require some regulations in place that require particular methods and disclosure format for measuring and communicating RI. Miihkinen (2012) finds that the introduction of an accounting standard (mandatory CRD requirement) that provides detailed guidance and examples of better RR has contributed to improving CRD quality. Mokhtar and Mellett (2013) also attribute the inadequacy of relevant and useful RI to the lack of risk-relevant regulations and argue that regulations place more emphasis on the presentation of information rather than its richness.

Likewise, Dobler (2005) indicates that more effective CRD regulations could enhance comparability of RI. Ryan (2012) also draws attention to presentation format of CRD and acknowledges the need for regulations to ensure comparability of RI. Therefore, Ryan recommends disclosing both historical (actual risk outcome) and forward-looking information (risk estimate). However, Linsley and Shrives (2000) indicate that CRD quality is not entirely guaranteed under a mandatory disclosure regime. Similarly, Dobler (2008, P. 184) states that

"we should not overestimate the informativeness of risk reporting even in a regulated environment", considering the nature of risk.

Beest, Braam and Boelens (2009) suggest that discussing the company's performance over the previous accounting periods should enhance comparability. They argue that that ratio analysis and index numbers are useful tools to enhance comparability. Hence, comparability could be more challenging in terms of CRD considering its qualitative nature. Miihkinen (2013) also places an emphasis on the disclosure of comparable RI that is useful to investors in evaluating the company's performance. Ryan (2012) further highlights that "absent such explanatory and comparability-enhancing disclosures, my belief is these disclosures are almost useless to users of financial reports" (PP. 317-318).

According to the ICAEW (1999), providing comparable RI can enable investors to evaluate management performance and serve as a basis for benchmarking. Reporting comparable RI is essential because firms in the same industry sector and facing similar risks have different objectives, risk appetites and risk tolerances, and apply different risk management strategies (ICAEW, 1997). It is imperative that investors have information about the actions taken by management to handle risks which should give them a better understanding of the impact of risk on the respective company performance. Therefore, the introduction of CRD regulations that prescribe particular methods for identifying, categorising, measuring, managing and presenting risks could enhance comparability by improving consistent RR practices. Yet, the impact of regulations on CRD quality is debatable.

Beest, Braam and Boelens (2009) also recommend disclosing any changes in the accounting polices used and their impact. They also suggest providing information that is comparable across different companies without providing further clarification of how it could be achieved. Table 3.3 presents the proposed sub-characteristics that could improve RI comparability.

Table 3.3: Proposed comprehensive CRD framework: Comparability-based risk disclosures

Comparability	- Consistency in measuring and reporting risks over time using the same measurement methods and presentation format for a single company and across companies. - Providing information on risk assessment methods and principles. - Disclosing changes in the methods used to measure risks. - Discussing the changes in company RE over time (inter-firm comparability). - Comparing the company's RE with its competitors and other companies in the same industry and/or market by discussing major risks affecting the business environment in which the company operates and how they have been identified, measured, managed and

	reported in comparison with other competitors (inter-industry comparability). - Providing more quantitative RI that can be easily comparable. - Disclosing historical and future RI to compare risk estimate with its actual impact and assess the effectiveness of RM. - Comparing a company's overall RM and RR practices against a best-practice framework. - Reporting risks in the same section within the AR over time so that they can be easily found and compared.

3.5.2.2. Verifiability

Verifiability is meant to "assure users that information faithfully represents the economic phenomena it purports to present" (FASB, 2010, p. 20). For a company to provide verifiable information it should make sufficient disclosures on the accounting principles, policies and measurement methods to help users validate the information provided (Jonas and Blanchet, 2000). RI and particularly forward-looking information is unverifiable or difficult to verify because of the subjectivity and judgement inherent in risk assessment. Hence, CRD represents management's view of a company's key risks.

The FASB acknowledges the difficulty of verifying forward-looking information. Therefore, it suggests disclosing the techniques applied to measure estimates and the conditions under which these estimates were produced. The ICAEW (1997) and Cabedo and Tirado (2004) also recommend that managers disclose risk measurement methods to assure investors that the information provided, to the best of their knowledge, faithfully represents the company's risk position. Similarly, Ryan (2012) emphasises the uncertainty inherent in risks and encourages companies to disclose their risk measurement methods. Dobler (2008) argues that non-verifiable RI lacks credibility and attributes the lack of verifiable RI to the costs and concerns about disclosing such information. Accordingly, Table 3.4 presents the sub-criteria of verifiability-based RI.

Table 3.4: Proposed comprehensive CRD framework: Verifiability-based risk disclosures

Verifiability	- Providing more quantitative and monetary information on past and future risks and their actual and potential impacts respectively. - Disclosing sufficient information on the overall RM system including risk measurement methods and RM plans. - Providing information on the methods employed to measure past risks. - Disclosing the principles of assessing future risks and the conditions

	associated with risk assessment. - Making RI available to all information users at the same time. - Narrative RR should be accompanied by specific and sufficient details.

3.5.2.3. Timeliness

The FASB (2010) defines timeliness as providing information that is capable of influencing users' decisions. Timeliness means providing information in a timely manner to assist users in making informed decisions. It also refers to disclosing information as long as it is relevant for investors (Jonas and Blanchet, 2000). The FASB also highlights the importance of disclosing historical information to help investors evaluate company performance over time.

Timeliness is important in terms of RR due to the changing nature of some risks and the dynamic business environment in which companies operate. Jonas and Blanchet (2000) encourage using information technology and the internet to provide timely financial reporting and overcome the information asymmetry problem.

Abayo, Adams and Roberts (1993) measure timeliness based on the time it takes to publish the annual reports after the end of the financial year. Beest, Braam and Boelens (2009) measure timeliness by the natural logarithm of the number of days between the company's year-end and the date of auditor's report. Solomon et al (2000) indicate that companies report material RI to institutional investors and analysts in private meetings which may make the information disclosed in the AR irrelevant and less timely, and this inevitably leads to information asymmetry problem.

Moreover, institutional investors reveal that they pay more attention to the information they receive in meetings with management (Financial Reporting Council, 2011). This could also imply that the AR is not the appropriate channel for CRD. Linsley and Shrives (2005a) suggest reporting risks via corporate websites to provide timely RI. Similarly, the ICAEW (2011) emphasises the importance of disclosing timely RI, and therefore recommends reporting risk-related information on corporate websites arguing that the AR lacks timeliness. Linsley and Shrives (2005b) also raise doubts about whether the AR is appropriate for RR.

On the other hand, the forward-looking nature of risk might make the AR a suitable platform for RR providing both past and future risk disclosures. Furthermore, the annual report provides a detailed and comprehensive description of a company`s overall financial performance and future prospects. Historical RI can be used as a basis for predicting future profits and estimating future risks. Ryan (2012) states that "forward-looking disclosures can be informed by historical experience" (P. 297), and hence argues that historical and future risk disclosures complement each other.

RR should not be limited to the AR or associated with a specific disclosure channel. Rather it depends on the significance of information or business event that investors should be informed about and hence other disclosure vehicles such as press releases and corporate websites can be used in addition to the AR. The table below presents the sub-characteristics of timely CRD.

Table 3.5: Proposed comprehensive CRD framework: Timeliness-based risk disclosures

Timeliness	- Providing risk-related information in a timely manner. - Using different disclosure vehicles such as corporate websites, press releases and interim reports to disclose risks more timely. - Providing time-bound risk disclosures. - Updating and discussing changes in previously reported risks regardless of the publication date of the AR. - Reporting timely RI as long as it is complete, relevant and reliable. - Reporting risks to different information users at the same time. - Keeping information users informed about emerging and ongoing risks. - Timely disclosure of RI compared to competitors. - Disclosing risks in the AR that provides a full picture of the company's financial position and risk profile.

3.5.2.4. Understandability

According to the FASB, information should be classified, described and presented in a clear and concise manner in order to be understandable. The FASB refers to the challenge of satisfying all the characteristics and argues that where the omission of complex information could improve understandability, it may well affect disclosure completeness and can be misleading for information users.

Most prior studies demonstrate that CRD is vague and difficult to read (Dobler, Lajili and Zeghal, 2011; Linsley and Lawrence, 2007, Linsley and Shrives, 2006). Beest, Braam and Boelens (2009) argue that clear and concise presentation of financial information should enhance understandability. Linsley and Lawrence (2007) demonstrate that the CRD quality will not improve unless readability and clarity of RI is further boosted.

Jonas and Blanchet (2000) emphasise the ease of reading of financial information using simple and understandable language as well as clear and concise presentation. Nevertheless, the FASB assumes that information users should have the minimum/reasonable knowledge to analyse and comprehend the information disclosed. The FASB also encourages information users to seek expert advice in order to understand complex information.

The FASB suggests some other ‘desirable characteristics’ to enhance understandbaility including transparency, high quality, internal consistency, true and fair view or fair presentation, and credibility. Although this set of characteristics is not explained in detail they do not appear to be different from the characteristics discussed above. Beest, Braam and Boelens (2009) recommend using graphs and tables to present information clearly and concisely and including a glossary to provide further information. They also examine the extent to which jargon is used which ultimately affects disclosure understandability. Accordingly, companies should avoid using jargon and technical terms that could hinder understandability; otherwise, they should explain these terms in a glossary.

In addition, the FRC (2014a) emphasises two main criteria of effective reporting; conciseness and clarity. However, it could be argued that clarity and conciseness are an outcome of meeting the above characteristics. The FRC indicates that the length of disclosure is a key aspect of conciseness and suggests that immaterial information and/or information on policies is disclosed in a separate report, website or appendices attached to the annual report to enhance conciseness. The FRC also recommends using cross-referencing to avoid unnecessary repetition and information overload as well as providing links where users can find additional information.

Table 3.6: Proposed comprehensive CRD framework: Understandability-based risk disclosures

Understandability	- Classifying and rating risks in terms of their significance and discussing each risk factor clearly and concisely. - Highlighting major risks and their impact. - Using tables and graphs to present RI. - Using plain and simple language and avoiding jargon and technical terminologies. - Using a glossary to explain technical terms. - Keeping information overload and unnecessary repetition to the minimum (Lee at al., 2002). - Disclosing monetary and quantitative RI. - Using cross-referencing and providing links to further RI. - Ensuring conciseness and readability of risk disclosures by considering the length of sentence and the length of the risk factor section. - Presenting RI in a well-organised manner.

3.6. Conclusion

There is a dearth of research on narrative disclosure quality and CRD quality in particular. Previous disclosure quality studies have used different proxies for information quality such as

quantity, value relevance and accruals quality. These proxies, however, do not necessarily capture the essence of disclosure quality and narrative disclosure quality in particular. Therefore, there is a need for developing an in-depth understanding of CRD quality and suggesting a way forward for improving the usefulness of RI considering the particular nature of risk and CRD.

This chapter develops an initial framework for CRD quality based on the FASB framework and the prior literature. The framework aims to identify the characteristics of quality RI that can improve its usefulness. These characteristics are further developed and refined in Chapter 7.

Some of the above characteristics might be difficult to meet in terms of CRD particularly because risk assessment is a complex and subjective process. Other characteristics may sound confusing to a certain extent. However, these characteristics are not contradictory; rather they are interrelated and complement each other (Jonas and Blanchet, 2000).

The FASB characteristics have been developed for financial reporting and serve as general principles. Furthermore, the FASB does not provide enough guidance on how each characteristic can be measured. Therefore, they should be defined in the respective context.

The next chapter presents the research methodology employed in this study in relation to the research philosophy and design, data collection and data analysis.

Chapter 4: Research methodology

4.1. Introduction

This chapter presents the research methodology utilised in this study. It describes the underlying philosophical assumptions and principles and research paradigms that informed the research approach and methodology, and the choice of the research method. The chapter explains and justifies the choice of semi-structured in-depth interviews as the appropriate method to answer the research questions. Moreover, the data collection and analysis methods are discussed. The chapter concludes by discussing the challenges of the qualitative research approach.

It is useful to reiterate the objective of the study is to develop a best practice framework for CRD quality of non-financial firms. This study disputes the idea of using CRD quantity, value relevance or compliance with regulations as a proxy for information quality. It rather focuses on the quality characteristics of risk information (RI) and, arguably, that improving the usefulness and quality of risk reporting (RR) must begin with identifying the needs of information users as well as constraints on annual report (AR) preparers in meeting these needs. The purpose is to identify how to best meet users' needs considering management concerns about reporting sensitive and forward-looking RI.

Therefore, the proposed framework takes account of the information needs of the different users of corporate reporting, and management's (information providers) incentives and disincentives for RR. The views of external auditors, members of regulatory and professional bodies (policymakers) and academics with relevant knowledge and expertise on CRD quality are also taken into account. Consequently, if applied by non-financial firms, the framework would potentially enhance the quality of their risk disclosures. The framework can also be used to assess the quality of risk disclosures made by companies, and inform policy.

Unlike the majority of prior research this study utilises the qualitative characteristics of the most recent FASB conceptual framework, which was developed jointly with IASB, to assess and improve CRD quality instead of applying other proxies that have been used in previous CRD studies that do not precisely capture the essence of CRD quality. Therefore, this study aims to operationalise the FASB characteristics to identify the attributes of useful RI informed by the interviews. The FASB conceptual framework represents a set of generally accepted principles and characteristics, and these principles represent the basis and framework for setting accounting standards (beest, braam and boelens, 2009). Likewise, the FASB (2010) states that "Concepts Statements are intended to set forth objectives and fundamental concepts that will be the basis for development of financial accounting and reporting guidance".

Given the purpose of corporate financial reporting is providing useful information to investors to assist them in making informed decisions, this study focuses on the quality of risk-related

information provided by non-financial companies for three reasons. Firstly, prior research has overlooked RR quality and primarily has focused on examining the quantity of RI within corporate reports. Nevertheless, these studies have raised doubts about the quality and usefulness of RI provided to information users. Likewise, there has been an increasing demand for more and higher quality CRD. Secondly, investors are interested not only in the amount of RI but also in its informativeness. Thirdly, RI is of importance to a wide range of stakeholders; including information users (such as investors), companies and capital markets as discussed in chapter 1.

Quality of risk disclosure should allegedly enhance its decision-usefulness to investors and other information users. The FASB (2010) highlights that "usefulness in making decisions is the objective of financial reporting" (p.12). Accordingly, more attention should be placed on RI content rather than its mere quantity. However, the study takes account of CRD quantity as one aspect of quality referring to the adequacy of RI within corporate reports. The study, therefore, answers the following research questions in order to attain the research objectives.

1- How do different CRD-related stakeholders comprehend the concept of risk?
2- What are the perceptions of information users, and other stakeholders, of the relevance of RR and of current CRD practices?
3- What are the management incentives and disincentives for RR?
4- What is quality and what are the characteristics associated with good quality risk disclosure?
5- How can the FASB qualitative characteristics be operationalised to create a CRD quality framework and how can CRD quality be further improved to correspond with the framework?

The following sections discuss the research philosophy and the methods of data collection and sample selection.

4.2. Research philosophy

Research practices are based on a number of philosophical considerations and theoretical principles informed by the nature of the research problem and research questions under investigation. There has been considerable debate regarding the choice of the relevant research approach and method which can be employed to investigate social phenomena and organizational problems (Daft, 1983). Cunliffe (2011) urges researchers to consider the philosophical concerns that govern their choice of the research methods. The various philosophical assumptions and theoretical perspectives to approaching and understanding organisational problems and social phenomena prompt researchers to use different research strategies and methods. Likewise, Morgan and Smircich (1980) refer to the underlying

philosophical considerations a researcher presumes and the theoretical perspectives adopted to approach a research problem as a key determinant of the appropriate research method.

The choice of a research method should be guided by the nature of the research problem or phenomenon. Researchers should employ a research method in light of the research problem or the social phenomenon they investigate and the objectives they seek to achieve rather than bias or inclination towards employing a particular research method (Silverman, 2010; Cunliffe, 2011). Similarly, Crotty (1998) asserts that researchers should justify the research methods and techniques they are going to utilize that ultimately depend on the nature of the research problem and purposes. The choice of the relevant method or technique should be preceded by identifying the underlying philosophical stance of the researcher that determines the theoretical perspective, and hence research strategy (Crotty, 1998).

There are two major research philosophies underpinning the conduct of research informed by the research problem and questions that guide the choice of an appropriate research strategy, approach, design and methodology: epistemology and ontology. The former refers to the nature or state of knowledge: how knowledge is acquired and generated. The latter concerns the nature or state of reality or being: how reality is perceived and understood.

A number of distinct research paradigms emerge from these two major research philosophies. Each paradigm assumes a number of philosophical principles and assumptions regarding the nature of knowledge (epistemology) in terms of positivism and interpretivism, and the view of social reality (ontology) with regard to objectivism and constructionism. Positivism is the research paradigm which adopts the scientific research model in the study of social phenomenon and organisational problems (Bryman and Bell, 2011). As Crotty (1998) indicates: "one thing is certain: positivism is linked to empirical science as closely as ever" (p. 27). According to this paradigm, researchers develop a number of hypotheses which are then tested to measure variables and examine relationships. Interpretivism, on the other hand, is the epistemological position which recognises the difference between natural and social science and emphasises the role of social researchers in understanding and explaining a particular problem or phenomenon and developing meaning from the perspective of social actors (individuals) to generate knowledge (Bryman and Bell; 2011, Silverman, 2011). Furthermore, Crotty (1998) states that "the interpretivist approach…looks for culturally derived and historically situated interpretations of the social life-world" (p. 67).

With regard to the nature of social reality, objectivism is the ontological position which views reality and being as objective and independent of the research participants or social actors (Bryman and Bell, 2011). Crotty (1998) supports this claim and argues that "the world is there regardless of human beings are conscious of it" (p. 10). This position assumes there is a single truth or reality that exists regardless of the social actors (people/individuals) involved. Constructionism is the ontological position which views social reality as constructed through

the interactions of social actors, research participants or individuals within an organisation (Bryman and Bell, 2011). Accordingly, social scientists seek to better understand social phenomena and organisational problems through understanding individuals' social interactions and relationships and the meanings behind them. These philosophical stances and positions should eventually guide the adoption of the relevant research strategy (quantitative or qualitative) and the appropriate research methodology.

4.2.1. Quantitative and qualitative research strategies

There are two major research strategies which are commonly used in social and management research: quantitative and qualitative research approaches. Some researchers favour a quantitative strategy arguing that it yields more rigorous, reliable and valid research findings that can be generalised to other settings. In contrast, others advocate a qualitative approach and adopt the view of organisation as a construction of actors' interactions and behaviours which can be better understood through the eyes of research participants and the researcher's immersion in the social setting under investigation (Silverman, 2010).

There are a number of differences between quantitative and qualitative research strategies. Quantitative research methods have been widely used in management research (Bryman and Bell, 2011), and accounting research in particular. Quantitative researchers are interested in numbers and quantification (measurement of relationships) (Bryman and Bell, 2011). Likewise, quantitative research is concerned with explaining the relationships within an organisation, while qualitative research is interested in understanding and interpreting these relationships as well as exploring new relationships (Symon and Cassell, 2012). Advocates of a quantitative approach argue that organisations can be better understood through the adoption of the natural science model/approach which focuses on problem solving while considering the theoretical considerations and philosophical commitments. However, Morgan and Smircich (1980) argue that quantitative methods are not always appropriate for all research projects.

On the other hand, many have argued that qualitative research has been recognised as a distinctive research strategy in social and business research (Bryman and Bell, 2011; Bryman, 2012). Morgan and Smircich (1980) highlight the growing interest in utilising qualitative research as an approach that comprises a variety of methods and techniques which are more effective and appropriate for studying particular research phenomena and problems. Daft (1983) stresses what he calls "firsthand learning" or knowledge implicitly referring to qualitative research as the perfect method to learn about an organisation and acquire more knowledge, and highlighting that significant research starts from the organisation not from prior literature or theories. He also suggests that in order to acquire significant knowledge and reach interesting findings one should begin research with no prior bias or preconceptions, and argues that quality

is achieved when the research yields unexpected results that are a surprise to the researcher, which is consistent with Bryman's (2012) view.

Furthermore, Daft (1983) emphasises that doing qualitative research requires paying more attention to the influence of human beings in creating social reality. Daft (1983) indicates that qualitative researchers are more concerned with gaining an in-depth understanding of the social world and organisational phenomena and interpreting behaviours and meanings through the eyes of their creators rather than emphasising data collection and analysis. Daft (1983) further refers to the understanding of a particular phenomenon as the knowledge or "the why", and states that "the why, not the data, is the contribution to knowledge" (P. 541).

Moreover, both quantitative and qualitative research strategies are different in terms of the philosophical assumptions they are aligned with; the epistemological assumptions (positivism or interpretivism) and ontological concerns (objectivism or constructionism). Morgan and Smircich (1980) refer to quantitative research as a synonym for the natural science model which embraces positivist assumptions in social and organisational research and view social reality as objective and independent of the people or research subjects (objectivism). Conversely, qualitative researchers adopt the interpretivist position as they view reality as socially constructed through the behaviours and interactions of research participants/social actors, and attempt to understand this reality from the view point of their creators (Stari, 2000).

Another major difference that exists between the two strategies is the relationship between theory and research or the theoretical perspectives underpinning each research strategy. Quantitative research follows the deductive approach that is concerned with theory testing, while qualitative research adopts the inductive approach where the development of theory is the ultimate purpose and outcome of research (Bryman, 2012). Moreover, Seale (2006) implicitly highlights the role of qualitative research and inductive approach and states that "theory is often generated rather than solely tested" (p.228). Alvesson and Karreman (2007) discuss how theory is generated and recommend researchers to focus on the "inconsistencies" that emerge from the data and uncover any "breakdowns" or "mysteries" that can be attained and yield better results regardless of the research method employed. However, Bryman and Bell (2011) argue that "not only does much qualitative research not generate theory, but also theory is often used as a background to qualitative investigations" (p. 13). They further indicate that both strategies are to some extent interrelated.

There are inevitable limitations associated with the use of qualitative research including the generalisability of research findings, subjectivity and validity. Qualitative researchers typically conduct their studies on a small number of people in a single setting which raises some concerns about generalisability, representativeness and subjectivity of the research and its results (Liamputtong and Ezzy, 2005), and subsequently with "the external validity of the study" (Seale, 2012, p.231). Morgan and Smircich (1980) refer to the issue of subjectivity inherent to

qualitative research and whether qualitative researchers can overcome this subjectivity as they depict how emphasis has been shifted towards a subjective view of social reality where the researcher attempts to gain a deeper understanding of reality through the eyes of people. However, they claim that qualitative researchers can distance themselves from being subjective. Liamputtong and Ezzy (2005) point out that qualitative researchers are not, and should not, only be interested in describing the world and people's behaviours but also in applying the knowledge and understanding they have gained to improve them.

On the other hand, there are also limitations to, and criticisms of, quantitative research. These criticisms, according to Bryman and Bell (2011), are related to both the philosophical underpinnings (epistemology and ontology) and the nature of the research methods informed by this strategy. Bryman and Bell (2011) discuss four criticisms of quantitative research strategy as follows. First, this strategy disregards the difference between natural and social science. Second, there is imprecision associated with the measurement of research variables. Third, there is a lack of connection between research and practice. Fourth, another concern that is a consequence of the previously mentioned criticisms is the generalisation of research findings tends to provide a single view or interpretation of a particular phenomenon and ignores the relevant social actors.

On the contrary to the abovementioned differences, Crotty (1998) argues that the differences between qualitative and quantitative research strategies fundamentally lie in the methods employed rather than the epistemological assumptions and theoretical perspectives related to each strategy. Crotty sheds light on the possibility of using either quantitative or qualitative methods to approach a particular social problem and phenomenon as well as combining both strategies in a single study, which is called the mixed methods approach. Hence, despite the differences mentioned above between both strategies, Bryman and Bell (2011) argue that qualitative research can corroborate quantitative research in developing hypotheses and measuring variables, and indicate that these differences should not be exaggerated. Morgan and Smircich (1980) also attempt to mitigate the controversy concerning the split between quantitative and qualitative methods by asserting that social and organisational research can be conducted using different methods and approaches. Likewise, many have argued that both quantitative and qualitative strategies can be integrated in the study of a particular phenomenon or problem (Stari, 2000).

Similarly, Alvesson and Karreman (2011) share the above view stating "there are no good or bad methods, only good or bad ways of using materials" (p. 106). Despite the claim that quantitative research is the most commonly used approach in business and management research, Cunliffe (2011) encourages qualitative researchers to adopt various methods that allow them to maintain direct contact with the organisations and research participants to gain a better understanding of the social interaction and relationships.

To conclude, although quantitative research strategy has been widely used in business and management research, there has been a growing interest in qualitative research. Quantitative research is concerned with testing the relationships within an organisation based on hypotheses, while qualitative research is interested in understanding and interpreting these relationships and exploring new relationships. The philosophical assumptions and theoretical perspectives play a pivotal role in determining the research approach and method a researcher can use. However, researchers can use quantitative, qualitative or mixed methods approach to attain their research objectives and take advantage of both approaches to obtain robust results.

There is no common agreement among researchers on the best method to approach social and organisational problems, therefore, researchers tend to adopt different approaches. However, there is an increasing interest in employing qualitative research methods in management research. In addition, researchers have paid careful attention to the use of the mixed methods research to take advantage of both strategies and reach rigorous findings (Bryman and Bell, 2011; Daft, 1983).

4.3. Data collection and sample selection

In the light of the discussion above, and in order to answer the research questions, this study adopts a qualitative approach using semi-structured in-depth interviews. Taking an interpretivist epistemological stance and a constructionist ontological position, the study attempts to understand the meaning of risk, CRD quality, what constitutes this quality, and perceptions of the overall RR process through the eyes of the research participants who are representatives of the different stakeholder groups involved in RR.

The qualitative research strategy is more appropriate considering the nature of the research problem and questions. This strategy helps gain an in-depth understanding of the research problem and fully address the research questions. By adopting an interview approach the study can investigate the essence, meaning and characteristics of quality in respect of CRD. Therefore, 28 semi-structured in-depth interviews were undertaken to further inform and improve the initial framework presented in the previous chapter considering the participants' views in terms of users' information needs, constraints on CRD and the potential for further improvement. The data collection method and research sample are further discussed below.

Primary data was collected through conducting the semi-structured in-depth interviews with people from the different stakeholder groups who are engaged in reporting and/or using risk-related information. These groups include information users (institutional and retail investors), AR preparers (risk directors/managers and chief finance officers), auditors (the four leading audit firms), academics (researchers who have extensively studied risk disclosure), independent audit/risk committee members and members of professional and regulatory bodies (FRC and

ICAEW, EFRAG, IFAC and IFRS Advisory Council) representing policy makers. A further discussion of the stakeholder groups that participated in this study is presented below.

The aim is to investigate the research problem from different perspectives and to gain a thorough understanding of the process of producing and communicating RI and information users' needs with regards to RR. The interviewees' responses were used to further enhance the initial framework in light of users' needs and recommendations of other interviewees as well as management concerns' about providing sensitive RI. The data collection method is further discussed below.

In addition, prior to the interviews a literature review of prior CRD research was conducted to help identify the research gap, define the characteristics of useful/quality RI and determine the areas to be investigated during the interviews. This review also encompassed the publications of professional and regulatory bodies in this regard. The definition and operationalisation of these characteristics consider the nature of risk and risk-related information such as its inherent uncertainty and forward-looking nature respectively. Accordingly, the proposed CRD quality framework is based on the literature review, the FASB conceptual framework and the interviewees' responses.

4.4. Commonly used methods in CRD literature

There are different research methods that have been used in the prior CRD literature to examine the extent of CRD and its attributes. The disclosure index method was used by Hassan (2009) to measure the level of CRD. Likewise, Linsley and Lawrence (2007) have investigated the readability of narrative RR within annual reports to measure the ease of reading of RI. Content analysis too has been widely used in the mainstream CRD literature (Abraham and cox, 2007; Beretta and Bozzolan, 2004a; Lajili and Zéghal, 2005; Linsley and Shrives, 2006; Linsley, Shrives and Crumpton, 2006; Mousa and Elamir, 2013; Deumes, 2008).

Quantitative content analysis is mainly used to count the number of instances within a document or text. The content analysis method has often been used for the analysis of texts (Hardy and Bryman, 2004). Disclosure index studies focus on examining the presence of particular RI, while content analysis emphasises the number of risk disclosures with less emphasis on the usefulness of the RI. These methods are time-consuming and inherently subjective, and do not necessarily yield accurate results. This may raise some concerns about the validity of previous results.

There is a noticeable lack of qualitative-based CRD research that takes account of the relevant stakeholders' perspectives (as discussed in chapter 2). Therefore, this study fills this research gap and develops a framework to gain an in-depth understanding of CRD quality considering the needs of information users as well as management concerns regarding the disclosure of risk-related information. The framework is intended to help evaluate and enhance RI quality

provided by non-financial companies in particular in terms of the FASB characteristics as discussed in the previous chapter.

Financial firms have been excluded from this study as they undertake different business activities and operations. Consequently, they are expected to face a number of different risks. Moreover, they are subject to a very different set of disclosure regulations and requirements, for example, Basel regulations. Therefore, they provide very different risk disclosures and a separate study would need to be undertaken to address CRD quality in financial firms.

4.5. Research method

4.5.1. Interviews

As discussed previously there is a paucity of research examining RR quality and its usefulness to information users. There has yet been a particular emphasis on examining the amount of RI provided by companies. Content analysis has been the most widely used method in previous CRD studies. The few studies that have purportedly examined CRD quality utilise some proxies for measuring RI quality that do not necessarily capture or reflect its usefulness (Beretta and Bozzolan, 2004a; Maffei et al. 2014; Miihkinen 2012, 2013; Mousa and Elamir, 2014). Based on the literature review, it is noted that there are a number of areas that have been overlooked in the prior literature including stakeholders' perception of risk and CRD quality.

To understand how to enhance CRD quality it appears most appropriate this should be investigated through stakeholders' lenses in terms of identifying users' needs, the role of regulators and external auditors, and constraints on managers and annual report preparers, which is lacking in the extant CRD literature. This study fills the gap in literature and examines the different aspects of CRD quality through understanding stakeholders' perspectives as the basis for improving CRD practices and overcoming the current limitations. Abraham, Marston and Slack (2014) argue that interviews are an appropriate method for investigating insufficiently addressed research areas such as this.

Accordingly, the semi-structured interview method was employed to collect the primary data. According to Myers (2011), semi-structured interview is the most appropriate interview approach as it allows the interviewer to have a set of prepared questions to address major themes while other questions can arise during the interview allowing for more in-depth discussion. Accordingly, a number of questions were constructed prior to the interviews to cover the different facets of CRD including the perception of risk among the participants, relevance of RE, the participants' evaluation of current CRD practices, CRD quality and CRD incentives and disincentives (see appendix 1). Other follow-up questions were asked based on the interviewees' responses, to clarify and expand their responses and to further elicit their views.

Open-ended questions allow the participants to explain and elaborate their views and provide unbiased answers. Eriksson and Kovaleinen (2011) and Silverman (2010) suggest that the interviewer should avoid direct or leading questions recommending open-ended questions instead that stimulate the participants to willingly provide more information. Therefore, open-ended questions were developed. This inevitably stimulated discussion and encouraged the emergence of new questions and allowed important points to be pursued.

Another important aspect that enriches semi-structured interviews and allows other questions to arise is flexibility and following up interviewees' responses (Bryman and Bel, 2011). Likewise, appropriately different questions were asked to different participants considering each participant's knowledge, experience and background. For example, investors were asked about their attitudes towards existing CRD practices, perceived benefit of CRD to their decisions, and their RI needs. Likewise, some questions were intended to elicit external auditors' views on their assessment of the current state of CRD and how they can contribute to improving CRD quality. It is acknowledged that a major limitation of semi-structured interviews is they are time-consuming to undertake, transcribe and analyse; however, the richness of the data is compensation of this.

This study sought to interview as many participants as possible. The participants were primarily identified and contacted by email. An extensive online search of corporate and professional websites (e.g. LinkedIn) was conducted to identify potential participants. The search revealed a number of potential relevant participants from the different stakeholder groups who might be interested in taking part. Other participants such as academics and members of professional accounting bodies were identified from their publications. Some participants were also asked to recommend other people whom they judged to have the relevant expertise and interest in taking part in the study. Likewise, my supervisors suggested a number of relevant participants. Potential participants were then contacted to ask them to take part in the study and obtain their informed consent.

The participants who took part in this study are UK-based participants. The interviews took place in person in the location of the interviewee's choice (the participants' organisations), over the phone and via Skype depending on the availability and preference of each participant. All the interviews were recorded and later transcribed, and handwritten notes were taken during the interviews as well. Face-to-face interviews can enable the interviewer/researcher to gain more information through observing the interviewee's body language that reveals further information in addition to their verbal responses (Opdenakker, 2006). Conversely, telephone and Skype interviews are less expensive and time-consuming than face-to-face interviews (Armitage and Marston, 2008), and facilitate gaining access to more interviewees (Opdenakker, 2006). In addition, Bryman and Bell (2011) maintain that telephone interviews enable interviewees to feel more comfortable in answering sensitive questions in particular. Bryman and Bell (2011) refer

to some technical problems related to conducting telephone interviews with regard to interview recording. All telephone and Skype interviews conducted were recorded successfully using a recording gadget and Amolto Call Recorder respectively. The sound quality of all the recorded interviews was clear.

The telephone and Skype interviews conducted proved to be effective as the participants were comfortable and willing to talk and answer all the questions. Some telephone and Skype interviews lasted about two hours, even longer than face-to-face interviews. These types of interviews proved to be effective and time and cost-efficient for both the interviewer and the interviewee.

The interviews were conducted between July 2015 and September 2016. 28 participants accepted the invitation to take part in this study representing the different stakeholder groups. Most of the participants have an extensive and mixed professional experience having previously worked as, for example, auditors and risk managers or being a professional practitioner and at the same time a member of one or more professional/regulatory bodies. The list of the interviewees is provided later in the chapter in Table 4.1 with interviewees' codes, job titles/positions, affiliation/organisation and interview method and date. As can be seen in Table 4.1, all the participants were suitable for the study as they are knowledgeable and have direct and relevant experience in using or being involved in CRD.

The interviewees' responses enabled the research questions to be fully and properly addressed and this includes developing a best practice framework for measuring and enhancing CRD quality. The framework addresses the quality characteristics of RI, location and presentation of risk disclosures. The framework develops a number of criteria for the RI quality that a company should meet and satisfy when reporting on risks in order to meet users' information needs.

The time taken to carry out each interview ranged from thirty minutes to approximately two hours depending on how busy the interviewee was and how willing to talk. However, the vast majority of the participants were enthusiastic to answer questions and engage in follow up questions and discussion. Nine interviews were face-to-face, fourteen were by phone and five were conducted over Skype. The different stakeholder groups that took part in the interview are discussed below in more detail.

4.5.2. Interview participants

There have been only a relatively few qualitative/interview-based studies that take into account stakeholders' perspectives on RR. However, these studies are limited in the sense they have focused primarily on one stakeholder group, investment analysts, and they have not been seeking to directly address the problem of CRD quality (Abraham, Marston and Darby, 2012; Abraham, Marston and Slack, 2014; Campbell and Slack, 2008; Slack and Campbell, 2016; Solomon et al., 2000). Abraham and Shrives (2014) draw attention to the contribution that the

above stakeholder groups can make towards improving the quality of RR but do not investigate CRD quality further in this respect. As corporate disclosure is intended to help different user groups make informed decisions, it is necessary to interview a wide range of stakeholders; for example, the information needs of other user groups such as retail/individual investors should be considered as they may lack the knowledge and expertise. Likewise, retail investors typically do not have access to the same information available to investment analysts and institutional investors. The other stakeholder groups can potentially provide valuable insights into CRD and suggest ways in which CRD quality might be improved. It is also important to understand AR preparers' perspectives on RR.

Table 4.1: Study participants

Interviewee Code	**Job title/organisation**	**Interview method**	**Date**
I1	Academic	Skype	16/07/2015
I2	Academic	Skype	16/07/2015
I3	Academic	Face-to-face	28/07/2015
I4	- Academic - CFA	Skype	12/10/2015
I5	Former Corporate Reporting Manager, ICAEW	Face-to-face	14/09/2015
I6	Financial Reporting Council (FRC)	Face-to-face	24/09/2015
I7	Financial Reporting Council (FRC)	Face-to-face	24/09/2015
I8	Auditor , Senior Partner – Audit firm	Telephone	30/09/2015
I9	Auditor , Senior Manager - Audit firm	Telephone	19/10/2015
I10	- Former Auditor - Head of Risk Management	Face-to-face	26/11/2015
I11	- Risk Director - Former Auditor	Face-to-face	01/12/2015
I12	Associate Risk Director	Face-to-face	01/12/2015

I13	Head of Responsible Investment Engagement – Investment analyst	Telephone	11/12/2015
I14	Retail/Individual Investor	Face-to-face	11/09/2015
I15	Chief Financial Officer & Group Business Development Officer	Telephone	12/01/2016
I16	- Chartered Accountant and risk management and audit expert - Risk consultant	Skype	18/02/2016
I17	Retail/Individual Investor	Face-to-face	22/02/2016
I18	- Chartered Financial Analyst and Advisor - Member of the Audit and Assurance Council of the Financial Reporting Council (FRC)	Telephone	23/03/2016
I19	Auditor, Associate Partner - Audit firm	Telephone	07/04/2016
I20	- Enterprise Risk Management Director - Financial Analyst	Telephone	14/04/2016
I21	Responsible Investment Analyst - SRI Analyst	Telephone	03/05/2016
I22	Head of Regulatory Affairs and advisor on regulatory developments – Audit firm	Telephone	03/05/2016
I23	- Independent consultant specialising in financial reporting, audit and corporate governance - Financial Reporting Advisory Board, HM Treasury - Financial Reporting	Skype	04/05/2016

	Committee, Institute of Chartered Accountants in England and Wales - Member, CBI Corporate Governance Forum - Member, Technical Advisory Board, Institute of Chartered Accountants in England and Wales - Member, Accountancy Tribunal Panels - Financial Reporting Council - Independent Member - Audit and Risk Committees - Member, External Audit Committee - International Monetary Fund		
I24	Auditor & Corporate Governance Consultant – Audit firm	Telephone	10/05/2016
I25	Director, Risk Scanning & Detection	Telephone	11/05/2016
I26	- Director of Financial Reporting and Technical Partner – Audit firm - International Financial Reporting Standards (IFRS) Advisory Council member - ICAEW Financial Reporting Committee member	Telephone	1/06/2016
I27	Group Chief Risk Officer	Telephone	14/06/2016
I28	- Director, Financial Reporting council (FRC) - Member of Technical Expert's Group of European Financial Reporting Advisory Group Board (TEG EFRAG)	Telephone	07/09/2016

	- Former Non-executive Board Member, Accounting Council, FRC - Former Director, Audit firm		

4.5.2.1. Different information users

Information users such as investment analysts and investors are commonly considered the primary user group for whom corporate reporting is intended. CRD should meet the information needs and enhance the decision making of both investment analysts and different types of investors. CRD quality and usefulness should be examined and evaluated from investors' perspective in terms of what their information needs are and what they deem to be useful information. Accordingly, investors were interviewed to identify their information needs and their evaluation of existing CRD practices and whether or not CRD is informative. The responses of information users have also been used to solicit more input and additional information to enhance the initial framework.

The ICAEW (2011) encourages companies to identify and meet the information needs of their investors in terms of RR. Moreover, Jonas and Blanchet (2000) state that "as the customers of financial reporting, the users should define reporting quality" (p. 358).

Investors can also be divided into two categories: risk averse and risk takers. Both types of investors need risk-related information to make informed decisions. Risk-averse investors who seek safe investment require RI to ensure and guarantee a return on their investments. Likewise, risk-taking investors also need RI that enables them to estimate risk premiums based on corporate exposure to risk. Additionally, retail and institutional investors are generally different in terms of their investment preferences, experience and strategies and, therefore, are expected to have different information needs.

The information user group comprises retail and institutional investors. It could be argued that institutional investors are not as much concerned about CRD as individual investors as they have a privilege over individual investors by having other information sources than the traditional corporate disclosure vehicles, which provide them with valuable information. Consequently, they can obtain risk-related information through private meetings with company management and/or other sources that may not be available to individual investors. Likewise, institutional investors can exercise some influence over company's policies, strategies and operations. Thus, they are expected to have some impact on its disclosure policies. Given the varying needs of information users, yet the AR is meant to meet the information needs of a wide range of users. Accordingly, a number of interviews were conducted with retail and institutional investors and investment analysts.

Table 4.2: Information user group (retail and institutional investors)

Interviewee Code	Job title/organisation	Interview method	Date
I13	Head of Responsible Investment Engagement – Investment analyst	Telephone	11/12/2015
I14	Retail/Individual Investor	Face-to-face	11/09/2015
I17	Retail/Individual Investor	Face-to-face	22/02/2016
I18	- Chartered Financial Analyst and Advisor - Member of the Audit and Assurance Council of the Financial Reporting Council (FRC)	Telephone	23/03/2016
I21	Responsible Investment Analyst - SRI Analyst	Telephone	03/05/2016

4.5.2.2. Annual report preparers

Managers exercise discretion over the amount and type of disclosures they make taking account of any potential consequences. This is particularly relevant to RR where there is a great deal of subjectivity and uncertainty in addition to the sensitivity of RI. Therefore, it is important to take account of managers' perspectives who may have concerns about providing RI in their publicly available reports.

Accordingly, a number of interviews with participants representing companies were carried out to understand the concerns of AR preparers about the constraints on companies regarding disclosing risk-related information. Company management should also consider the information needs of current and potential investors and strive to meet these needs in an effective manner. Prior literature refers to two major obstacles to RR: sensitivity of particular RI and the potential litigation costs of reporting forward-looking RI (Linsley and Shrives, 2006). Abraham, Marston and Darby (2012) indicate that whether risk-related information reveals business opportunities or threats it can be used by competitors to their advantage.

In addition, suggesting a framework which identifies quality characteristics that companies should meet when reporting their risks without considering their concerns about reporting such information could be fruitless. There could be a number of incentives for managers such as

highlighting their abilities to effectively manage risk or justifying poor company performance through attributing it to other external factors out of their control (Linsley and Shrives, 2000). Likewise, managers can use CRD to assure investors and others they are monitoring different risks and uncertainties and setting forth risk management (RM) strategies. Accordingly, there is a need to understand and consider managements and AR preparers' views regarding risk disclosures in developing a best-practice framework for CRD quality. Furthermore, this study considers managers' perspectives on the other aspects of CRD quality.

Table 4.3: Annual report preparers group

Interviewee Code	**Job title/organisation**	**Interview method**	**Date**
I10	- Former Auditor - Head of Risk Management	Face-to-face	26/11/2015
I11	- Risk Director - Former Auditor	Face-to-face	01/12/2015
I12	Associate Risk Director	Face-to-face	01/12/2015
I15	Chief Financial Officer & Group Business Development Officer	Telephone	12/01/2016
I16	- Chartered Accountant and risk management and audit expert - Risk consultant	Skype	18/02/2016
I20	- Enterprise Risk Management Director - Financial Analyst	Telephone	14/04/2016
I25	Director, Risk Scanning & Detection	Telephone	11/05/2016
I27	Group Chief Risk Officer	Telephone	14/06/2016

4.5.2.3. Auditors

Auditors play a key role in ensuring that AR reflects the company's actual financial position and risk exposure and, hence, lend credibility to corporate information published publicly. It is imperative to investigate their views on RR practices of companies in terms of the amount and

quality of RI currently being disclosed considering that they have access to internal company documents. They can also provide some valuable insight into how RR can be further enhanced and the incentives and disincentives for companies to disclose or withhold risk-related information. Accordingly, some interviews were conducted with a number of auditors in the big four auditing firms.

Table 4.4: Auditors group

Interviewee Code	Job title/organisation	Interview method	Date
I8	Auditor, Senior Partner – Audit firm	Telephone	30/09/2015
I9	Auditor, Senior Manager - Audit firm	Telephone	19/10/2015
I19	Auditor, Associate Partner - Audit firm	Telephone	07/04/2016
I22	Head of Regulatory Affairs and advisor on regulatory developments – Audit firm	Telephone	03/05/2016
I24	Auditor & Corporate Governance Consultant – Audit firm	Telephone	10/05/2016
I26	- Director of Financial Reporting and Technical Partner – Audit firm - International Financial Reporting Standards (IFRS) Advisory Council member - ICAEW Financial Reporting Committee member	Telephone	1/06/2016

4.5.2.4. Members of professional and regulatory bodies

The findings of this study could be used to inform policy-making and the input of the members of these bodies on the quality of CRD can contribute to a better framework. Policy makers usually need to consider how to maintain the balance between information users' needs as well as the constraints on and concerns of managers when introducing new disclosure regulations and/or guidelines. For example, disclosure regulations and requirements may need to address the different aspects of CRD such as the concept of risk, risk identification, risk measurement, risk communication and RM to develop more effective regulations. Similarly, this group of

interviewees need to consider whether voluntary or mandatory approach is more appropriate for CRD.

Table 4.5: Members of professional and regulatory bodies group

Interviewee Code	Job title/organisation	Interview method	Date
I5	Former Corporate Reporting Manager, ICAEW	Face-to-face	14/09/2015
I6	Financial Reporting Council (FRC)	Face-to-face	24/09/2015
I7	Financial Reporting Council (FRC)	Face-to-face	24/09/2015
I23	- Independent consultant specialising in financial reporting, audit and corporate governance - Financial Reporting Advisory Board, HM Treasury - Financial Reporting Committee, Institute of Chartered Accountants in England and Wales - Member, CBI Corporate Governance Forum - Member, Technical Advisory Board, Institute of Chartered Accountants in England and Wales - Member, Accountancy Tribunal Panels - Financial Reporting Council - Independent Member - Audit and Risk Committees - Member, External Audit Committee - International Monetary Fund	Skype	04/05/2016

I28	- Director, Financial Reporting council (FRC) - Member of Technical Expert's Group of European Financial Reporting Advisory Group Board (TEG EFRAG) - Former Non-executive Board Member, Accounting Council, FRC - Former Director, Audit firm	Telephone	07/09/2016

4.5.2.5. Academics

A number of academics with relevant expertise in the area of CRD were interviewed to understand their views on RR. These academics have published research studies on RR. Academics always attempt to investigate and understand CRD practices and provide suggestions to inform policy and practice. In addition to what has been already addressed in the prior CRD literature, this study investigates other facets that have been overlooked in the prior CRD literature. Therefore, academics can potentially offer new and valuable dimensions on CRD quality. Arguably, they may also provide a neutral view on how RR quality can be improved.

Table 4.6: Academics group

Interviewee Code	Interview method	Date
I1	Skype	16/07/2015
I2	Skype	16/07/2015
I3	Face-to-face	28/07/2015
I4	Skype	12/10/2015

4.5.3. Ethical considerations

There are some ethical considerations associated with carrying out interviews including maintaining the anonymity of the participants and the confidentiality of their responses. This study took account of all the ethical issues that may arise before, during and after the interviews. The interviews generally did not address any sensitive issues or CRD practices related to the

organisations the participants work for or are affiliated with. The purpose of the interviews was to explore each participant's view on CRD in general and their suggestions for improving its quality and usefulness.

All the interviews were audio recorded and transcribed following the participants' approval. No participant refused to audio record or use any direct quotations, comments or responses attributed to them in the analysis. Before embarking on conducting the interviews, the researcher applied to the Economics, Law, Management, Politics and Sociology Ethics Committee (ELMPS) of the University of York to obtain ethical approval for the study in May 2015, and approval was given in June 2015.

The researcher complied with the ethical procedures and standards set out by the ELMPS. Accordingly, this study considered the following aspects to assure the participants and mitigate their concerns.

1- The interviewees were approached by email and post to invite them to take part in the study and an information sheet briefly explaining the research problem and objectives was attached as well so that they could decide whether they wanted to take part in the study (see Appendix 2), and they could also prepare in advance and feel more comfortable (Armitage and Marston, 2008).
2- The participants were assured about the confidentiality of their responses in the first email.
3- The participants were asked to choose the date most convenient for them and the interview method; face-to-face, Skype or phone.
4- After the participant's approval to take part in the study, a consent form was sent to them prior to the interview including information about their rights as interviewees to further assure them that anonymity and confidentiality are preserved. They were asked to read, sign and return the consent forms to the researcher.
5- The consent form clearly states that the participants are free from any coercion and have the right to refuse to participate or withdraw from participation in the interview at any time (see Appendix 3).
6- The informed consent forms were obtained and the researcher has the signed consent forms of all the participants.
7- Each participant was assigned an anonymous code that is only known to the researcher to maintain their anonymity.
8- The interview transcripts and handwritten notes are stored in a lockable pedestal. The pedestal is located in the PhD suite in The York Management School which has authorised entry only. The pedestal key is held by the researcher and accessible only to him.

9- The participants will be given a copy of the results and the thesis upon the completion of this research.

4.6. The limitations of interviews

In addition to the advantages of interviews as a method there are also a number of limitations attached to the method. Conducting interviews is a time-consuming process (Bryman and Bell, 2011), in terms of identifying and approaching potential participants, setting up the interview time, and transcribing and analysing the interview data. Eriksson and Kovalainen (2008) draw attention to the challenges of conducting interviews and particularly indicate that "it is even more difficult to analyse them well" (p.78). Similarly, Burnard (1991) emphasises the difficulty of maintaining complete neutrality and recognises the inherent bias in reporting interview analysis and writing up research results. However, in this study I focused only on analysing what the interviewees say without attempting to make judgements on the data as indicated in the following chapters which include direct quotes from the interviews.

Whilst the number of interviews (28) is significant, it was generally difficult to gain access to more research participants. Some interviews were rescheduled due to the participant being busy. The potential lack of generalisability of research results is another issue in interview-based research, and the subjectivity of interviewees' responses as they give their perspective on the research problem is also a potential issue. Furthermore, interviewees may intend to convey a particular conception or impression (Solomon et al., 2011). However, data saturation was reached among the participants who shared their views on a number of aspects as discussed in the next three analysis chapters. The interviews were conducted until no new themes emerged, which is called "the point of data saturation" (Francis et al., 2010, p. 1234). In addition, the questions asked about the interviewees' views and perceptions of the different facets of RR were undertaken without any direct and specific questions about their positions and respective organisations, which is consistent with Solomon et al.'s (2011) approach. Therefore, it appeared the interviewees felt comfortable during the interviews and provided sufficient data concerning each question and theme.

The agreement among the interviewees on a number of themes particularly with regard to the relevance and current practices of RR, CRD incentives and disincentives and RI quality characteristics may represent a common understanding of RR and how it can be further enhanced. In addition, no new issues emerged after conducting a number of interviews. The interview transcripts were read multiple times to identify relevant themes. Likewise, the analysis was undertaken in a number of rounds to ensure the validity and reliability of the findings. Some findings are in accord with previous CRD studies, whilst other findings have not been addressed in the prior CRD literature.

4.7. Data Analysis

The interviews were undertaken to answer the above research questions and address the different aspects of CRD quality. Bryman and Bell (2011) suggest developing an interview guide containing a number of the key questions or themes to be covered during the interview. Hence, I developed an interview guide comprising a series of questions informed by the prior CRD literature and the research gap identified. Moreover, further themes emerged during the interview including the role of corporate governance and risk culture within companies in improving external RR practices.

The analysis was conducted following a number of steps as suggested by Bryman and Bell (2011, pp. 584-589) and in line with Armitage and Marston (2008, p. 320). First, the interviews were transcribed and notes were taken and an initial coding was performed throughout the transcription process. Second, I read and reread through the interview transcripts and picked up some interesting themes. Third, the transcripts were then read repeatedly and carefully to capture further themes and gain an in-depth understanding of the data and develop the coding. Fourth, detailed and specific notes were made in respect of each main question and a coding scheme was developed to summarise the interviewees' views regarding each question in a table. For example, how each participant perceives risk in terms of upside, downside or neutral to explore the different stakeholder groups' attitude towards risk.

Accordingly, a number of themes were identified and analysed during the process of analysing the interview transcripts. I immersed myself in the interview transcripts to familiarise myself with the data. The responses were analysed with relevant sentences, passages and key words and terms being highlighted in line with Silverman (2011). Therefore, following Burnard (1991) the interview transcripts were read and reread several times and notes were taken throughout the analysis process to capture the commonalties and differences among the different participants in terms of their perspectives on the above aspects. The transcripts were coded manually following Solomon et al. (2011) by reading the interview transcripts thoroughly and picking up themes arising from the data.

Considering that some interview questions were informed by the prior literature, this link with the literature was important for interpreting and gaining further understanding of the research data. It also revealed new issues not addressed in the prior literature and/or taken-for-granted assumptions that need further investigation. Thus, this study extends our understanding of the prior literature by examining CRD quality as discussed in the next chapters.

The interviews covered a number of major themes including the stakeholders' perception of the concept of risk, stakeholders and information users in particular attitude towards risk disclosure currently made by companies, participants' perceived benefit of CRD. The purpose was to explore how different stakeholders define risk and whether there is a common definition of risk

among the different participants particularly investors (information users), companies (information providers) and regulators. The participants were asked about their views of the existing CRD practices in order to determine the limitations and indirectly identify information users' needs. These themes were developed prior to the interviews in addition to other themes that emerged during the interviews and analysis such as the impact of corporate governance practices and corporate crises and scandals on external RR.

Likewise, another major theme that was investigated is the constraints on managers to disclose risk-related information. The aim was to gain an understanding of management's behaviour and discretionary CRD decision. In other words, this study explores the incentives and disincentives for managers to reveal and/or conceal RI. The study also sought to explore the factors and benefits that may drive and encourage companies to disclose risk-related information and/or provide more risk disclosures in order to mitigate the concerns (disincentives) for companies to report on their risk exposure and disclose sensitive information.

In addition, how quality is defined and can be measured in the context of RR is another theme that was addressed. The participants were asked about their definition of quality and suggestions for improving CRD quality. The FASB qualitative characteristics have been operationalised in the context of RR considering the specific nature of risk. The interviewees were given the FASB's definition of each characteristic, and then they were asked to indicate how each characteristic can apply to RR specifically with respect to how it can be measured and improved. Accordingly, recommendations have been made for companies on how to provide higher quality risk disclosures. For example, with regard to timeliness as a characteristic the participants were asked about the disclosure channel that is more appropriate to satisfy this characteristic. The responses were then coded and analysed to identify the different disclosure channels mentioned and the channel that is perceived to be more appropriate from the participants' perspective and why.

4.8. Conclusion

This chapter addresses the research philosophy, design and method utilised in this thesis. The study adopted a semi-structured in-depth interview approach. The chapter presents how the interviews were conducted and analysed, the different stakeholder groups that participated in the study, and the limitations of the interview method. The next three chapters present the results of the data analysis. Chapter 5 answers the first two research questions through exploring the participants' perspectives on the concept of risk, and their perceptions of current CRD practices and of the relevance of RR.

Chapter 5: Conceptualisation and contextualisation of risk reporting: Concepts, relevance and current practices

5.1. Introduction

This chapter addresses the first two research questions. The chapter explores how different stakeholders perceive the concept of risk and investigates the perceptions of information users, and other stakeholders, of the relevance of risk reporting (RR) and of current CRD practices. The purpose is to identify users' information needs and areas for CRD quality improvement.

5.2. Defining Risk

5.2.1. Introduction

This section of the analysis addresses the first research question: How do different CRD-related stakeholders comprehend the concept of risk? In the context of RR, Linsley and Shrives (2006) emphasise that defining risk is a key challenge facing researchers examining risk disclosures by companies. They adopt a broad definition of risk that encompasses both the potential and actual positive (upside/opportunity) and negative (downside/threat) impacts of risks and uncertainties. Their definition of risk includes the disclosure of "any opportunity or prospect, or of any hazard, danger, harm, threat or exposure, that has already impacted upon the company or may impact upon the company in the future or of the management of any such opportunity, prospect, hazard, harm, threat or exposure" (p. 389).

The above definition equates risk with uncertainty where there is a possibility of either upside or downside risk. Likewise, the majority of prior CRD research has adopted Linsley and Shrives' risk definition with no clear attempt made to examine the concept of risk in depth. Consequently, these studies ignore the possibility that different stakeholders may perceive the concept of risk differently in the context of corporate reporting. This is an important omission as it is not possible to assess how CRD quality can be improved if stakeholders' conceptions of risk are not understood. That is, an investor's perception of risk will determine their information needs and expectations. Hence, any difference among the stakeholders with regard to their interpretation of risk could result in an information gap. Relatedly, if different stakeholders have different conceptions of risk it may be difficult for companies to provide risk disclosures that meet the needs of all stakeholders. The different conceptions of risk of the interviewees, and the implications, are discussed in the next sections.

In addition, it needs recognising that companies are not only exposed to risks in pursuit of their business objectives, but that they have their own risk appetites, risk preferences and risk

tolerances. This affects the risks companies will accept to achieve their strategic objectives, to grow and to be sustainable. Therefore, companies need to be transparent not only in respect of their risk definition, but also their risk appetite and risk tolerance

5.2.2. Alternative perspectives on risk and initial remarks on defining risk

This section provides some initial remarks concerning the participants' definition of risk before moving on to discuss the risk definitions more specifically in subsequent sections. The interview data reveals a lack of a common understanding and agreement on the concept of risk. Different participants held different views and there were differing definitions even within the same stakeholder group. This all points to the absence of a unified definition of risk. The definitions provided were sometimes contradictory not only across the interviews, but also some interviewees contradicted themselves by providing different definitions of risk during the course of the interview.

The participants often found it difficult to articulate a definition of risk. For example, I2; an academic, refers to the challenge of defining risk stating "*It is one of those things that we can identify risk, but perhaps it is quite difficult to define it*". I11; a former auditor and risk director, indicates "*… risk is difficult to define, but for me to define risk you need to put it in a context*".

Therefore, it is understandable some participants looked to provide an intuitive definition of risk by drawing attention to their belief that they did not make a distinction between corporate risk and personal risk. For example, I8; a senior audit partner, states "*Every aspect of life contains risk. It is not negative or positive; it is just a fact of life*". In this way, the participants were indicating that risk can be understood as *a fact of life* and, hence, the implication being that risk is as unavoidable and inherent within business life as it is in personal life. This discussion of risk as a fact of life sometimes lead to participants highlighting that companies have to accept, take and handle risk effectively in order not only to survive and remain in business but also to thrive and achieve profitable growth.

What was not clear was whether the participants who viewed risk as a fact of life believed this might apply both to the regular minor risks that companies run on a daily basis and to its key risks, or just to the regular minor risks.

A further initial remark is the participants stressed it was important for businesses to take risks. In acknowledging this need for business to take risks, they discussed how when companies attempt to completely avoid or eliminate every single risk this could hinder the achievement of their strategic and business objectives, and this would neither ensure the survival or growth of the company. I8 describes this as the 'negative' side of risk in the following sense: "*where it does become a negative for businesses if you are trying to eliminate risk and you implement too many controls and processes that get in the way of doing business*". Similarly, I9; a senior audit manager, points out that "*from a business perspective you are taking on an adequate level of*

risk that allows the business to grow up". Because of this need to take on risk, they emphasised an equal need for effective risk management (RM), stating it is essential for companies to decide on the appropriate RM strategies regarding whether to accept, mitigate, avoid, or transfer a particular risk.

Knight (1921) made a distinction between risk and uncertainty calling the former 'measurable uncertainty' and the latter 'unmeasurable uncertainty'. However, whilst this distinction is well-known in academic finance, I2 is the only interviewee who referred to the difference between risk and uncertainty in terms of estimating the likelihood of occurrence, and other participants made no distinction between these two terms. For example, I20; an enterprise risk management director, defines risk as a synonym for uncertainty remarking "*Our global risk office and the way we try to position risk is just to recognise that simply it means uncertainty*".

A final initial remark is that, whilst defining risk was challenging, according to the responses, risk can be broadly understood in terms of both its forward-looking nature (uncertainty and time-horizon) and materiality (impact of future outcomes on company performance). This perception of risk in terms of what may occur in the future rather than what has occurred in the past was to such an extent they were prone to consider any past risk that has occurred as a business event that has happened rather than a risk. For example, I18; a chartered financial analyst and advisor, states "*I regard the past as known knowns*".

These initial remarks regarding the interviewees' conception of risk are indicative of risk being a highly complex concept. However, it was evident that the interviewees fell into one of three primary categories in respect of how they perceived risk and these are now discussed.

5.2.3. A first definition of risk: downside risk

Some participants define risk solely in terms of potential unfavourable outcomes. These participants are more concerned with the downside aspect of risk which they perceive as any likely threat or harm to the business. Risk is, according to these participants, any material event or threat that could prevent the business from achieving its strategic objectives and/or lead to future unfavourable outcomes. This means that risk is something negative; a loss or harm that could affect the company's future performance and prospects. I9 states that risk is "*the areas of concern or the areas where things can go wrong*". Furthermore, I7; a project director at the FRC, comments "*risks are always downside; there is no positive for risk*".

These participants are differentiating between risk and opportunity as they consider upside and downside risks as two mutually exclusive concepts. They acknowledge the uncertainty inherent in risk and the importance of companies taking risks for business growth and therefore are not implying that businesses should somehow avoid risks. However, their concern lies with the downside risks. Consequently, this has implications in respect of CRD information needs.

This view is shared by the members of regulatory and professional bodies; FRC and ICAEW, who took part in the interviews: I5, I6 and I7. I5; a former Corporate Reporting Manager at the ICAEW, defines risk primarily in terms of what could go wrong and justifies his definition by arguing that in the context of RR information users are more concerned with the potential negative outcomes of risk (downside risk) which companies should focus on when reporting on their risk exposure (RE).

> "*I would say it* (risk) *is uncertainty about the future, but I would say it is mainly uncertainty about things that are likely to go wrong in the future…The reason people want risk reporting is normally because they are worried about things that are going to go wrong and, therefore, I think it is more useful in terms of working out what people want and what they want to learn about to focus on uncertainties as the likelihood of potential things going wrong rather than the upside risk…when they say we want better risk reporting they do not actually want better risk reporting…they want better warning when things are likely to go wrong*". (I5)

> "*When I think of risk the thing that immediately comes to my mind is…exposure certainly on the downside to something that will be detrimental to the performance of the corporate. It is not opportunity for sure and I know of some would think of it in equal terms, but the risk is definitely that anything that will be detrimental to the performance and delivery under the business model*". (I6)

Likewise, I7 holds the same view of risk as the downside as indicated above. I18 who is also a member of the Audit and Assurance Council at the FRC defines risk generally as an event that could have a wide range of outcomes, however, she is only concerned about downside risk stating:

> "*I always think about it (risk) as negative. As a positive I think that is a positive surprise, so I would not think about that. For me risk is always a risk that something will not turn out as I have expected or hoped for so I think that in the negative way*".

So, the interviewees representing the FRC and ICAEW regard risk generally as the potential hazard or harm. This view of risk, however, does not necessarily reflect the FRC or ICAEW perspectives on risk as highlighted by I5 and discussed in chapter 8. These two bodies take a broad approach to the concept of risk that comprises both upside and downside outcomes calling for disclosing future threats and opportunities facing companies. This perspective also depends on the risk level and the degree of its seriousness and severity. For example, I24; an auditor and corporate governance (CG) and assurance practice consultant, who perceives risk as both upside and downside refers to *existential risks* that could threaten the future of a business and prevent it from fulfilling its strategy within the time frame envisaged.

Other participants view risk in terms of uncertainty of future outcomes, yet only in the negative direction. I10, a former auditor and head of risk management, defines risk as "*a bad thing that might happen*". Likewise, I16; a former audit expert and risk manager and consultant, has a personal perspective on risk that is consistent with the above argument, yet different from the bank he used to work for. He defines risk in respect of downside outcomes as "*the probability of suffering unexpected losses*". However, as a banker and risk manager, I16 perceives risk differently in a way that is consistent with the bank's approach considering the upside aspect of risk as well. Accordingly, he further explained:

> "*As a banker, obviously there is a positive side because banks work and use a risk-reward basis. So, banks are one of those few businesses that actually create risk for a return, but in creating that risk you have got to be concerned about the risk management practices that you have that give you an assurance that you are accepting risk within a controlled risk management framework and within a risk appetite*".

Furthermore, it does need to be acknowledged that there are two complexities in respect of the above discussion particularly concerning the risk perspectives of the members of professional and regulatory bodies. The first complexity is that there is some acknowledgement by some interviewees that their definition of risk as wholly downside risk may not be shared by all their colleagues in the organisation. Thus, I5 states:

> "*That is not everybody's definition of risk, but I know there are some people including this institute at one time they were very careful to define risk in terms of neutrality if you like between potential good things happening and potential bad things happening…I recognize that there is another way of defining it which is valid. I just do not think that is the one that matters*".

The second complexity is that the interviewees' perspectives may be influenced by their prior roles and occupations not just their current roles in the relevant organisations. For example, I6 state that her downside view of risk comes from her previously working as a credit analyst remarking:

> "*It probably comes from some of my experience as a credit analyst because this sort of the upside goes to others; the downside may fall to those who have credit relationships. So definitely we will be looking to that downside doom and gloom*".

One possible reason for the above view is that these bodies and institutes are more concerned with corporate failure and survival, and hence they place more emphasis on the downside aspect of risk and its potential impact on the company. They are also interested in managing their reputational and other risks in their respective roles particular when a corporate failure or crisis occurs. This view could have implications in terms of regulations and guidelines introduced by these bodies and institutions.

5.2.4. A second, broader, definition of risk: downside and upside risk

A second definition of risk that is perceived by the majority of the interviewees encompasses both potential downside and upside outcomes. The participants highlight that risk is inherently forward-looking and associated with uncertainty that could impact on company performance. They also demonstrate that risk concerns a range of potential outcomes as a result of its inherent uncertainty, which could be favourable or unfavourable. They argue that there is a particular emphasis on downside risk and therefore companies are more interested in avoiding and mitigating the impact of risk rather than taking advantage of the potential opportunities associated with risk. For example, I23; an independent member of audit and risk committees, defines risk as "*…the potential future variability of outcomes that an organisation might be facing, and how wide that is, and what way it can cope with those potential outcomes*".

There also seems to be a shift in the way that practitioners and companies (risk managers and directors) perceive risk from the traditional approach to risk as being potential unfavourable consequences to a broad view that includes both positive and adverse outcomes. The participants acknowledge the inevitable uncertainty associated with risk that companies manage to minimise downside risks and/or maximise upside risks. They place particular emphasis on RM plans companies have in place to reduce uncertainty and accept risk within an effective RM framework and a previously established risk appetite.

This shift in organisational thinking about risk is explained and highlighted by I20 who defines risk as uncertainty that matters commenting:

> "*In the past…risk has been seen very much as of a negative and where something is going to adversely affect outcomes…We are trying to help shift the course of the narrative for our organisation. It is not just about negative outcomes, it is essentially an area of uncertainty where things could go very favourably, favourably, stay as they are or be adverse. So, a risk manager is essentially looking to reduce the level of uncertainty to the point that you are comfortable with…and essentially the exposure that you have*".

For example, oil prices could be both a risk and an opportunity for a particular company depending on the volatility in oil prices. So, where the decline in oil prices is a downside risk for oil companies, it is, at the same time, an opportunity for energy companies and other oil-consuming industries to capitalise on and vice versa. This definition is consistent with the ISO's 31000:2009 definition of risk as the "effect of uncertainty on business objectives" (p. 1). The definition is based on the idea that risk is a synonym for and/or an outcome of uncertainty where risk managers should focus on minimising this uncertainty to an acceptable level without hampering the firm's ability to execute its business strategy and achieve its objectives. Accordingly, risk can be defined as a function and combination of both uncertainty; the

probability of a future event occurring; and materiality; the impact it might have on firm performance.

Nevertheless, some participants recognise the difficulty and concerns about perceiving risk in a favourable manner. One reason for this, according to I11, is that "*upside risk is very difficult to articulate*". Likewise, I27; a group chief risk officer, demonstrates "*We may have to include the opportunities, although they are often a bit harder to quantify and justify*".

According to the interview data, risk should be understood and perceived within the broader context of business and RR considering a number of aspects. First, the complexity and dynamic nature of business environment expose companies to risks and uncertainties. Second, each company should have its own risk appetite and tolerance in order to survive, thrive and continue to create value. Third, the impact of risk should be taken into account. For example, there are risks that the company runs on a daily or regular basis and the management is comfortable with managing them, whereas other risks could have a detrimental impact on the business. Fourth, the way the company approaches and handles a risk determines to an extent its potential impact. This view is shared either implicitly or explicitly by both the participants who view risk as only the downside and those who perceive risk in a wider context as both the upside and downside respectively as discussed below.

5.2.4.1. Risk appetite and exposure

The participants highlight the importance of taking and accepting risks to businesses and investors in order to achieve growth and profitability. Companies and investors may arguably be more concerned about downside risks, but they have to have an appetite for risk to make profits. The interviewees indicate that the company's approach to and perception of risk depends on its maturity. They emphasise the fact that companies are inevitably exposed to different risks that should be managed or mitigated effectively.

Accordingly, participants underline that each company has its own risk appetite and tolerance, which is the managerial ability and willingness to deliberately take and accept risks in order to achieve its business objectives. The responses further emphasise that taking and accepting risk should be within a predefined risk appetite.

Therefore, the participants encourage companies to consider the potential upside impact of risk. For example, I11 states "*To be in business requires one to take an element of risk, to make a profit there has to be some embedded risk*". I23 argues "*There is a tendency for most managements to think of risk in terms of downside, whereas I think more sophisticated managements will think about it more in terms of upside as well as downside*". Similarly, I24 points out "*People tend to focus too much on risk as always being something negative…risk is also an opportunity*".

The participants further draw attention to the possibility that a company's risk appetite may change; increase or decrease, over time in pursuit of its business strategy and objectives. I11 suggests that companies should be "*knowingly taking risk rather than be unwittingly exposed or caught out*" and defines risk as "*…two sides; risk can have a downside because it can be a negative risk or it can be an opportunity to develop to take advantage of a position*". Likewise, I15; a chief finance officer, states "*We would have risk appetite for different risks, so some risks we would like and some risks we would not like*". I9 also refers to "*a risk reward balance*" that a business needs to maintain in order to prosper.

Furthermore, I23 confirms and justifies the view of downside/upside risk and the importance of a business having its own risk appetite and tolerance commenting:

> "*...without upside risk you cannot make a profit. So there has to be some risk appetite, you have to take risk to make profits. So, organisations although they tend to focus on the downside risk, it is also about upside and what you can make out of, what can be a positive from that variability of return*".

It was obvious from the interviews that defining risk is problematic and can sometimes be confusing and contradicting. I27 defines risk from a company's perspective in general as the "*threat to our financial security or our strategic position from uncertain future events/uncertainty*". Whereas this definition seems to focus on the downside, she indicates that risk from her own perspective is both upside and downside stating "*It is personally both side. There are often two sides to every risk coin*". She then addressed her company's perspective on risk and referred to the company's risk appetite which includes upside risk remarking:

> "*We have got a section in the annual report which is the risks we prefer, so the things which we take on in our business deliberately because we think we are good at managing them. And I think that is quite a powerful statement of the fact that you cannot get rid of all those risks, those are the risks which we are used to take, they are risks in which we see opportunity to make money*".

A clear definition of risk may be necessary not only for the readers of the accounts but also for employees within the same company to avoid personal interpretations or misinterpretations of risk and agree on the company's approach to RM. However, some participants reveal that companies do not provide a specific definition of risk in their risk disclosures because they are not obliged to, assuming that it can be implicitly understood based on their risk appetite statement in terms of both upside and downside. They further indicate that some companies disclose their risk appetite while others do not. They do not consider providing a definition of risk significantly important as long as companies disclose their overall RM framework and governance.

> "*We do not provide a definition for a risk in our reports…We take it that our audience understands in general what risk is. I think that is a fair assumption, but people generally would understand what you mean by risk. Yes, they are confused between risk as an issue and technically today it does not matter that much for the purposes of the audience as long as we provide them with the correct information*". (I25)

> "*I do not think we have made it clear that it is upside and downside. I think that is implied by the rest of the report and accounts. This section in our report and accounts is definitely focusing on that is the downside, but I think the fact that we say we actively take some risks…implies that opportunity side, but it is not explicit*". (I27)

In addition, the interviewees emphasise that risk is inherent in running a business and the achievement of its objectives. I24 demonstrates "*It is your business model and strategy which obviously expose you to the downside risk*". The interviewees underline the importance of setting and operating within a specified risk appetite that could increase as the business seeks to achieve more profits and growth. I24 remarks "*Taking risk is a fundamental part of achieving any business strategy. Your appetite for a risk increases when you see more returns*". I19; chairman of the audit committee institute at a big four audit firm, comments "*Businesses lean to accept and thrive on risk, without risk there is no opportunity*". Hence, the previous discussions highlight the upside facet of risk which leads to meeting firm's strategic objectives provided that risks are managed effectively.

The participants also acknowledge the variability in identifying and assessing risk, and the fact that companies are exposed to unavoidable risks; systematic risks, that need to be handled effectively. I20 highlights "*We are taking on risk or accepting risk that can result in a favourable outcome because you might otherwise have to spend more money to reduce the uncertainty to a lower level*". Another associate risk director (I12) defines risk as uncertainty of future outcomes stating "*anything that might happen; good or bad*".

Accordingly, a business opportunity could be inherent in risk facing the company and it predominantly depends on how risk is being managed particularly in terms of reducing its uncertainty and impact to an acceptable level that matches the company's risk appetite.

5.2.4.2. Risk management

A firm's perception of risk depends on its future prospects and RM approach and capabilities. The interviewees highlight that risk should be understood in the context of RM where adopting a comprehensive definition of risk could be beneficial to companies and contribute to effective RM. Accordingly, they suggest that companies could capitalise on downside risks and existing variability and turn them into business opportunities, or at least reduce their impact. They also indicate that companies can enhance their resilience and flexibility not only by reducing their

downside risk but also gaining a competitive advantage over competitors through effective RM. Thus, they underline that the company can take advantage of its competitors' downside risks.

For example, I11 argues "*I am a great believer that you can turn negative risk into positive risk by the way you approach it, by the way you manage it*". I27 demonstrates "*Risk can cause other people's business models to have problems and you can step in and take market share or improve your profitability through that volatility in market*". I26; IFRS Advisory Council member and ICAEW Financial Reporting Committee member, also comments "*Someone else's risk might be an opportunity for you*". The participants further indicate that risk becomes an issue when companies attempt to completely avoid or eliminate every possible risk through excessive controls that could disrupt and hinder business performance. I20 emphasises "*If you spend all your time trying to take away every possibility of risk you may put yourself down*".

Furthermore, reporting on RM strategies and plans represents a major part of a company's risk disclosures to reassure investors. Considering the uncertainty of risk outcomes, the participants argue that RM plays an important role in determining the potential impact of risk. I13; a buy-side investment analyst, highlights this as she defines risk as "*something that could damage the value of one of our investments in the long-term if not manged correctly*".

I27 gives an example of Brexit as a significant event that brings threats and opportunities for companies to look forward to depending on how they approach and respond to the great uncertainty created by Brexit. Surprisingly, I25; a director of risk scanning and detection, provides a broad and definitive definition of risk contradicting the above argument that companies place more emphasis on downside risk and highlights the differences among companies regarding their perceptions and management of risk.

> "*Risk is the possibility of an adverse or a positive event happening in the future, it can be both upside and downside risk. From my experience, different companies have different maturities of risk management and reporting. There is only one definition of risk and it just depends on the maturity of a company or an organisation in how they are communicating their risks and their risk management programme*". (I25)

The participants who hold a comprehensive view of risk highlight that it is important for companies to recognise the rewards associated with risk when making their RR. This could be an incentive for companies to report more risk-related information on upside and downside risks. I25 refers to the upside aspect of risk stating "*If you do good risk management it can become a competitive advantage when the environment that you are operating in becomes more complex*".

Accordingly, a statement on the company's risk appetite and tolerance could give information users a clear picture of its risk approach and profile. Such a statement should generally form a good basis and introduction for understanding a company's risk disclosures.

It is noticeable that academics support a broad definition of risk as both threats and opportunities. Risk from their perspective is fundamentally deviation from the expected outcomes or volatility of outcomes either positive or negative. This view is also consistent with the definition of risk adopted in the CRD literature. For example, I4 defines risk as "…*the variance in cash flows, variability in what you would have normally expected…So variability can be both positive and negative*".

Likewise, I1 simply defines risk as "*potential losses or unexpected returns*". Similarly, I2 states that risk is "*opportunities which is the positive side, the threats which is the negative side*". Risk is also defined by I3 as "*Deviation from the expected or targeted outcome which could be positive (opportunities) or negative (threats)*". Other participants adopt the same definition of risk. For example, I19 states "*I always think of risks and opportunities as the same thing as both the upside and downside*".

Academics' perspective on risk is not necessarily affected by the technical definition of risk, but it is likely that their view is greatly influenced by Linsley and Shrives' (2006) definition that is becoming commonly accepted in the literature. An alternative reason is that they could be influenced by their academic background in accounting and finance.

5.2.5. Professional and retail investors: a third, contradictory, definition of risk

It might have been expected that the previous two definitions of risk would have arisen; however, what was not expected is a third conception of risk. What was also not expected was that this definition would be held by the particular group who expressed it. This group includes investment analysts representing institutional investors and individual/retail investors. This risk definition could be described as a hybrid definition. They have a greater concern about the downside risk that they initially consider and focus on when thinking about company's risk.

These participants are predominantly concerned about what could go wrong in terms of a company's share price and hence a potential loss. In the meantime, they acknowledge the upside aspect of risk as they take account of the potential profits associated with their investment decisions, which could implicitly refer to the upside aspect of risk. I17; a retail investor, remarks "*Risk…is the downside, the risk of sudden drops in the share price. If somebody says are you worried about risk, then my immediate association with that is the downside risk*". I14; an individual investor, also defines risk as "*...how much I am prepared to lose*".

However, they then provide a contradicting view as they highlight that individual investors place more emphasis on future profits in respect of the profitability of and volatility in share price in the short and medium term. I14 further states "*If I am going to enter a market how much can I afford to lose, but I am looking to make 20% or 30 % gain on the share in return for a certain amount of money invested*". I17 also comments "*it has got to be just based on the total*

returns that you are going to get from the company. So, you are looking at what the share price is going to do".

I17 suggests that introducing two separate concepts of upside and downside risks could be more appropriate. However, he demonstrates "*You have got to buy risky assets with a risk upside if you want to have any chance*". I13 adopts a similar view of risk arguing that "*When we talk about risk it is mostly the negative, and then you would probably talk about the opportunities if a company handled the risk correctly should that be the upside*".

I21, a responsible investment analyst, states "*From a risk perspective it is just the negative impact we are looking at*". However, He provides a contrary argument that risk is the degree of deviation from achieving corporate strategic objectives either by surpassing its objectives or failing to meet previously set objectives depending on the impact of external factors and how risks are being managed. This view encompasses both the upside and downside directions of risk as I21 indicates "*The extents of risk in my mind may or may not be a bad thing*".

Likewise, I26 defines risk as "*something that could negatively impact like person like business entity*". Nevertheless, he also acknowledges the positive side of risk highlighting that there might be opportunities associated with the exposure to risk stating "*Risk is in my mind predominantly downside, but that does not mean that you would not then assess whether there is an upside*".

Similarly, I28; a director at the FRC, argues that risk is widely perceived by companies in terms of the downside and, therefore, they focus on disclosing the potential unfavourable outcomes of risk. He indicates "*Habitually it* (risk) *just tends to be used in the sort of the clean English meaning rather than the sort of academically correct meaning*". I28 defines risk as "*a factor that might have adverse impact on the future of the business and the ability to meet its objectives*". Furthermore, he contends that risk can be both positive and negative stating "…*it is not quite the mathematical such of definition of the variation of possible returns*".

Meanwhile, I28 encourages and assumes that companies will generally report on both favourable and unfavourable uncertainties commenting "*If a preparer happened to use risk to mean just the downside, I would also expect them to report on those uncertainties that have an upside potential too*". He further contradicts his previous argument of risk as downside stating "*From a more technical perspective yes risk is both upside and downside. It is the variation of possible returns, but generally in terms of corporate risk disclosures it genuinely focuses on the negative side*".

The previous discussion further proves the complexity of the concept of risk. This complexity and disagreement result from the absence of a clear definition of risk. Investors and other stakeholders are arguably influenced by their occupations, expertise and/or nature of their investments. It was unexpected that investors in particular are thinking this way as they should

be considering the expected return on their investment in the first place. Otherwise, they might choose not to invest.

5.2.6. The implications of the spectrum of risk definitions for CRD

Based on the above discussion, there is a lack of an agreed-upon definition of risk. Risk has proved to be a confusing and challenging concept to define in the context of CRD. Risk is a complex concept and there is a spectrum of risk definitions. Risk and uncertainty are used interchangeably. The participants did not provide or use technical terms, but they simply address risk in terms of its forward-looking and uncertainty nature.

However, there is a need for reaching a common understanding of risk as a starting point for developing a framework for CRD and improving its quality. The absence of a unified definition of risk could have implications for CRD practices considering that UK regulations, for example, are vaguely worded and lack clarity. This could create an information gap between managers and investors, and between informed and uninformed investors considering the different definitions provided by the interviewees. Information users may misinterpret a company's risk disclosures and hence misevaluate its risk exposure/profile, which could have unfavourable consequences. This lack of a common understanding of risk could also raise questions about the findings and recommendations of previous studies.

Based on the definitions above it would seem that it is most appropriate to adopt a broad definition of risk if a CRD framework is developed or new regulations are introduced. Such a definition can satisfy the information needs of different stakeholders as well as the three definitions above as companies disclose their upside risks, downsides risks and their interrelation. Therefore, a unified definition of risk can help settle this disagreement and avoid the problems associated with the absence of a definition in terms of policy and practice.

5.3. The relevance of CRD

5.3.1. Introduction

This section of the chapter addresses the first part of the second research question: What are the perceptions of the information users, and other stakeholders, of the relevance of RR and of current CRD practices? Therefore, this section investigates the perceived benefit of CRD to different stakeholders. It explores the extent to which RR is useful to investors in particular as the capital providers. The section also discusses whether RR is of any importance for companies providing this information.

Understanding the benefits of CRD for information users could encourage companies to disclose more risk information (RI) that meets users' information needs as well as encourage the readers of the accounts to pay more attention to this information as they make their decisions.

Likewise, investigating the potential benefits of CRD for companies could help understand their incentives and disincentives for reporting more RI as discussed in detail in the next chapter.

This section comprises two main subsections. The first subsection discusses the perspective of the interviewees on the overall importance of CRD to investors in particular. The second subsection explores the benefits companies could achieve from reporting on their RE.

5.3.2. The perspectives of participants on the overall importance of CRD

On this theme the same question was asked to all the participants about the benefits of CRD (if any) in general from their perspective. The participants generally perceive CRD as beneficial to information users and to companies disclosing RI. They indicate that annual reports cannot be understood in isolation from risk disclosures. Thus, they demonstrate that gaining an understanding of a company's risk profile and exposure is crucial to understanding its overall performance, financial health and the risks that could hinder the execution of its strategy and business objectives. Accordingly, investors can make predictions and match a company's RE and profile to their risk appetite. For example, I7 states that CRD is "*is very important because…what you are really investing in is the future of the business and that investment will be impacted by the risks*". I20 also highlights that RR is "*useful and helpful for the shareholders…and potential investors to better understand the organisation*".

The interviewees demonstrate that CRD may also serve as a source of reassurance to existing and potential investors about the level of risk the company is exposed to, and that management is aware of the risks facing the business and have robust risk management plans in place to handle them. This is significantly important considering the dynamic business environment in which companies operate. The participants also emphasise that companies through RR can highlight not only their ability to adapt to change but also take the lead in accepting and managing risks effectively. Therefore, CRD appears to be mutually beneficial to companies and investors. I27 comments "*The quality of external disclosures tells you something about the security of our company, the debts that we are hedging on risk to. It is an important reflection on how good we are*". I20 also remarks *"There are other investors or analysts who are interested in are we leading edge, are we staying ahead of the fast-changing world of regulations*".

From institutional investors' perspectives CRD assists them in comparing the risk profile of different companies and hence investing in the best stock. Better CRD also helps investors attach a fair value to a company's stock and reduce information asymmetry problem that is important for companies and investors. I15 states "*It is important to rating agencies and analysts who assess the value of what price our equity stock should be*". Likewise, I28 argues:

"*As long as readers understand the level of assurance that has been given and the work that has been done to support that assurance, then to some extent it can improve people's reliance on that information and thereby reduce information asymmetry*".

In addition, investors can assess management's stewardship and hold managers to account based on their RM and RR activities. This could be achieved through maintaining transparency about the company's risk exposure and meeting users' information needs. I28 highlights "*Usefulness is not just about making prediction about the future; it is also about assessing stewardship*". I26 emphasises "*The disclosure should show how management are safeguarding investors' capital through their management of risk*". I25 also demonstrates "*you have an obligation to the people who own your company…you provide them with reports on financial performance, on the behaviours and ethics and values of the company, and the activities that you engage in*".

The responses also reveal that CRD is important to other stakeholders depending on their interest in the company and the types of risk they are exposed to. For example, regulators and capital market authorities always seek to enhance and ensure transparency and health and safety measures. Likewise, environmental organisations and activists are interested in the impact of business operations on the environment and the actions taken by companies to keep this impact to a minimum. CRD, according to the participants, is also important to employees and suppliers who are concerned about their job retention and getting paid respectively.

For example, I23 states "*Some risks are very important to other stakeholder. So, the risk of pollution, for example, or health and safety breaches to employees…can affect the company but can also affect other individuals*". I23 further gave an example of the Gulf of Mexico oil spill where the wider community and other stakeholders such as environmental activists and pressure groups were concerned about the impact of this disaster. Accordingly, by reporting on its risks particularly in times of crisis a company can ensure and reassure different stakeholders that it is fulfilling its ethical and social responsibility, and hence improve its image.

On the other hand, a number of participants argue, as they criticise current CRD practices, that RI is not important to investors because they focus more on financial information related to business profitability, cash flows, future prospects, and the market in which the company operates. Therefore, they indicate that information users may disregard risk information particularly if the company is performing well financially.

"*Sometimes stakeholders are so enamour with the performance of the company that the people who are running the company get away with writing whatever they want to write because at the end of the day it is the money that is doing the talking*". (I25)

These participants generally recognise the relevance of CRD to information users provided that it is of a high quality that can help investors understand a company's RE and RM strategies. However, they highlight the limitations of current CRD practices in terms of lack of quality and

informativeness as discussed below arguing that information users do not pay much attention to RI because it does not influence their decisions. I11 indicates "*Risk reporting is important, but I do not think it tells people a lot*".

I8 also highlights "*Many companies disclose pretty much boilerplate about risks which actually do not really benefit anybody*". Similarly, I5 states "*There are also some people…who would say they do not pay attention to it because they regard it as too subjective*". While I16 agrees that CRD is significantly important, he emphasises the absence of mechanisms that can help companies identify, measure, manage and ultimately report on risks in a meaningful manner. I8 further remarks:

> "*I do not think that the businesses I talk to, the analysts I talk to, the shareholders I talk to…would have it in their top five considerations whether to invest in a business or not…they would all look at profitability…cash flows…the markets in which the business operates…the great prospects…the quality of the management team, the profit of its sales or the product that it sells, the services that it provides…before they have even thought about risk*".

Moreover, retail investors who took part in this study underline that they pay more attention to financial information and ratios including share price, earnings per share, and growth in sales that is indicative of a company's financial health and profitability. I17 states "*Risk disclosure is not a big part of my investment procedures*". Another issue highlighted by retail investors is the lack of CRD understandability, which may deter them from reading risk disclosures.

Nevertheless, retail investors acknowledge the importance of information related to conflict of interests resulting from executive directors holding shares in a company, major shareholders exerting control over board's decisions and how the company is run, overpaid CEO, poor governance practices and overreliance on one customer or supplier. This information could be regarded as risk-related information. Therefore, risk is a key indicator of a company's overall financial performance which should be considered as well.

Factoring RI into the decision-making of individual investors may also depend on their expertise and knowledge. I14 and I17 are two retail investors with different backgrounds that may affect their decision-making process. I14 depends heavily on online sources and platforms to obtain investment advice where other investors virtually meet up and share information and opinions about investment opportunities. I17 is a more knowledgeable investor with a PhD in finance, and he has a process that he goes through prior to any investment to make informed decisions rather than seeking advice from an investment advisor.

Thus, unreliable online information sources such as investors' chat rooms and online forums could provide misleading information and consequently have an unfavourable impact on the

firm's value and stock price. This should encourage companies to provide more and transparent RI to reduce investors' reliance on such sources.

It is perhaps not surprising that investors are more interested in the company's profitability and expected returns than its risks. However, the participants emphasise that risk is associated either directly or indirectly with achieving profitability. They point out that the company's profitability and cash flows are ultimately affected by its RE and cannot be assessed apart from the risks inherent in its business model and strategy. They further demonstrate that investors need to understand the degree of riskiness attached to their investments and match it with their own risk appetite. For example, I19 remarks "*I cannot make investment decisions unless I have a good understanding of the risk involved in the strategy*".

The previous argument also sheds light on the need for raising awareness among investors and information users in general of the importance of RI to take into account when making decisions. Investors should not only focus on the company's profitability but should also pay attention to the risks that may affect profitability either positively or negatively. Thus, investors should perform a risk-reward analysis to assess the risk and reward profile attached to different investment options. Likewise, companies should improve the quality of their RR.

5.3.3. The benefits of CRD for companies

Some participants draw attention to the negative consequences CRD may have on company's performance and stock price as discussed in the next chapter in more detail and argue that RR could expose companies to more risks by increasing the probability of a risk materialising or RI being misinterpreted by information users leading to unfavourable outcomes. These concerns could ultimately discourage companies from providing more and useful RI particularly in the absence of a sound RM and governance framework.

> "*It (CRD) has significant negative consequences. It can be interpreted incorrectly and as a repercussion your stakeholders…may start inquiries and investigations, move away their investments to elsewhere… investors groups and people will look at…the chairman's and CEO letter, the financial statements and the risks, you get an idea of what they are going to do or what they have done, and you can imagine what their future strategy might be*". (I25)

However, the participants do not suggest that companies withhold this information but rather encourage them to maintain clarity and transparency about their RE. They also indicate that the concerns about misinterpretation of RI should be an incentive for companies not only to provide more RI but also to ensure its quality to avoid any unfavourable consequences. I25 suggests that more transparency can help avoid or reduce potential unfavourable outcomes stating:

> "*You manage it* (risk) *proactively, you try and be very clear in your risk reporting, you help educate your community what is the definition of risk, what is the impact, what are the are*

major risks you are taking, what is the context for that risk, and then you can go a little deeper and talk about who is the owner of the risk in the company, how the risk level has changed".

Other participants reject the claim about misinterpretation of RI and call for more CRD. Likewise, they caution against the danger of companies becoming more secretive about their RE and approaching their RR as a compliance exercise without providing useful information and argue that withholding RI and lack of CRD quality could raise investors' concerns about the effectiveness of the overall RM process. I25 states that CRD is an "*opportunity to have a transparent conversation with your stakeholders*". I2 comments "*If they do not report…questions are getting to be asked*". I12 emphasises "*There is nothing worse than being told about a risk as a company…because it exposes you completely*". In addition, I28 argues "*Transparency matters. The idea of talking about risk would materialise that risk to me would not hold much water except in some kind of absolutely extreme situations*".

Participants also highlight that stakeholders understand and accept the importance of taking risks for companies in pursuit of their business strategies, and hence expect companies to disclose RI to reassure them and mitigate their concerns. They emphasise that external stakeholders particularly investment analysts who are interested in and following a company are already aware of the major risks it is facing and have their own risk assessment. I6 contends the claim that a risk may transpire by disclosing it demonstrating "*There is no such thing, markets have grown up, and anybody expects companies to be spelling out risks*".

"*If they refuse to disclose a risk that they know is there just because they think that is going to cause the risk to materialise then I think that is rather short-sighted because most investors looking at a company, in fact most people from the outside will be able to tell that risk was missing. I do not think that by definition disclosing that risk in itself will cause the risk to crystallise*". (I23)

"*Most risks that companies face, frankly, if you looked at that company from the outside you would probably be able to identify 90% of those anyway. So, I do not think there is anything magic that makes secret in risk reporting, and there are generally no risks that an outside investor would not with time and thought be able to actually identify*". (I26)

In addition, the vast majority of the participants underline the benefits that companies can realise through better RR including financial benefits (for example, lower cost of capital) that are discussed in the next chapter. These benefits concern three interrelated themes: transparency, reassurance, and RM practices and capabilities.

The participants indicate that in addition to fulfilling its regulatory obligations by disclosing its RE the company can signal the effectiveness of its RM strategies and plans. External CRD could be an opportunity for companies to demonstrate that they monitor and understand the

business environment they operate in, and they are aware of the risks facing their business and have robust RM plans in place. Therefore, the company can take advantage of disclosing this information and reassuring its investors.

> "*For the company that is publishing information about the risk we are demonstrating that we understand the landscape in which we operate, we appreciate where the exposures are for us, and we are able to explain what we are doing to manage those exposures to an acceptable level*". (I20)

Some participants claim that external CRD could lead to more effective RM and internal control practices because companies should ensure that they have an appropriate RM system to identify, measure and report risks. They emphasise the relevance of building and ensuring a proper risk culture within the organisation including internal risk discussion and reporting that could ultimately enhance RM and external CRD. I8 states "*The benefits of disclosing risks are that you have to go through a process to identify those risks to be able to disclose them*". I10 comments "*It* (CRD) *is important for the board of directors as a whole to try and reach a common agreement and understanding of all of the key risks*". Similarly, I18 emphasises "*It helps focus the board's mind on the biggest risks to the company's future success*".

The interviewees suggest that discussing risks internally within the company and disclosing them publicly is significantly important for managing risks effectively through getting employees and shareholders informed and engaged in the RM process. So, employees through the internal risk conversation can inform the board of directors and management about the company's risk profile and exposure, and assist them in determining its risk appetite and setting a proper risk governance and management framework. Investors can also have a better understanding of the company's key risks and how they are being manged.

I7 demonstrates "*It gets that conversation within an organisation, makes them think about risk, makes them have that conversation at the board, decide what is their appetite for risk, what other mitigating actions that they could undertake*". I26 remarks "*If you do a proper risk analysis and say what are the big risks, how likely are they, and could we actually manage or mitigate them in some way, it helps focus your energies and efforts clearly*". Likewise, I12 states "

> "*Everybody should take responsibility for risk within a company no matter how junior how senior because it allows you to understand what your exposure is and how then you manage that…Reporting a risk is a form of risk management because it gives you an opportunity also to demonstrate how you are actually managing those risks as well as how proactive and what controls you have got in place and what you are doing to strengthen, for example, your position in the market depending on the risk*".

Based on the above discussion, the question then arises whether external RR drives better RM or the other way around. I5 provides some answer commenting "*I suspect that it* (CRD) *is not useful to companies because companies think about risk all the time*".

The participants argue that companies can attain the claimed financial benefits of CRD through maintaining transparency, keeping investors informed about their RE and fulfilling their stewardship responsibilities. This transparency is also related to providing further reassurance over how risks are being identified, measured and managed, and how well the company is managed in general that gives comfort to investors and builds their confidence. Reassurance can be ensured through management commitment to better RM and transparency. Accordingly, better RM and reporting goes hand in hand with the overall business performance.

The participants' views regarding the relevance of CRD are to some extent influenced by their understanding of risk as previously discussed.

> "*The important thing about risk assessment and reporting of risk assessment to me is a message you are sending to investors about…these are the risks that we have identified that we think are material to this business and this how we are seeking to manage and mitigate those risks*". (I26)

The interviewees further emphasise that companies can take advantage of their effective RM systems as discussed earlier to enhance their corporate image and reputation through transparency and sending a positive message to existing and potential investors. They argue that transparency about a company's RE can help boost its image, enhance its legitimacy and gain a competitive advantage as it becomes more attractive to investors. Hence, this could mitigate managers' concerns about disclosing RI.

I25 argues "*The more disclosure that you provide builds people's confidence and your professionalism*". I15 confirms this view stating "*It is important to disclose this information because it gives analysts comfort that you are managing the risks and thinking through those risks and doing it to an acceptable level*". Likewise, I10 addresses the financial benefits of better CRD remarking:

> "*The longer your investors have known about that the less of a surprise it is for them and the more they can hold you to account for how you are managing it, the more your share price actually should reflect the true value of the company. So, it should help guard against volatility in the share price*".

Accordingly, external CRD is mutually beneficial for investors and companies. Investors can be better informed about a company's RE, make informed decisions and hold managers to account. Companies can also take advantage of their RR to increase their value and safeguard against stock price volatility through enhancing investors' confidence and trust. For example, I11

emphasises "*Organisation…will also gain extra credibility in the market because they are seen as a risk manager, a risk taker who manages it rather than a cow boy or a completely risk-unaware individual*". Similarly, I12 demonstrates "*It* (CRD) *gives them* (Companies) *credibility. It is perceived that the company has a handle on their risk because they already know it, and are already proactive and is one step ahead of its external stakeholders*".

Furthermore, participants further mitigate the concerns about disclosing risks and downside risks in particular emphasising that greater transparency about risk is perceived favourably by investors and enhances the company's credibility. They also refer to the financial implications of higher quality CRD. Hence, the company can seize opportunities and gain a competitive advantage over its competitors as it becomes more attractive to investors by disclosing its risks and how they are being managed effectively.

> "*Investors…do see the potential value and where they do get good risk disclosures then they rate the company more highly…Being able to identify the right risks and talk about risks in a meaningful way is an indicator on an external basis that you have got a good handle on those risks on an internal basis as well that is one of the things that investors do recognise and value*". (I24)

> "*The better the investor community understands the organisation, its business model, its strategy, its risk…then the more accurate value that they can put on the organisation. It is not in the company's interest to have inappropriate market value*". (I19)

The interrelationship between transparency, reassurance and RM is clearly evident. The responses highlight that managers spend a considerable amount of their time identifying, assessing and managing risks and therefore are encouraged to address their RM practices in their external CRD. I23 argues "*This is about running a company well then making sure that the disclosure reflects that*".

Transparency about a company's RE can also enhance its resilience, performance and sustainability particularly during natural disasters and corporate crises and scandals as the company can recover more quickly; otherwise it may take a longer time. This is primarily because investors are engaged in and well-informed about the company's RE and RM. The importance of CRD is also related to the necessity for companies to take risks to achieve their business strategy. I20 demonstrates "*Being comfortable to accept risk is a positive from timeliness of decision making, the speed of action. It helps you to learn faster as an organisation*". I27 also remarks:

> "*Share prices can be resilient to bad weather claims or storms or all sorts of things as long as you have told the market this is the business that we are in, these are the risks that we run, this is what could go wrong. Well, if there is anything then goes wrong you will recover*

from that position as generally a lot faster than if you have not been talking about those risks".

5.4. Stakeholders' perspectives on current CRD practices

5.4.1. Introduction

This section of the chapter addresses the second part of the second research question. The section explores the views of the different participants on current CRD practices to identify and highlight the limitations and areas for improvement. The purpose was also to indirectly identify users' RI needs and highlight the information gap between users' needs and RI currently being disclosed by companies. Users' information needs are then taken into account in building the CRD quality framework.

The interview responses reveal a mixed view on existing CRD practices. Participants from the same stakeholder group hold different views. The majority of the interviewees highlight that CRD has improved in terms of its quantity and informativeness. Meanwhile, they demonstrate that there is still significant room for improvement and encourage companies to provide more and quality RI to overcome the existing limitations.

For example, I26 states "*It* (CRD) *is improving. I think there is still some way to go*". I25 argues "*Overall, risk reporting has progressed*". Similarly, I13 points out "*They are informative, but are not enough*". Likewise, I24 indicates "*It is on a steady upward path, steady but gentle*".

Some participants draw attention to the absence of a framework and/or a benchmark for CRD quality which makes it difficult to assess the level and quality of CRD. I20 states "*There is not a simple and clear set of measures that can be used. It is a very complicated arena*". Moreover, I1 attributes the difficulty of assessing current CRD practices to the absence of a unified concept of quality and the lack of a benchmark to evaluate CRD quality against.

5.4.2. General remarks and mixed view

The majority of the participants hold a more positive view regarding existing CRD practices and demonstrate that information users will always call for more disclosure. I15 states "*Different stakeholders would like more*". Participants claim that sufficient RI is being disclosed by companies but it depends on how RI is being used and interpreted by information users. They further indicate that companies have to manage and maintain the balance between disclosing too much information that could expose them to more risks and informing investors about their RE. Some participants also call for encouraging companies to provide more and meaningful RI rather than criticising their RR practices. I2 states "*We need to encourage companies to improve the quality rather than continually pointing out that it is not very helpful*".

According to participants, RR has improved in terms of both its quantity and quality. They identify a number of aspects where there has been some improvement in respect of disclosing company-specific RI, linking CRD to the company's business model and strategy, and reporting on RM actions and plans.

> "*Overall, the quality of the most significant risks, the presentation of the companies sharing their risk framework is very good. There are some leading examples where they have heat maps and they have a risk level direction like is it increasing or decreasing…risk owner within the company which department takes responsibility for a particular risk, and linkage to strategy and business model*". (I25)

> "*There has been quite a considerable improvement in the last few years. I think companies are trying to make it much more specific to their own investment plan and what they are trying to do…So, it is becoming more specific and bespoke to their own specific circumstances*". (I23)

> "*There is more information disclosed and therefore that should be more useful to the users, but again it depends to what extent it is decoupled from the reality, but from my perspective the quality of risk reporting does seem to be improving a bit*". (I2)

In terms of the linkage and integration between CRD and other relevant information in the annual report, I19 demonstrates "*Some* companies *do some clever things like linking back to the strategy and the business model so the whole annual report tells a story and you can understand why these risks are the right risks*". Likewise, I24 remarks "*There has been a move to link through from business model to strategy to risk to performance*".

Investment analysts who participated in this study also demonstrate that RI currently disclosed by companies is useful and informative. I21 highlights "*It is improving, it is getting more useful*". I13 also argues "*It is quite useful, but it could be very very useful*"**.** Moreover, I18 states:

> "*It has improved a lot in recent years in two ways. I think now there is much more of an attempt to prioritise principal risks. We have a shorter list and it is clear what the principal risks, top ones, are. We also have reporting on the ways which the board and management are trying to mitigate the risk which is very important*".

In addition, participants also acknowledge that there has been an improvement in terms of internal RM practices of companies and argue that it is not yet completely reflected in their external RR. They address the gap between what companies do regarding RM and the information available internally, and what is being disclosed externally to stakeholders. Therefore, they call for better RR to highlight the amount of time and effort devoted to RM to reassure investors.

> "*There was a huge amount of work done by companies internally…but we did not see that step change in disclosure. Some of that good work that has been done internally is still underway. We started to hear about things like key risk indicators*". (I24)

However, the participants emphasise that CRD could be further enhanced. They also identify a number of limitations of current CRD practices that need to be overcome to further improve CRD quality and ensure information users' engagement as discussed below. They call for risk quantification, greater clarity, less boilerplate and more forward-looking RI. For example, I26 states "*There is a significant room for improvement*". I7 also comments "*There is still definitely work to be done in terms of making the reporting better*".

Some participants oppose this generalisation and emphasise that CRD practices vary widely across different companies, industry sectors and jurisdictions. They attribute this variation in terms of CRD quantity and quality to a number of factors including company-specific characteristics such as company size and industry type, the business environment in which the company operates, and the regulatory framework the company is subject to. I10 states "*It is very mixed…there is probably some very very good reporting, and there is some very bad reporting*". I25 also confirms "*There are some exceptional examples of companies that made a great progress in risk reporting*". Furthermore, I19 remarks:

> "*There is a spread…those companies that are doing it well are probably 8 out of 10… it goes way down to probably 3 or 4 out of 10 for those that are not doing it well. I think sectors like oil & gas, utilities, and supermarkets, big retail, are generally quite good*".

Furthermore, some participants indicate that CRD quality for financial companies and banks in particular is better than for non-financial companies due to the nature of their business and the disclosure regulations and requirements they are subject to. These regulations require financial companies to make more detailed and specific risk disclosures. For example, I15 states "*I think for banks and insurance companies it is informative and enough*". I27 comments "*We have a huge amount of risk information in our report and accounts that runs to about 50 pages*". Similarly, I18 indicates "*with banks risk reporting can run to 100 pages now*".

Now the question arises as to whether the quantity is too much that could be confusing or hard to understand by some investors. There is also a balance that companies need to maintain between providing too much RI and concise yet useful information. I27 indicates that they provide a large amount of RI in their annual report and wonders whether it could detract from CRD quality and affect its clarity and understandability remarking "*Do we make it harder for people to really assess which ones are the key risks, which are the ones that could really cause damage to the company much?*"

Another question that arises is whether companies deliberately provide too much information to distract information users from their actual and key risks. This also sheds light on the

importance of CRD quality rather than quantity. Thus, companies should provide sufficient information that enables information users to gain an understanding of their RE. In order to improve CRD quality and make it more engaging, I27 suggests using "*more diagrams or pictures or infographics, fewer words, more stories that you can get your head around*".

I17 draws a comparison between CRD practices in the UK and the US and raises concerns about the lack of RI provided by UK companies arguing that it affects understandability of the company's RE. I17 highlights:

> "*It* (CRD) *is not so informative in the UK. In the UK it seems a fairly short and very formulaic what you get in there…In the US it is much much more thicker at least, and it is much more detailed is what you get to see*".

Conversely, a number of participants strongly disagree with the previous argument. They emphasise the deficiency and poor quality of current CRD practices that render RI less useful for information users with no influence on their decision-making. Their responses indicate that CRD is generally uninformative. I7 states "*What gets reported is very unlikely to be the real risk*". I4 demonstrates "*I do not think they take it very seriously*". I8 also comments "*Really do not tell you anything. If you are scoring out of ten you would say it is probably about a 5 or 6*". Similarly, I17 argues "*I have not noticed any improvement since I have been investing…it does not seem to be getting any better from what I have seen over the years*".

I11 and I12 who work for the same company as risk managers share a similar view arguing that CRD is not particularly useful. I11 states "*It is written for user consumption not for user knowledge…I do not think there is a lot of benefit to anyone. I think it meets the corporate requirements. A few companies are very very good*". I12 points out "*I do not think it is necessarily informative*". I10 also indicates "*It does not tell you much. Very few understandably will talk about their risk management or their risks, the better ones will talk about the actual process they have gone through*".

Furthermore, I16 holds an extreme view on extant CRD practices describing RR by banks in particular as "*Non-existent, seriously non-existent, totally misleading. We would not have found out if we were not hit by the financial crisis. I stick by my statement that effective meaningful risk reporting certainly in the financial industry does not exist*". He attributes the lack of CRD quality to the absence of a reliable and appropriate RM system that can assist banks in identifying, measuring and ultimately reporting on risks in a meaningful way.

5.4.3. Major CRD limitations

The differences among the participants in terms of their perception and evaluation of CRD were expected due to their different occupations and expertise. The participants in general shed light on a number of key limitations of extant CRD practices which could be interpreted as users'

needs in terms of RR that companies should consider to further improve their CRD quality and usefulness.

First, a major issue is the generic nature of RI that does not change over time and could apply to different companies, which makes CRD uninformative to information users. The participants indicate that due to the difficulty of identifying and assessing risks managements may tend to provide more boilerplate information on their RM processes and plans rather than risks themselves and their impact on company performance.

Some participants attribute the poor quality and generic nature of CRD to the way that companies approach their RM and RR. They demonstrate that companies approach their RR as a compliance or a 'tick-box' exercise rather than providing informative disclosures. They also emphasise the fear of litigation and legal issues that managers may encounter as a result of disclosing or withholding particular risks that cause managers to make bald risk disclosures. Consequently, companies may end up disclosing a long list of risks that may not be specific to their circumstances rather than reporting their principal risks and uncertainties. Such practices do not reflect the change in the company's RE over time.

For example, I22 states "*I think it (CRD) is quite bald…because it is often viewed as a compliance exercise*". I25 comments "*There is a really long list and it seems like this a protective measure and I do not think that is a progress*". I24 also emphasises "*Too many risk disclosures that are still highly generic*". Further examples are below.

> "*There are some companies out there that you could pick that page or two pages from their annual report up and you could stick it into another company in a completely different sector and it would read just as well because they say we are concerned about geopolitical risk, UK regulation, interest rate fluctuations, raw material pricing or commodity pricing…and it means nothing*". (I19)

> "*It tends to be a little bit boilerplate in places…Companies tend to sort of set out their principal risks and uncertainties, and remarkably they do not change over time. You would also find much longer lists so companies would be disclosing every single risk and uncertainty under the sun*". (I26)

Second, the interviewees emphasise the lack of quantitative RI. This limitation is related to the previous one because lack of risk quantification could lead to disclosing generic RI where it becomes difficult for information users to understand the impact of risk on company performance. The responses demonstrate that RR is predominantly qualitative in nature, which I1 refers to as "*cheap talk*", due to the absence of numbers attached to risks regarding their potential impact and likelihood of occurrence. This may also affect CRD clarity and understandability.

"*My experience would reflect that there is a lot of it in words; it is just paragraphs of word. There is a lot of fencing with words…I think in a day to day of managing risk within the organisation it is perhaps less about how it is worded and more about the measures and the processes and the activities*". (I20)

The participants generally recognise that it may be difficult to assess particular risks or harmful to the company to disclose quantitative RI. Therefore, they demonstrate that qualitative CRD could be helpful in giving information users some insight into the impact and probability of a risk.

Third, another major limitation of CRD practices is the dispersion of RI throughout the annual report, and the lack of linkage and integration between risk disclosures, and between risk disclosures and other relevant disclosures such as the company's business model and strategy. The interviewees highlight that RI is difficult to locate in the annual report due to this lack of linkage. They argue that this lack of linkage may discourage investors from reading and analysing RI because of its vagueness and lack of informativeness. I25 indicates "*I think that is pretty weak overall the link between risk and strategy in risk reporting. There is so long way to go on that the link between risk and strategy*".

Furthermore, some participants claim that companies intentionally hide RI in their annual reports, and hence they spend more time on reading the annual report and finding relevant information and figures such as provisions to gain an understanding of the business RE.

"*Companies previously, well still some of them do hide risk, but they have to disclose it under provisions. So, if I was to deal with another bank that has a provision hidden in page 227 with a bullet point size of like 8 it is going to get picked up. So, I do not know why they do it and you also have certain banks which do not disclose enough under provisions*". (I21)

Accordingly, the interviewees underline the importance of integrating risk disclosures throughout the annual report and linking them to the company's business model, strategy and overall performance to improve CRD quality. They point out that CRD can be better understood in light of the company's business model and strategy. Hence, investors can be better informed about the risks threatening the achievement of business strategic objectives and the prospect of achieving or surpassing these objectives.

"*One of the big things about risk disclosures that we advocate a lot is that they need to become less isolated and less in a silo within the annual report. We want to see them being more integrated with the rest of the disclosures in the annual report whether that business model, strategy, performance whatever, and we are seeing that happening more often than we used to do*". (I24)

Fourth, some interviewees refer to the information gap between managers and information users particularly retail investors who lack knowledge and expertise in terms of the company's perception of and approach to risk and RM as discussed in the first section of this chapter. They draw attention to the possibility that retail investors may find it difficult to understand or misinterpret RI due to its poor quality or insufficiency. Therefore, there is a need for more transparency about the company's overall approach to risk including its definition of risk and risk appetite.

> "*There is still a misconception that stands between companies and people reading their accounts as to what it is they are actually disclosing. So, they are not trying to disclose every potential risk that might face the business in terms of total variability of outcome, what they are there to do is say what their management's view is of what the risks are facing the business and how they are dealing with it and mitigating that risk or taking the upside from it*". (I23)

Fifth, a number of participants particularly investment analysts underline the absence of disclosure of long-term risks and call for more information on long-term risks rather than giving a short-term view of the company's RE. This could be attributed to the nature, amount and time horizon of their investments. They are interested in gaining insight into the potential impact of sustainability risks such as climate change and water scarcity on company performance and sustainability, and how well the company is prepared for the future. I13 states "*It (CRD) is very short-term in nature…they are very sophisticated when it comes to long-term risks. I think they focus on the short-term too much…some companies do not even do it*". I13 further explains why they need such information commenting:

> "*Because we have liabilities that last for 50 years, we run pension fund money and lots of clients will not be retiring for another 50 years. So, we have to think okay first of all for just 50 years what do things look like? How will water scarcity…climate change impact on the company we are investing in? So, in (X company) it is not looking very good at the moment…in terms of the planet resources and which companies will survive in that scenario*".

Moreover, participants recognise the importance of information on long-term risks in giving them assurance that managers are aware of these risks and take them into account. Moreover, they acknowledge the significant difficulty of measuring the impact of long-term risks and providing quantitative information and, therefore, suggest that companies undertake horizon scanning of their business environment to explore what the future holds for them regarding potential threats and opportunities. They also indicate that companies can use scenario-based disclosure to discuss the potential outcomes of a particular long-term risk and their strategies to handle the risk accordingly.

“*My high-level recommendation would be think more about long-term risks in everything that you do. So, companies should think more about long-term risks, regulators should think more about long-term risks when they are designing a policy, and investors as well should think more about long-term risks for their portfolio… if you are talking about what is going happen in ten years’ time then we understand that it can be scenario-based. So, Shell and BP, for example, talk about different scenarios; what will oil be like if there are two degrees of climate change, what oil will be like if they are 6 degrees, and the answer to 6 degrees and above. So, I think we understand it is not a precise science but if you can talk about scenarios and how the risk is manged in those scenarios then that is also really helpful*”. (I13)

5.5. Conclusion

This chapter answers the first two research questions. The chapter discusses how different stakeholders perceive the concept of risk in the context of business and corporate reporting. It is clearly evident that risk is a complex concept where there is generally no commonly agreed upon definition, and a spectrum of risk definitions is provided by the interviewees. This lack of a common agreement on the definition of risk has implications for CRD quality and practices. It is more appropriate though if companies adopt a broad definition of risk to satisfy the information needs of different users and meet the spectrum of definitions.

With regard to the perceived benefit of reporting on risk generally, CRD is definitely of particular importance to companies and investors alike if it is of high quality. Hence, investors can gain a better understanding of the company’s RE and make informed investment decisions accordingly, whilst companies can attain some benefits. The findings also reveal that CRD has improved over time, but there is a room for improvement. There are still a number of limitations affecting CRD quality that need to be overcome. These limitations should be considered by companies and regulatory and professional bodies as a starting point for further improvements.

The next chapter continues the analysis to address the third research question.

Chapter 6: Incentives and disincentives for risk reporting

6.1. Introduction

This chapter addresses the third research question: What are the management incentives and disincentives for risk reporting (RR)? Having investigated the shortcomings of current CRD practices and identified the major needs of information users in terms of RR in the previous chapter, this chapter provides possible explanations of these shortcomings. The chapter explores managers' motives behind the disclosure and non-disclosure of risk-related information by companies. In other words, the chapter examines the perceived advantages and disadvantages that encourage and discourage companies, respectively, to disclose high quality risk information (RI).

The purpose is to mitigate companies' concerns about disclosing RI considering its inherent sensitivity and uncertainty. Another purpose is to make managers more aware of the benefits companies can attain through maintaining transparency about their risk exposure (RE), and the potential consequences of lack of disclosure and non-disclosure. Furthermore, in addition to considering users' RI needs, management incentives and disincentives need to be taken into account to understand CRD behaviour if new regulations and/or guidelines are to be introduced to better meet users' needs and improve CRD practices. Likewise, identifying these incentives and disincentives could also help explain the lack of CRD quality as discussed in the previous chapter and how it could be further improved.

This is the first study to investigate the motives for CRD and non-disclosure from a multi-stakeholder perspective. Incentives and disincentives presumably play a key part in determining the level and quality of corporate disclosure. There are considerations that managements take into account to determine the amount, format, presentation and probably the timing of providing particular information. This chapter investigates the rationale behind management discretion over CRD in terms of disclosing particular RI or withholding other.

6.2. CRD decisions

This section provides some introductory remarks about CRD decisions. Company's managers take account of the potential benefits and costs associated with the disclosures they make. Therefore, managers make decisions regarding what, and how much, RI to make available publicly and what information to keep private. CRD decisions lie ultimately in the hands of management, depending largely on the consequences of disclosure and nondisclosure. I10 states "*It is up to the management to draw that line of what is public and what is private, and then it is up to the auditors to challenge them*".

However, the participants argue that there is a balance that companies should manage between providing too much information that could raise more questions or increase their risk exposure, and disclosing sufficient information to meet information users' needs and help them gain an insight into the risks the company is facing. I15 highlights "*There is a balance between giving too much and too little*".

In this respect some participants refer to a conflict of interest between managers and investors, whereby investors demand more information whilst managers may have concerns about disclosing particular information. I15 states "*Analysts will always ask for more* (information) *because it helps them come up with new insights. We* (companies) *will always look for less*". I11 also comments "*I do not believe that any organisation is going to give too much in its risk reporting because it is open to public*".

Materiality of RI also influences CRD decisions. Companies may not report immaterial risks that have no significant impact on company performance and are not important to investors. The interviewees recommend that companies focus on reporting risks that could have detrimental impact on their performance, and refrain from disclosing generic risks; risks that a business runs on a regular basis and are known to stakeholders, "*The ones which are not principal risks that could be a reasonably expected decision and those things which are so generic and everyone knows already*" (I28).

The participants indicate that managers' discretion regarding the extent of CRD depends ultimately on the seriousness of risk and suggest that all material risks must be disclosed. For example, I19 states "*The degree to which the disclosures may be prejudicial to the business will impact the extent of the disclosure, but I do not think any significant risk should be excluded altogether…that would be very wrong*". I16 supports this argument remarking:

> "*If you are aware of a material risk and you do not disclose that material risk then I would say you are looking for misreporting, but I cannot think of any circumstances where it would be okay not to report a risk that would potentially be material, that would be a manipulation of accounting that could get you into deep trouble*".

The participants generally define material risks as risks that may render either direct or indirect significant financial implications. For example, I15 describes materiality from a company's point of view stating "*We are a big company, we would not report anything that has less than a £100 million impact on our balance sheet or our profit*". Likewise, I18 illustrates that material risks are business events where "*too much money and too much reputation, too much capital personal and financial capital tied up in big decisions*".

Accordingly, companies are suggested to concentrate their time and resources on handling and reporting key risks and uncertainties that could have a significant impact on achieving business objectives.

"*I would be really really surprised if there was something that the board considered to be a significant risk that has been discussed in board meetings, and is high on the risk register, and was completely omitted from the annual reports and accounts. I would be really surprised within the FTSE 100. They might be presented slightly different*". (I19)

Participants justify the exclusion of immaterial risks and irrelevant information primarily because they could distract managers and investors from focusing on principal risks, and hence may affect risk management (RM) and CRD quality. I10 argues "*they* (companies) *do not want to waste anybody's time by telling them stuff that is very uncertain*". I23 also comments:

"*Companies should not report things that are not going to make a difference to the users of the financial statements. So, the risks that are too trivial that they would not really affect whether people would invest in them or not, but they also would not report things where they think that although it might be significant in some ways, the company could actually deal with it in a reasonable fashion*".

However, whilst it appears self-evident that companies should disclose their key risks, the participants draw attention to the problematic nature of risk. They point out that risk is an area that involves an element of uncertainty, and hence there is subjectivity in identifying, measuring, managing and ultimately reporting key business risks. This subjectivity may make it difficult for companies to identify their major risks. Other participants assert that this subjectivity also provides opportunities for companies to be selective in their risk disclosure. For example, I11 highlights this and argues "*When you get into a subject that is subjective as risk identification is, there is a far more scope for an organisation to paint the picture it wants to because it is subjective*".

CRD is also problematic because stakeholders potentially may question the information provided, and hence companies may be more inclined to withhold such information or present it in a generic form, and this is discussed in the next section which considers disincentives for CRD. However, some participants argue that companies use such claims to justify non-disclosure of risks. A number of participants demonstrate that companies do not deliberately conceal RI but they are either unaware of the risks or fail to anticipate and assess their potential impact accurately. I24 indicates "*In my experience there are very few instances of companies refusing to say something about a particular area of risk*". Likewise, I10 states "*I do not think they consciously hide things*".

There is a common agreement among the participants on some motives for disclosing and withholding RI. Interestingly, the participants highlight a number of factors that could serve as incentives and disincentives for RR at the same time as discussed in the following sections. Understandably, companies will not disclose every risk they are facing for various reasons. These reasons, however, raise more questions than answers.

6.3. CRD disincentives

The major disincentive discussed concerns sensitivity of RI and hence is discussed in a separate subsection. However, there are a number of disincentives noted by the participants that may also explain managers' non-disclosure of RI. First, the problematic of identifying particular risks and measuring their impact, and hence companies may not be able to disclose them properly. For example, I6 states "*I think sometimes they* (companies) *just have not anticipated the issues*". Likewise, I22 highlights "*I do not actually agree that this is correct, but I think companies are not as good at reporting risks which are very difficult to measure such as reputational risk*". I10 refers to managers' ignorance of a risk or uncertainty demonstrating:

> "*They do not even realise themselves that it is an important risk, and sometimes they might withhold it because they are just not quite sure they know enough about it to give an honest description and do a fair assessment*".

The interviewees argue that failure to report some risks might raise investors' concerns about the effectiveness of the company's RM system and could expose it to more risks. Therefore, management should also consider the unfavourable consequences non-disclosure or lack of disclosure might lead to.

Moreover, other participants argue that the difficulty of assessing risks and disclosing quantitative RI should not justify non-disclosure or discourage companies from reporting on risks. They further indicate that deficiency of CRD could draw stakeholders' attention to managers' lack of understanding of the company's RE, and underline the absence of an appropriate risk governance framework. I10 remarks "*Where it is bad I think it is human nature for people sometimes not having proper corporate governance over risk and over how it is evaluated, manged, reported*".

Second, another disincentive indicated by the participants representing risk directors group is the case of an ongoing internal investigation and legal issues where companies may be reluctant to disclose them until they are resolved or their impacts crystallise. Managers have concerns about disclosing certain RI that could affect the outcomes of ongoing investigations, negotiations, or unresolved legal issues. Participants demonstrate that companies' management would rather consult their legal advisor about whether or not to disclose this information. Accordingly, managers can identify the appropriate level and timing of CRD that can be divulged and shared publicly to comply with regulations.

I25 discourages companies from disclosing such information stating "*Risk information related to ongoing investigations companies should not be reporting on*". Similarly, I20 comments "*We may have an ongoing internal investigation, and our legal counsel advises us that it is inappropriate to share that externally, that is one small example*". I27 also explains why managers should think carefully before disseminating such information arguing:

> "*There may be some areas where you have got particularly sensitive negotiations or legal type of challenges where you would be very careful on how you talk about those risks externally. For example, if you had a big regulatory or legal case that both were very sensitive and not debated clearly that might have a risk that the outcome was not the outcome that you were trying to get to*".

Third, in addition to organisational disincentives, managerial disincentives could play a key part in CRD. Managers and employees' financial and personal interests such as retaining their jobs and moving up the organisation's ladder may lead them to conceal RI or present a different image of the actual risks. These disincentives could affect whether management want to be entirely neutral and transparent in their RR. I26 explains how managers' personal interests and motives affect their CRD decisions stating "*If I disclose this risk what impact does that actually have on the value of my shares or my share options or even the value of any bonus arrangements I may be expecting to receive*". I16 strongly supports this argument referring to a private conversation with a former colleague stating:

> "*If our management knew the risks we were taking in Italy I would have been fired years ago. Now I think that is pervasive. I think financial institutions are taking risks, are accepting risks that only the individuals accepting those risks know about because like I say the risk reporting mechanisms are still inadequate*".

This view also underlines the lack of transparency within companies, which could ultimately lead to inadequate external CRD and may also contribute to inappropriate RM practices.

Fourth, some participants argue that the absence of specific regulations that prescribe a method, format and place for CRD to force companies to identify, assess and disclose their risks is another reason for the lack of CRD. They indicate that CRD should be compulsory, considering the significance of RI to information users, with a set of prescriptive rules in order to improve its quality; otherwise managers will have considerable discretion in RR. I13 demonstrates "*If they* (companies) *do not have to why would they say it?*" I1 also comments "*If a company was not obliged to report on risks why would it?*" The role of disclosure regulations is discussed below in more detail.

6.3.1. Sensitivity of CRD

The major disincentive for CRD, according to participants, is the commercial and competitive sensitivity of RI that could be prejudicial to the company. There is a potential danger of putting the company at a competitive disadvantage by giving away informative disclosures of either upside or downside risks that could be utilised by competitors. The participants gave examples of sensitive and proprietary information including pricing structures, contract pricing with suppliers, ongoing investigations, unresolved legal problems and sensitive negotiations. This kind of information is often price-sensitive information and could directly affect the stock price.

However, it is not always so. There are some risks that are sensitive in different ways. For example, I27 remarks "*I think people are a bit reticent about talking about things like cyber vulnerabilities in their businesses, do not attract the cyber terrorists into your business*".

The participants identify a number of factors that companies will consider before reporting sensitive and anticompetitive RI. They highlight that companies undertake a cost-benefit analysis of their RR considering the advantages and disadvantages of providing sensitive RI. Firstly, companies will consider the possibility that reporting a risk could expose them to more risks or lead to the risk materialising. Therefore, companies carefully consider their CRD so that information that could be commercially and financially harmful to them cannot be used by competitors. The interviewees emphasise the consequences of disclosing sensitive information and attaching a number to the magnitude of a risk that could be harmful to the company. I7 explains this disincentive as follows:

> "*Probably where companies get a bit reticent about reporting is if through reporting and giving a kind of quantification and identifying a potential risk that kind of helps crystallise a risk. So, if you said I am going to put up to 18 billion dollars a side in case we get fined for X Y Z, well that immediately says to the people who are doing the fining so well they have offset it, they have got a point and they have done it, and you know they have got this money and they have put it aside*". (I7)

Secondly, whilst companies could be more reluctant to disclose negative information (downside risks), they may also be unwilling to provide information on business opportunities (upside risks) that could, for example, encourage other companies to enter the market. This claim is contended by other participants who call for reporting and presenting such important information but without necessarily providing specific or quantitative information that could be detrimental to the company. Companies may provide RI without describing the real risks that could then be misinterpreted by information users or exploited by current or potential competitors. This can be called the risk of RR.

Companies may incur costs in the case of disclosing either sensitive upside or downside risks. Reporting on an upside risk which represents a business opportunity could attract the attention of current and potential competitors to take advantage of the business opportunities available, whereas disclosing downside risks could encourage competitors and other stakeholders to capitalise on the company's failure or lead to investors and customers' mis-reaction.

However, the participants place more emphasis on the potential consequences of disclosing downside risks. I8 explains why companies may refrain from reporting commercially sensitive information stating "*It would put them at potential disadvantage to other competitors*". I16 highlights "*No manager will voluntarily report bad news unless they have absolutely no choice*". I5 also indicates "*People can see what you are doing well and what you are doing*

badly, and then they position to take advantage of that for their own benefit". Similarly, I11 explains why companies might withhold both favourable and unfavourable RI arguing:

> "*I do not think they will report on anything in relation to key strategic decisions or thinking because they might be entering a new market. They would not wish to report on risks in relation to manufacture because it might indicate a fundamental flurry in their overall business model. So, it comes about not willing to give anything away undermining my customers, giving my competitors an advantage or occasionally giving my team member or my staff an advantage*".

The interviewees further justify the non-disclosure of commercially sensitive RI that could endanger the company's competitive position "*If we are publishing that we are reducing our competitive advantages, it is not to the benefit of our shareholders*" (I20). I12 also emphasises "*You would not want to lose out to the competition, and it is not about being dishonest. You would not want to put yourself in a non-competitive situation, and therefore you might not report on a risk*".

Thirdly, CRD could lead to fluctuations in the share price caused by market and investors' reaction to RI. A company may be perceived to be more risky as a consequence of disclosing its risks. Hence, investors may react by selling their shares or requiring a risk premium due to the greater uncertainty and risk associated with their investment which will ultimately lead to a higher cost of capital. Therefore, companies are always concerned about the impact CRD might have on firm value and share price and make their CRD accordingly. I26 highlights this argument stating "*If I disclose this risk what impact will it have on share price*".

In addition, companies could refrain from reporting particular risks considering that it could be interpreted incorrectly or met with unfavourable investor's reaction, and consequently expose the company to the risk of misvaluation or undervaluation. I25 states "*Risk reporting can be misinterpreted*". Nevertheless, meeting investors' information needs should be a key driver for companies to ensure transparency about their RE. The lack of CRD could lead investors to either sell their shares or look for other information sources, which could contribute to higher cost of capital. Hence, the participants recommend more transparency to enhance investor's confidence. The above claim is rejected by other participants. For example, I13 remarks "*If you can have some honest reporting about the challenges that they* (companies) *are facing then we look much more favourably on that company*".

Participants recommend that companies need to maintain the balance between the amount of RI available internally and external CRD. Companies also need to tailor and manage their CRD effectively to meet users' information needs in a clear and transparent manner and avoid the risk of RI being misinterpreted. Therefore, companies considering non-disclosure of RI should take account of the potential consequences resulting from market and investors' reaction.

Some participants caution against withholding RI and emphasise the implications it may have particularly in the long-term. They argue that companies cannot withhold such information forever. I22 refutes the argument that disclosing RI and quantitative information in particular could increase a company's RE demonstrating:

> "*Could it be harmful? Well, I really do not believe it would be harmful because that information in the point of time is going to find its way into reality, but I do not think really it should be harmful over the long-term. I can see that it might call some short-term preservation*".

The participants, however, do not suggest sensitive information will be concealed completely. They argue that companies will be likely to provide sensitive risk disclosures in a more generic form without providing quantitative or specific information that could endanger their business. Accordingly, managers will present the information in a way that recognises the risk, meanwhile not revealing too much or meaningful information that can be used against the company. I27 points out "*I suspect that most firms just do not talk about the details of some of those items, things as you say the risk you are crystallising, the risk that you were worried about in the first place*". I24 also indicates "*They* (companies) *will make it* (CRD) *very generic so it does not really mean much*". Furthermore, I11 claims that RI could be manipulated to avoid unfavourable consequences or portray a better image a company's risk profile commenting:

> "*I can almost write your risk report; I think there is a lot of that done, so I am not giving you anything new. I will be dressing it up and changing the flavour such as health and safety in oil rigs, liquidity in banks*".

Some participants suggest another way of handling competitively sensitive information to justify non-disclosure to investors. They suggest that companies can explain to investors why they refrain from reporting a particular risk and argue that it will be perceived favourably by investors. They indicate that investors understand the implications of reporting sensitive information on firm performance and competitive position. I5 states "*As an investor, I do not actually want them to give away any information that is valuable to competitors anyway*". Similarly, I2 comments:

> "*Companies do not like to disclose commercially sensitive information, but I would prefer if that was the case they just said we are not disclosing this information…the commercial sensitivity might affect a deal, it might affect the profitability of the company, it might affect the going concern*".

However, sensitivity is not the only reason for withholding RI. Companies also consider whether or not the information is known to stakeholders. If a risk is already in the public domain companies will have to respond by disclosing this risk to reassure investors and mitigate their concerns. I15 indicates "*If it is sensitive it depends what it is. If it is in the public domain*

then you would report it, if it is not in the public domain then you would not report it". Companies may also be perceived to be more risky and incur some costs if they disclose a risk that stakeholders are unaware of. I5 argues "*if you talk a lot about risks which people were not aware of…you might give the impression that management is not handling the risks properly*".

Companies, according to participants, will generally not report any sensitive information unless it is already in the public domain, and this applies to both positive and negative sensitive information. However, they recommend that companies pay careful attention to unintended consequences of non-disclosure.

6.4. CRD incentives

There are a number of incentives for companies to improve their CRD quality highlighted by the participants and are discussed extensively. These incentives are closely associated with firm's perceived benefits from CRD, as discussed in the previous chapter, by highlighting how it takes advantage of upside risks and the opportunities available in the market it operates in as well as mitigate downside risks. It is also worth highlighting that these incentives are interrelated to some extent.

However, a few participants claim that there are no incentives that could encourage companies to disclose more RI, whereas a limited number of participants are sceptical about the extent to which incentives could contribute to enhancing CRD quality considering the nature of RI. I7 argues "*It is very difficult to think of any incentives for companies to report more risk information*". I4 also states "*I do not think there could be too many incentives to disclose information that is more meaningful*".

These participants refer to the previously discussed disincentives and the potential consequences associated with reporting commercially and competitively sensitive information in particular. They also emphasise the impact of management discretion on CRD. I15 comments "*If it is sensitive companies won't report it*". I16 claims "*There is no incentive because the narrative reporting of risk is our risk management processes are excellent…every bank will write that*". I5 also demonstrates:

> "*We have to be realistic about risk and accept that in a competitive market we are not going to get as much information about risk as we would like, partly because you cannot take away from the managers this imperative they have to present themselves in the best possible light*".

In addition, I8 claims that companies do not place more emphasis on RR because of its lack of relevance to information users commenting:

> "*I am not sure there is any incentive because it is probably one of the least read elements of an annual report…because it is not that relevant to most people, it does not affect most*

people`s decisions, but part of that is because the quality of what is disclosed is not particularly good".

On the other hand, the majority of the participants draw managers' attention to the advantages of transparency in RR to mitigate their concerns about CRD. They highlight a number of incentives to refute the above claims concerning the factors that may deter companies from disclosing RI. These incentives can be classified into internal and external incentives, where the former refers to company's own incentives to voluntarily disclose more RI to take advantage of CRD, and the latter refers to the external factors that drive companies to respond to by improving their CRD quality. The internal incentives are discussed first.

6.4.1. Internal incentives

The participants refer to some company's internal incentives relating to promoting internal reporting and whistle blowing, creating a culture of openness and transparency about risk, and promoting employees' ethical behaviour. Likewise, ensuring good corporate governance (CG) mechanisms is another internal incentive addressed by the participants for better RR. For example, the existence of internal auditors, audit and/or risk committee and non-executive directors as mechanisms for monitoring and challenging management could further improve CRD quality. The participants further indicate that good CG practices should be the key driver for companies to disclose quality RI.

The data reveals a number of incentives for companies to improve their CRD quality. These incentives and benefits are closely interrelated. First, a company through voluntarily providing more RI can gain a better understanding of the impact of risk on its overall performance. The company can assess the impact of risk and CRD on investor's perception and decision, and hence on the cost of capital. I28 demonstrates "*Positive incentives would be gaining a great understanding of how this impacts on investors` assessments, the cost of capital for the business, how is there a relation between this and the ultimate performance*".

Participants emphasise the importance of providing transparent RI and underline the possibility that investors may seek alternative information sources, probably unreliable sources, which could increase the cost of capital. They place more emphasis on the potential financial implications of better CRD in terms of lower cost of capital, and reducing information asymmetry and share price volatility as the key driver for higher CRD quality.

Identifying users' information needs and assessing current CRD practices to identify the information gap are the starting point for better CRD. Companies should strive to meet the information needs of users particularly investors as the capital providers. Therefore, companies should seek investors' feedback and comments on their RR and take them into account. The participants argue that enhancing investors' engagement through transparency about RE is important for companies to avoid sudden movements and fluctuations in their share prices.

Likewise, they suggest that investors should read risk disclosures and feedback their views to companies.

A major financial incentive highlighted by the participants is that better CRD should enhance shareholders' engagement leading to the company being perceived favourably by investors, which could ultimately drive lower cost of capital. Therefore, CRD could increase stakeholders' confidence as they gain a better insight into the company's RE and profile, and the plans and processes in place to manage and mitigate risks. For example, I22 asserts "*Better shareholder engagement ultimately should drive a lower cost of capital*". I24 states:

> "*The holy grail would be trying to prove some sort of link between quality of your risk reporting and your cost of capital…I guess it is very difficult to isolate the effect of your risk reporting on something like cost of capital personally*".

In addition, I25 supports the argument that better reporting on the company's exposure to either upside or downside risks enhances investors' trust and enables companies to reduce their cost of capital stating:

> "*The more conversant you are in understanding your risks and discussing them, the more likely you are to raise capital, the more likely you are to gain support with your key stakeholder groups that you need to get things done because they understand that you have got strategic perspectives but also you are being aware of what can go wrong*".

Likewise, other participants illustrate that companies can safeguard against stock price fluctuations through transparency about their RE and RM that ultimately improves stakeholders' engagement. I23 explains the consequences of lack of CRD quality for companies stating "*Their share price is going to fall and that is when directors are exposed when the share price starts to fall*".

However, there is a need for further investigation and evidence on the relationship between better CRD and potential financial benefits particularly its impact on the cost of capital as the ultimate incentive for companies to improve their RR quality. Some participants consider this claim a *theoretical position* and argue that it may not necessarily hold in practice. I26 states "*If there was a clear evidence that good risk reporting led to improved cost of equity, improved cost of debt that might be a motivation for management*".

Second, RR may protect companies during times of crises by increasing their flexibility and stability. Hence, transparency about the company's RE enhances investor's confidence that can help the company recover quickly from a crisis. Companies can also reduce or avoid potential unfavourable implications resulting from negative investors' reaction by keeping them informed about their risks.

"*I have always been a fan of making sure that you have clear risk disclosure because I think it protects you in the times when things go bad. So that is a natural incentive as your business will recover better*". (I27)

However, I27 calls for more research and evidence on this relationship that could encourage companies to provide quality RI suggesting "*More research to support would probably help as an incentive to be really transparent about the risks in your business*".

The interviewees point out that companies can conceal RI, however, in the long-term this hidden information will come out and the consequences could be significant. For example, a corporate scandal such as the Volkswagens emission scandal that was discovered and the company has suffered severe consequences ever since. Therefore, a corporate crisis or scandal forces companies to provide more and meaningful information as they attempt to restore their image and reputation. They also seek to restore investor's confidence by being more transparent about their risk position and performance in general.

Thus, corporate crises and scandals could be another incentive for more CRD. The participants also refer to the impact of peer pressure discussed below that influences CRD practices. So crises and scandals could lead not only companies under crisis conditions but also other companies in the same market to approach their RM and RR in a different and more informative manner to maintain their corporate image and reassure their investors. Therefore, companies are encouraged to disclose their risks sooner than later when the disclosure costs could be higher.

Third, another major incentive for companies is highlighting that they are well managed and successful in a highly competitive and volatile business environment. It is also an opportunity for a company to distinguish itself from its competitors in terms of understanding its business environment and RE and having a robust RM system in place. Accordingly, the company may take advantage of its effective RM and overall risk governance framework. Effective RM could lead to better CRD where managers may feel more comfortable addressing their risks, and highlighting how effectively they manage them and provide reassurance to stakeholders. So, companies can use RR to promote their RM practices and reputation. I12 supports this argument commenting:

"*It is the selling of risk management is it not? You are trying to promote risk management within an organisation. For a company to understand the tangible benefits of being able to report on risk…it shows the world that they have got a risk management programme in place and they are actively managing their risk, and therefore the risks are less likely to occur...If you have got confidence that a company you are interested or investing in is going to be reporting on risks, then…their customers will stay loyal*".

Companies can, through transparent CRD, send positive messages to shareholders and other investors that they are aware of the risks facing their business and handle them effectively to gain their confidence and trust. They can also gain a competitive edge over their competitors.

> "*Companies want to imply that they are very good at risk management, and therefore the shareholders and other stakeholders can trust them, and therefore the incentive is to produce a very organised risk report and then they appear to be a leader in the area of risk reporting, and may be shareholders will feel happier that the company is managing the risk better. So, it would be like signalling*". (I2)

Likewise, companies are recommended to disclose both downside and upside risks and explain how they manage and mitigate threats (downside risks) and capitalise on business opportunities (upside risks). Accordingly, maintaining a robust RM system should encourage companies to disclose more RI where they can also present their downside risks in a favourable way. I5 points out "*Management's concern conveys the impression that it is running the business capably*". I6 states "*It can be helpful to mention the industry risk and make clear how small it is for you*". I23 also remarks "*The quality of risk reporting is indicative of the quality of the risk management*". Furthermore, I25 argues that companies should "*disclose what the downsides are or what opportunities you are expecting to take advantage of because of the risk and the market place that you operate in*".

Fourth, the existence of a proper risk culture and transparency about risk within the company could be a driver for effective RM, and hence better external CRD. I11 highlights the importance of risk culture stating "*Risk reporting depends on the attitude and the culture of the company*". The participants also emphasise the role management can play in terms of ethical conduct and behaviour of managers in reinforcing an appropriate risk culture and ensuring that risks are addressed properly throughout the company.

> "*Having the right culture and behaviours in the board room and in the organisation in general, the board should take responsibility for risk oversight and ensuring the effectiveness of risk management systems and internal controls in place, and this should be highlighted in risk disclosure*". (I24)

> "*Having a management that is capable and has a high integrity…So as long as you have excessive reward and excessive greed you will never eradicate it, you will never stop them completely, but you just have to keep it under control. I think the best defence is to have a management that is capable an ethical*". (I10)

In addition, maintaining transparency and building a proper risk culture can contribute to effective RM through ensuring a common understanding of the key risks facing the company and how they can be managed. I10 suggests "*A really formal whistleblowing process and*

whistle-blowers should have absolute protection. You probably do not want to reward it too much". I27 also remarks:

> "*The more that you talk about the risks that you are running in your business, the more people realise that it is not something that is too dangerous to talk about, that is an advantage. I think that has a reinforcing impact on your culture that people are open*".

Fifth, CG mechanisms and practices could have a significant impact on RM and CRD practices and quality. CG practices are also associated with creating a proper risk culture. The participants highlight that there is a direct relationship between CG mechanisms and practices, and CRD. They particularly highlight two aspects of CG that can contribute to better RR. Firstly, the existence of an audit and/or risk committee that oversees and ensures the effectiveness of RM. They emphasise the committee composition in terms of the independence and financial expertise of its members that can enable them to challenge management regarding its RM processes and plans as well as ensure transparency of external CRD.

For example, I11 demonstrates "*Risk reporting is a key element of corporate governance*". I28 states "*Corporate governance and corporate reporting are both two sides of the same currency*". Likewise, I27 explains how CG contributes to better CRD commenting:

> "*Our external risk reporting goes through a huge amount of internal governance and a huge amount of debate about is it pitched at the right level? Is it engaging enough? Are we saying the right things? Are we being open enough? And that all goes through several ways of internal governance at both an executive and a nonexecutive level*".

Participants further emphasise the role of the audit/risk committee and the importance of having the right mix of people on these committees. I15 demonstrates "*Good corporate governance is having a risk committee chaired by an independent nonexecutive with a non-executive majority who are challenging management on the risks they run by the company*". I27 also emphasises:

> "*You need a diverse range of mixed people on those committees. You need people who are knowledgeable in risk and think about risk, but also come from a variety of different backgrounds so you can really see things from different perspectives, and then you can have a good debate about how you are going to talk about those things to the external world*".

Secondly, the existence of independent non-executive directors on corporate boards with the relevant financial and industry expertise who can challenge management can also enhance both RM and RR practices. I26 underlines the role of non-executive directors commenting:

> "*Non-executive directors should be there to hold executive directors to account. It is not part of their job to be growing the business; it is not part of their job to be providing contacts which help the executive directors to grow the business. They are there to say ok*

what have you done this year, and what are you doing, what are the risks, and how are you reporting, have you thought about?"

6.4.2. External incentives

External factors also play their part in influencing the extent and quality of CRD. The participants discussed a number of external factors that could drive companies to improve their CRD quality as they have to respond to these factors such as market reaction and pressures by providing more RI in order to avoid any potential negative consequences.

6.4.2.1. Investor feedback

Investors as the capital providers can play a significant role in encouraging and/or forcing companies to disclose more RI. Therefore, they should pay careful attention to the risk factor section by reading it, providing feedback, asking questions and seeking clarifications from companies about their RE so that companies can identify their information needs and meet them. Interviewees indicate that companies spend a great deal of their time and resources to manage and disclose risks and expect some feedback from investors in return. They argue that investor feedback is mutually beneficial for investors and companies where investors can gain a better understanding of the company's RE and the company can reduce the cost of capital through effective shareholder engagement.

> "*Feedback from investors would help. Lots of the companies I meet with they would say to me they spent hours and hours and hours on the risk report and they never get any feedback. So, I think investors should take the time and just say I read this it was helpful, here is what I liked, just a simple statement*". (I13)

I22 explains the outcome of better shareholders' engagement remarking:

> "*If they* (companies) *make that disclosure and the shareholders are engaged with it, and ask questions, and increase their understanding of the company I think that engagement which ultimately should drive a lower cost of capital that should be the ultimate incentive*".

Companies may also be interested in investor's view on their RR. Hence, investors can exercise their power against management by giving their feedback to companies, and send a message that they read their risk disclosures and consider when making investment decisions. Companies should also respond by disclosing more and quality RI. I24 highlights this stating "*Obviously the people that companies will typically listen to are investors. So, if they get a message from investors that they are being favoured because they are doing good risk reporting then that would probably have an effect*". I6 points out that "*I would hope better insight on how the information is used by investors, what is meaningful, what is helpful, identifying the investors community needs and use of information*".

Meanwhile, companies are encouraged to identify users' needs and tailor their CRD accordingly. Managers also need to seek feedback from investors on their CRD practices to ensure their engagement, accommodate their needs, and reassure them. Considering investor and market reaction companies can also take advantage of their CRD by providing further reassurance to stakeholders and get investors engaged in their RM and RR. Therefore, companies can gain and build investor's confidence that could enhance organisational resilience and flexibility to a changing business environment so that companies can respond advantageously to uncertainties and potential unfavourable events.

Accordingly, interviewees highlight the importance of having a transparent conversation with investors and other stakeholders about risk for maintaining their confidence, which could improve RM. They also emphasise the impact of lack of transparency on investor's trust that could ultimately lead to unfavourable outcomes and investor mis-reaction. I19 argues "*Where it is much more known in the investment community I think that sometimes preparers get some credit for. If their disclosures become too anodyne, boilerplate and meaningless that trust goes*". I25 remarks:

> "*The more conversant you are in understanding your risks and discussing them, the more likely you are to gain support from your key stakeholder groups that you need to get things done because they understand that you have got strategic perspectives, but also you are being aware of what can go wrong*".

6.4.2.2. Investor and market reaction

Companies should consider investor and market reaction to the lack of CRD. Companies can mitigate any potential impact of adverse investor and/or market reaction to the disclosure of unfavourable information (downside risks) in particular through maintaining transparency about their RE. It could be argued that there is a limit to the extent of risk disclosure companies can make. However, the impact of market reaction and pressure exercised by investors and other stakeholders could play a significant part in encouraging and/or obliging companies to disclose more RI.

Poor CRD may be perceived negatively by investors and lead to unfavourable outcomes resulting from investor mis-reaction. Investors could consider the lack of CRD as either managers concealing important information or lacking awareness of risks facing the company highlighting the deficiency of its RM system. I13 states "*If they* (companies) *do not mention it, it still tells you something*".

Accordingly, stakeholders including shareholders may respond by calling for more transparency and could take actions against the company. The participants suggest that companies disclose transparent RI and meanwhile recommend investors to appreciate this transparency, read risk

disclosures and ask companies for clarifications, rather than mis-reacting and punishing companies by selling their shares.

> "*Investor reaction is the best way to get companies to do better. The secondary line of that of course is regulators to do more. I do think it is much more effective if investors criticise rather than just dumping the shares. I think if investors can find a way of telling management that they are not happy with what they are saying, they do not really understand the risks that the company is facing, then I think that is a real incentive for companies to do better because if they do not their share price is going to fall*". (I23)

This incentive is related to the financial incentives discussed above. Management could disclose more RI to avoid misevaluation of company due to adverse actions taken by investors. Investor reaction should be a major catalyst for companies to make better CRD that meets investors' needs, reassure them and mitigate their concerns, and hence avoid or reduce stock price volatility. The fear of misevaluation or undervaluation of the company by investment analysts and rating agencies results from the lack of transparency and increasing investor's uncertainty leading to adverse reactions.

The participants continue to place particular emphasis on the impact of investor and market pressure on CRD quality.

> "*If the investors put out guidelines saying we will vote against the re-election of the chairman of the audit committee if you do not do X, Y and Z, then that would have an impact…something that companies do take into their account that is something that in theory could have an impact in practice*". (I24)

Likewise, I7 explains how transparency about RE could alleviate the problems that might arise from disclosing unfavourable information stating:

> "*If you did a good job of reporting risks and giving some numbers around it, as those risks crystallised from risks into actual events then the market impact would be less because people say we already knew that after they had factored that into the equation, and they had a great understanding, that helps build confidence in management*".

In addition, the participants representing retail investors group indicate that they use other information sources more heavily than corporate reports such as investment magazines and websites that collate information about companies and offer analysis, information and advice about company performance and future prospects. Hence, they do not spend too much time reading through the annual report (AR) and the technical data in particular. They focus more on expert opinions published on such websites or magazines. They also use chat rooms where they share information about companies with other investors. Therefore, there is a concern about the accuracy and reliability of this information. Companies should voluntarily provide more RI to

confront those sources that could provide misleading information and lead to adverse reactions by investors. I9 highlights the importance of building and maintaining investor confidence through more transparency stating:

> "*You cannot be such a poor reporter that you lose the trust. So, investors are always, to some extent, the ones that are policing that spectrum between the great reporters and the poor reporters, and no one is going to go too far below the line*".

6.4.2.3. Peer pressure

Another incentive for companies to report more RI is peer pressure, where some companies take the lead and disclose particular RI and/or provide better risk disclosures, then other companies may have to respond by disclosing more RI to avoid being questioned by investors or perceived to be more risky. So, if a risk that all companies are exposed to was disclosed by one company that could drive other companies to disclose it. Some participants recommend that companies address their risks considering the industry and the market they operate in and their competitors' RR as well. They point out that companies should maintain the balance between meeting users' information needs and ensuring the level of transparency in the same industry or market.

Market pressure could also play a role in encouraging the company to report more RI following its competitors and/or responding to significant market changes or events to mitigate potential adverse actions and reduce investors' concerns and uncertainty about its performance. Moreover, the company disclosing its risks could be exposing other companies that withhold such information, and meanwhile gaining a competitive advantage and ensuring its lead over competitors. I20 recommends companies to "*find the right level of detail based on what investors' queries have been, referencing other companies to make sure we are in line with their similar levels of transparency*".

Accordingly, whereas companies should and may focus on reporting their key risks, yet it could be helpful, according to some participants, to disclose particular immaterial unsystematic risks. Participants also suggest that companies explain to investors why a particular risk is not considered material to their business and what they are doing to monitor and manage it rather than remaining silent, because otherwise investors may raise concerns about their RM. So, the disclosure of risks by some companies could expose other companies that choose not to disclose.

> "*It can be helpful to mention the industry risk and make clear how small it is for you. If they are not mentioning the same issue or at least dismissing it, if it is not an issue for them that sort of peer pressure will work and investors and analysts will be asking about the issue*". (I6)

Although the disclosure of particularly sensitive RI may be a major concern for a company with the possibility of increasing its risk exposure and being punished by investors if it is the only company disclosing this information, yet such information could expose the whole sector or market. Thus, investors may start raising questions about the RR practices of other companies and whether they are hiding any information, which could force companies to disclose more RI. I6 explains how market pressure works in practice remarking:

> "*On the positive side good incentives, they* (companies) *can see from investors what is meaningful what is not. I think there is a bit of a problem potentially for the companies that are bold and tackling issue and describe a risk, there is of course a risk that they are then punished for it because they are the only one mentioning this thing, but I think in the end that is going to be better…And frankly what probably works best is companies for whom an issue is not as sensitive as big, but big enough to mention, if they disclose frankly that then does bring the other guys along…here you see in the market VW announces a problem what happens? The whole of the sector drops oh my god what is everybody else doing, everybody scrambles around, and then they are sort of equalise and come back…those that are reluctant frankly they will either be discounted for not doing it…but they will have to disclose because the other guys are*".

6.4.2.4. Acknowledgement of good CRD practices

Some companies may choose to take the initiative and make better risk disclosures. Therefore, the participants call for positively acknowledging companies that disclose high quality RI by professional and regulatory bodies. The participants refer to the awards given to companies by some professional bodies and audit firms in recognition of their CRD practices. The interviewees further argue that such acknowledgment and awards should encourage other companies to provide more and higher quality RI. For example, I4 indicates "*Having the champion companies do these things that are useful, it may improve it a bit*".

The responses also highlight that some companies are interested in obtaining recognition of the effectiveness of their RM and transparency of their RR. The participants emphasise that companies consider such recognition in signalling their performance, boosting their competitive advantage and position and reassuring investors. They point out that such a recognition is perceived as a certification that companies pursue for a number of reasons including improving its corporate image and gaining a competitive edge. This could encourage other companies to follow their footsteps.

> "*One of the incentives that is out there for us actually is the Dow Jones Sustainability Index…and part of that is about how we manage risk and what we do to manage risk. So, for us to demonstrate that we are transparent and effective in our risk management we will reply in the Dow Jones questionnaire, and so the incentive for us is to make sure we are*

leading edge and we are ahead of the competition so that we reach the desired status in that index because it is a positive measure…it helps us reinforce our commitments and our ethical standards and our leading status to our investors". (I20)

In addition, the participants representing auditors group draw attention to the awards that some audit firms and other professional bodies grant to recognise good CRD practices as an incentive for companies to improve their RR quality. I19 states "*The various awards that are out there in the market place…is a good thing of course*". I24 also highlights:

"*One of the things that we do, and this is a very small incentive, we try and recognise companies that do a good job… so we have our Building Public Trust Awards recognising companies that do a good job, and therefore to some extent encouraging the others to try and do a better job is one way that you can go about things*".

Accordingly, introducing a best-practice framework by professional and regulatory bodies as a leading example could work as an incentive for companies to improve CRD quality, gain an advantage over competitors, and reassure investors and maintain their confidence. One of the objectives of this study is to develop a framework for CRD quality which could form a basis of such awards. I27 also demonstrates:

"*Our report and accounts won an award issued for the best report and accounts in the FTSE 100, though I guess that is not specific to our risk section, but I think people think our report and accounts put them in a good place*".

6.4.2.5. Availability of information in the public domain

As discussed before, a key factor that will encourage or compel companies to disclose more RI is the availability of information in the public domain where investors and other stakeholders are already aware of the risks facing the company. Accordingly, companies may respond by providing more information depending on the type of risk and its significance, and the information available to investors to reassure stakeholders and avoid unfavourable consequences. Some participants also refer to risks that companies run on a regular basis and are known to investors who expect companies to report them and at the same time managers are more comfortable to disclose them.

"*they* (companies) *are quite happy to report on things that are currently in the public domain, and of course with the internet now…it is very difficult to keep anything quite so as anything happens can very quickly hit the streets*". (I11)

It is argued that while a company might withhold information related to unsystematic (internal) risks they are expected to disclose systematic risks which all companies are exposed to and stakeholders might be aware of in a more transparent manner. Companies may be more willing

to withhold some RI; sensitive information in particular, if it is not publicly available considering the potential consequences as discussed above.

Participants draw attention to the changes in the business environment and technology that expose companies to more and new risks. They refer to the various information sources that investors can use to gather information on a company's RE. The participants also caution companies against withholding information, and encourage them to provide adequate CRD and consider the information available on different platforms that could be misleading and lead to investor mis-reaction. I12 provides an example of how companies should respond to a major threat through more disclosure:

> "*If you had a data leak that is very high up there in the press on data leaks, would you want to be reporting it? You would be wanting to; you might recognise that you have got vulnerabilities in your infrastructure; you might be doing something about that. So, you may want to report on some of the proactive measures that you have taken to prevent data leak or what is your cyber security programme*".

In addition, participants highlight that investors recognise the fact that companies take and face risks and expect companies to disclose risk-related information. They also point out that investors and investment analysts (sector specialist) in particular will be aware of the key risks an industry sector or company is exposed to. Hence, they argue that withholding or manipulating RI might have some positive impacts in the short-term, but it could have significant negative consequences in the long-term when the information becomes available to investors.

> "*Any sector specialist would know what the five top things are for the industry, and so if the company was not mentioning that they would be sort of looking for these things…but then many would be reading specifically looking for things because of the geography, the sector, the various characteristics of the company*". (I6)

Accordingly, keeping investors informed could help avoid problems relating to investors challenging management, questioning their RM strategies and taking adverse actions. Companies should acknowledge and respond to investors' needs and concerns who have their own risk assessment and risk appetite that they match against the company's assessment and appetite. Accordingly, any inconsistency could raise concerns about the company's risk profile and RM strategy.

6.4.2.6. External assurance

Review and assurance provided by external auditors could be another incentive for companies to provide better quality RI. Participants highlight the role external auditors can play to ensure the informativeness of CRD by challenging management and asking for more disclosure and

clarification. External auditors are in a position where they can access internal company documents including risk register, board and audit/risk committee minutes, and hence they can provide assurance that the key risks discussed internally are disclosed externally.

I9 explains the auditor's responsibility stating "*The auditors have to specifically comment on key risks, and comment on the work around key risks*". I19 emphasises "*we have the audit role…the audit role is important*". I26 also indicates "*Clearly the auditors play a role. We have some form of input into the front-end but it is significantly limited by our responsibilities*". The role of the external auditor is discussed in more detail in the next chapter.

Furthermore, other participants indicate that an independent third-party that can review the company's RM plans and provide assurance that the company has a sound RM system in place could encourage companies to improve their CRD quality. Likewise, disclosing this information is more likely to provide comfort to investors and other stakeholders.

6.4.2.7. CRD guidelines

The majority of the participants demonstrate that, in a voluntary or principles-based standard setting, companies may willingly disclose more RI. Therefore, they demonstrate that introducing some guidelines in the form of good examples or best practices of CRD could be more effective than regulations and enhance CRD quality. These guidelines should be general and appropriate for all companies to avoid producing boilerplate risk disclosures. I9 argues "*offering more voluntary further guidelines is a better approach*". I10 also emphasises "*If an example format, best practice, I think that is going to be really helpful*". Further examples are as follows:

> "*It is quite possible to introduce suggestions on how risk reporting should be done with imaginary examples. This would be useful in our view as far as risk reporting meant, but I think making it mandatory would be a backward step. We need to encourage companies to improve the quality rather than continually pointing out that it is not very helpful*". (I2)

> "*I think guidelines, best practice, the power of peer comparisons so that is all very helpful for getting better quality reporting, feedback from investors talking about what is useful because that is ultimately what the point of the financial statements is to be useful to investors etc., but a very specific regulation is probably not helpful*". (I7)

Participants also suggest that such examples and guidelines have contributed to better quality CRD and could further encourage companies to improve their RR practices. For example, I23 highlights "*We have basically seen improvements over time rather than expecting companies just change overnight. I think they* (FRC) *give quite good examples…quite good points to process and how you would be expected to do things*".

However, I24 claims that the introduction of the revised FRC guidance and revised UK CG Code has led to significant improvements in term of RM and internal controls but with no similar improvement in RR stating "*We really see there is an opportunity for a step change to happen to risk disclosures and we were looking out to see if the 2014 Code would deliver that step change, but it has not done that so far*". Conversely, I24 raises concerns about the effectiveness of guidelines commenting "*I am sceptical about the value of more guidelines*".

The participants also underline the role professional and regulatory bodies can play in enhancing CRD quality through providing guidelines or examples rather than more prescriptive regulations. The FRC places more emphasis on CRD and the participants representing the FRC indicated that they are undertaking a project to develop some best practices to help and encourage companies to disclose more and useful RI.

> "*What we are set out to find is what represents a really good practice in the hopes that others then say oh I did not realise that, I will do it now because now I know it is a good practice. So, I think we have got some more work to do, but it is in positive examples not in new rules and requirements*". (I6)

The next section discusses the role of regulations in more detail.

6.4.3. The role of regulations

6.4.3.1. Introduction

Disclosure regulations and requirements could be seen as one way for improving CRD by obliging companies to disclose more and particular RI. This section explores the role disclosure regulations can play and the disclosure approach; voluntary or mandatory approach, that is more appropriate for improving CRD quality. The section also investigates the impact and effectiveness of disclosure regulations and whether the introduction of more requirements could contribute to better RR and overcome the shortcomings of current CRD practices. Accordingly, the participants were asked about the disclosure approach they support to enhance the informativeness of CRD.

The participants hold different views about the extent to which regulations can be effective in respect of CRD. While a few interviewees call for more regulations, others suggest more guidelines to guide and encourage companies to disclose more RI voluntarily as discussed above. The majority of the participants highlight that the existing regulations are sufficient and do not recommend introducing more regulations.

Another incentive highlighted by the participants either directly or indirectly is that companies may not want to attract the attention of regulators and lawmakers, and therefore comply with the existing regulations or even provide more information on a voluntary basis to avoid the introduction of further regulations and criticism by regulators.

"*Another incentive is the company disclosing the information itself before some regulators makes it a law or requirement. So, if the company provides good disclosure, it looks good, it looks realistic then the regulator is less likely to come out with some accounting standard which says the following things need to be disclosed*". (I2)

6.4.3.2. A mixed view

There is common agreement among the interviewees that in principle CRD should be compulsory, but they disagree on the restrictions imposed by regulations. The interviewees indicate that regulations are still an option to require companies to provide more RI. However, they disagree about the impact regulations could have on CRD quality in particular.

"*Regulators could come out with rules and regulations, and they could say we need this disclosure, and it has to be disclosed in this way. If the company does not provide the disclosure, then they could be asked to provide it*". (I2)

Accordingly, all the participants agree that regulations are important to ensure that companies disclose their risks. For example, I15 states "*they just would not report it unless they are required to by the listing authority*". Likewise, I9 indicates "*If you open it to voluntary, then it would not happen*".

Disclosure regulations and requirements are referred to by some participants as a *negative incentive* where companies have to comply with and are obliged to provide certain information to fulfil their legal responsibility. The consequences of non-compliance should also be considered as companies may be criticised by regulators and asked to provide more information. Therefore, disclosure regulations can play a part in RR, yet their impact on CRD quality is questionable. I28 demonstrates "*The negative incentive that your firm will comply with the law and meet the requirements*". Likewise, I22 refers to the consequences of non-compliance commenting "*There is a sort of negative regulatory incentive. So, if they do not do it and then likely they might get criticised by regulator*".

The above argument emphasises that regulations are not necessarily associated with better CRD quality. Participants highlight that companies may attempt to comply with regulations to avoid the consequences of non-compliance without providing useful RI that meets users' information needs.

"*Not very many people will get praised by regulators, but they will get criticised if the disclosure has not been very precise or is not complete. So, all what you are trying to do is to avoid criticism rather than do it for any positive reason*". (I22)

The majority of the participants are in favour of a principles-based approach to RR where companies are generally required to disclose their principal risks and uncertainties, but at the same time they can exercise some discretion over the level and format of their risk disclosures

considering their own circumstances. They also argue that such approach should lead to better CRD quality.

The participants also emphasise the importance of regulations arguing that companies may be reluctant to disclose particularly sensitive and anti-competitive RI on a voluntary basis. They indicate that regulations are necessary so that companies can provide the minimum level of CRD. They further encourage companies to voluntarily disclose additional useful RI. I4 states "*Regulation is important to make companies report risk on a basic level and to get started*". I9 also argues "*There has to be an element of regulation and enforcement*". I7 explains the role of regulations commenting:

> "*What regulation can do is to provide kind of a safety net…like the minimum level of requirement really, and it is always okay for companies to do more, do things better and do things in a way that works for them. Probably too many companies stick to the regulations and just sort of do exactly what is required, rather than thinking about what is good quality risk disclosure and doing more*".

In addition, participants argue that the existence of some regulations is important to ensure that companies think more about their risks and manage them effectively because they ultimately have to discuss them in their external reports. I23 states "*The only reason we ask companies to report their principal risks is effectively to make them manage those risks and make them think about them*". I27 comments:

> "*Some of the FRC responsibility is really helping with being a requirement that you have to put certain statements in your accounts, and that is really helping people think about the fact that they have to disclose more risk information in their accounts*".

According to the majority of the interviewees, disclosure regulations that generally require companies to report on their principal risks and uncertainties without prescribing further requirements could be more helpful. They oppose overly prescriptive regulations that could lead to unintended consequences as discussed below. I27 states "*I genuinely think that saying anything beyond that would be unhelpful*".

Therefore, a mixture of compulsory and voluntary approaches may give managers some discretion to tailor their CRD to the company's unique circumstances and stakeholders' information needs. The participants highlight that other incentives and company-specific characteristics will also come into play to encourage companies to disclose more RI. They also underline the nature of risk and the subjectivity of risk identification and measurement that makes it necessary to exercise discretion over CRD.

For example, I3 suggests "*There must be some regulations in place, an element of obligation, and at the same time a room for incentives to play their part. It is very difficult to see a completely voluntary or a completely mandatory approach*". Similarly, I4 emphasises:

> "*It is somewhere in between. Inevitably risk reporting will have a voluntary element as long as it has the future in it; as long as qualitative information is there it is going to be voluntary in spite of having the regulation*".

On the other hand, a few participants attribute the lack of CRD quality to the absence of strict regulations and/or limitations of existing regulations. Hence, they call for introducing more regulations that provide prescriptive guidance to assist companies in disclosing their risks to overcome these limitations and enhance CRD quality. They also cast doubts on companies willingly/voluntarily providing RI unless they are required to. However, they raise the question of how to make effective regulations that could improve CRD quality.

> "*They* (companies) *are purposely not making it* (CRD) *informative because the law does not require them to make it informative. It should be a legal requirement…but the problem is could you put it into a law that this risk report should be as informative as possible?*" (I17)

> "*The current regulatory framework should be reformed through primarily identifying users' information needs, assessing existing risk reporting practices to identify the information gap between what investors need and what companies actually provide. Consequently, regulators can introduce regulations to fill the gap*". (I1)

Some participants gave an example of financial companies and banks in particular where specific and prescriptive regulations lead to more risk disclosures. They refer to the different nature of risk disclosures made by financial companies specifically in terms of the volume of CRD. I15 justifies the large amount of CRD made by banks commenting "*Because the regulator requires the three lines of defence model and because of rating agencies' focus on enterprise risk management*". There is still, however, the question as to whether the level of CRD reflects its quality and usefulness.

However, the majority of the participants oppose introducing further regulations and demonstrate that the existing regulations are sufficient. They argue that regulations are needed only to set clear expectations for companies in terms of RR. I27 states "*We have plenty of regulations; we have got plenty of accounting standards*". I23 emphasises "*We have already got sufficient regulations*". Likewise, I8 demonstrates "*Regulations are sufficient and provide enough background for what is needed*".

6.4.3.3. Principles-based vs rules-based approaches

There are two general approaches to disclosure regulations: principles-based approach and rules-based approach, where the former is adopted and advocated in the UK and the latter is

implemented in the USA. Proponents of the UK approach to RR argue that it gives managers more discretion in approaching their CRD in a way that is appropriate for their business and activities. They further emphasise that a rules-based approach ultimately leads to boilerplate RR as discussed below.

In this respect, the participants draw a comparison between the UK and the US regulatory frameworks and the impact of each framework on CRD practices in each respective country. They describe the US approach as a very legislative approach that requires companies to report every single risk a company is exposed to, whereas the UK framework advocates the disclosure of principal risks and uncertainties. The FRC's, UK's independent regulator, approach is basically a principles-based approach that is "based as far as possible on facilitation rather than dictation on principles rather than rules" (FRC, 2014a, p. 3).

The vast majority of the participants support the current UK principles-based approach highlighting that disclosure guidelines and regulations should be general in order to apply to different companies in different circumstances and give managers some discretion to disclose company-specific RI. They also demonstrate that the UK's approach is more effective than the USA's prescriptive approach and has yielded better results in terms of RR. I28 states "*Risk reporting in the UK continues to improve both in terms of the policy and practice*". I6 explains the advantages of the UK approach stating "*The result of what I see in the UK companies is better, and it is twofold, it is pretty focussed on what is significant, and what the mitigation steps are*". Furthermore, I28 comments:

> "*Our* (FRC) *regulatory philosophy was always to hold back from becoming very prescriptive, this is what you should do in this format etc. And that comes back to the point that there is a trait of qualitative characteristics. I think to aim towards actual consistency and kind of template format or uniformity is very likely to detract you from the qualitative characteristics*".

On the other hand, I17 criticises the UK regulatory approach and CRD practices of UK companies. He advocates the US regulatory approach and CRD practices particularly in terms of providing sufficient RI remarking:

> "*The USA style of having much more informative long risk report is useful for people who are prepared to put the time into reading it, but it is also the wording of the risk report…It* (CRD) *is not so informative in the UK. In the UK it seems a fairly short and very formulaic what you get in there. So, it is as if the regulator has said these are the subheadings that you need in your risk section, and this is what they are going through, so it is very similar. What they are putting there in the US is much, much more thicker at least, and it is much more detailed is what you get to see. So, looking at the annual report of (X company), for*

> *example, it is 10 or 20 pages of risks. So, if you are reading that in detail you will very rapidly get a good understanding of how their business of fracking for oil and gas goes on*".

The participants representing the annual report preparers group do not support a prescriptive mandatory approach. They highlight that disclosure requirements should ensure flexibility and take account of company-specific characteristics. They also emphasise that companies should tailor their risk disclosures in light of their own circumstances. I20 indicates "*I do not think that all the industries that report to the stock market are in such a similar position that it would be very straightforward to simply offer prescriptive guidelines as an incentive for us*". Similarly, I27 highlights "*Coming up with a framework is very tricky that making sure that it can be flexible enough so lots of different companies can use it*".

Participants further argue that prescriptive disclosure rules ultimately lead companies to disclosing generic RI that is not useful for information users as they attempt to comply with regulations as discussed below. They also indicate that companies can adapt to regulations and find a way to comply with them whilst avoiding disclosing sensitive information. I25 points out "*I do not think more regulation in itself is a way to improve risk management*". I23 also addresses the risk of imposing prescriptive regulations demonstrating:

> "*I think you run the risk that you are forcing everybody into one way of doing things and that is not necessarily terribly helpful, and you run the risk that you are actually going to lose information rather than gaining it. The more specific you are the less likely you are going to actually get something that is going to tell you about the relevant company*".

Participants indicate that companies will always seek to maintain a balance between sharing a reasonable amount of RI publicly and meeting mandatory disclosure requirements. In doing so they consult with their legal counsellor/lawyer to maintain this balance and comply with regulations, meanwhile not necessarily reporting sensitive information that could increase their RE.

> "*The stock market rules and regulations as well come into play about how much information you can share about that, how we balance it we take advice from our legal counsellor, from our corporate secretariat, from our communications teams. We hope to balance sharing the right amount of information, sharing sufficient information but also making sure that we do not breach legal issues or that we do not expose ourselves to anticompetitive or stock market regulatory sort of requirements*". (I20)

In addition, participants place more emphasis on the impact of the above-discussed incentives and disincentives on the level and usefulness of CRD as they cast doubt on the effectiveness of regulations. They recommend that regulators should consider these incentives and disincentives, and encourage companies to disclose more RI by highlighting the benefits of CRD and the consequences of non-disclosure. The principles-based approach is also perceived to be more

helpful because investors can then assess management's credibility and transparency in addressing risks as they match their own risk assessment with the information a company discloses.

The interviewees emphasise that introducing more regulations should not be the first or only option and highlight the impact of incentives in terms of the perceived advantages of CRD and disadvantages of reticence around RE. I25 states "*I do not support less regulation; I just do not support regulation as the step that is going to necessarily improve risk reporting and risk management*". So, disclosure incentives such as market and investors' pressure should be allowed to play their part as well. I4 comments "*It is up to the investors to push the companies to report more if they want to get that information not the government doing it*". Moreover, I6 emphasises "*We need to let the market mechanisms work a bit rather than from a regulatory standard-setting standpoint require more*". I5 also contends a prescriptive approach remarking:

> "*The most important thing is that managers realise that this is important information for investors and investors have got to now stress to managers that they want to know about risks as far as that is possible. I think a voluntary approach is the only realistic one*".

6.4.3.4. The problems of prescriptive regulations

The majority of the interviewees are mainly against a prescriptive compulsory (rules-based) approach. They, for a number of reasons, emphasise the negative consequences associated with introducing more and strict disclosure requirements. First, more regulations may not necessarily contribute to better CRD, which is the ultimate objective. Rather, regulations could result in poor CRD quality particularly in terms of boilerplate and generic RI. For example, I11 states "*I could say legislation, but I do not think legislation will because whenever legislation comes in what tends to happen is that you come back to boilerplates*".

Furthermore, the participants point to risks associated with imposing more disclosure requirements. I24 highlights "*There is always a danger in issuing more guidelines*". Participants further argue that a very prescriptive regulatory approach to RR is highly likely to detract from the quality of RI. They demonstrate that it may achieve high consistency and uniformity in respect of comparability across companies but at the expense of information quality. I20 states "*I support a compulsory approach, but I do not think that it should be so prescriptive. So, I do not think a compulsory submission that meets a very detailed or rigorous guideline is appropriate*". I19 comments:

> "*My personal view is that hard regulations around disclosure ultimately tend to lead to poor disclosure. As soon as you start saying risk disclosure must include this, this, this and this at a quite granular level… you will be moving to a very compliance-driven space that ultimately detracts from the disclosures rather than improves them*".

Companies could react to more regulations by disclosing the minimum amount of RI to meet the regulatory requirements without necessarily providing useful information. Moreover, regulations that impose a lot of restrictions may discourage companies from disclosing more RI on a voluntary basis and ultimately lead to "tick-box" approach. I25 demonstrates that companies "*are more creative, they would find ways around. I just do not support regulation as the step that is going to necessarily improve risk reporting and risk management*". Similarly, I12 remarks:

> "*If you got on a compulsory route I think it becomes a bit of a tick box exercise, and people will do it because they have to do it, and they will find ways of working around what they do not want to report, and they will get quite clever. They will not be giving transparent information. They will be looking more about we do not really want to report this but how do we put the best spin on it. So, we are not lying, but not enough that we really telling the true story. I think it becomes a risk in itself*".

Likewise, I2 highlights "*Making it required by some sort of regulations is a possibility, but probably is not good for proper risk reporting. It would reduce the quality and possibly, possibly companies would just report the bear minimum*". I11 also emphasises "*As soon as you get it compulsory you will get boilerplate. So, if I say you must you will but you will do the minimum*".

Second, regulations should consider the differences among companies and ensure flexibility. Managers should be given some discretion to tailor their risk disclosures considering the nature and circumstance of their businesses. Accordingly, regulations should be general and flexible in order to apply to different companies. Therefore, the majority of the participants support a principles-based approach. The interviewees also argue that regulations have failed to improve CRD practices. Some participants call for more clarity in regulations as well. The examples below explain why a principles-based approach is more appropriate for CRD.

> "*You need to maintain an element of flexibility primarily because actually the risks will be different for different entities, and if you increase regulation around that I think what you will find is a move towards more boilerplate. So, you will move away from information which is useful to the information which is more comparable potentially across entities, but actually therefore less useful*". (I26)

> "*I do not support a prescriptive mandatory approach. So, I think to try and come up with several rules that you have to follow on a mandatory basis is the wrong track to be going done because it will genuinely be impossible to achieve that in every set of circumstances. So, I think we do have to take a principles-based approach of the sort that we have currently got and we have to encourage companies to do the right thing*". (I24)

Third, the judgmental and subjectivity nature of risk makes it a difficult area to regulate and make disclosure requirements prescriptive. Managers have to make judgements particularly related to identifying and assessing key risks. Therefore, more regulations may not overcome the limitations of existing CRD practices. This difficulty is also associated with defining and assessing risk by companies in one hand, and setting regulations to require companies to disclose complete and accurate RI on the other hand. I17 emphasises this difficulty demonstrating "*You cannot write a law saying make your risk disclosure informative*". I7 also comments:

> "*It is very unlikely to identify what really needs to be reported. So, it will increase the burden on companies, and it probably means that they will do what is required by the regulation rather than really think about what will be useful for people. The trouble for regulations in turn when it comes to risk reporting is risks are so wide, so varied*".

Fourth, there are a number of other problems that cannot be resolved by imposing more disclosure requirements. These issues are related to internal RM practices within companies including the effectiveness of RM systems and plans and the ethics and behaviours of managers and employees (risk culture). This also highlights the role of internal incentives in improving RR practices. So, better CRD starts with building a proper risk culture and transparency within the company and an effective risk governance and management framework. I25 highlights this stating:

> "*Volumes and volumes of regulations do not get to the root of the problem, which is behaviours and ethics and values and culture and that cannot be put into a regulation unfortunately. It would be nice if you could just run a company where everybody was ethical, and had good values, and did the right thing*".

Accordingly, there is a balance that needs to be maintained between laying down disclosure requirements and the company's own incentives and culture. Furthermore, there should be some realistic expectations and considerations of the impact of regulations.

> "*If companies are not very good at assessing risk and so their disclosures are not very good, there is no point saying make your disclosures better. You have actually got to give them the opportunity to think about it in more depth so that once they have done that and they have actually got their processes and risk management sorted out the good disclosures will follow on from that. This is about just running a company well, then making sure that the disclosure reflects that*". (I23)

6.4.3.5. Regulatory pressure

The interviewees demonstrate that the problem is the lack of adherence by companies with existing regulations and argue that this lack of adherence could be overcome through more

regulatory pressures, not more regulations, on companies to ensure transparency about their RE. I26 demonstrates "*I am happy with the current regulatory framework albeit companies do not necessarily always adhere to it particularly well. I think there is a question there for what the regulator should be doing*".

The participants suggest that regulators exert more pressure on companies as an alternative to introducing more regulations by reviewing and evaluating companies' risk disclosures and asking them to provide more and transparent information accordingly. They indicate that such a regulatory pressure could have a positive impact on CRD quality than simply setting new disclosure requirements. They also recommend ranking companies according to their RR practices.

Likewise, some participants indicate that regulatory pressures have already contributed to improving CRD quality. They attribute the improvement in CRD practices in the UK partly to the regulatory pressures where companies have to respond to regulators and oversight bodies' comments by disclosing more information. However, a CRD quality framework is needed to assess and improve CRD quality. I26 argues "*in the last few years partly as a result of the regulatory pressure here in the UK you will see companies start to address some of those concerns*". Participants emphasise the effectiveness of regulatory and investors' pressure and its impact on CRD quality as follows:

> "*Some companies are still listing risks in a very boilerplate way…not making them probably bespoke to the company and what it is doing…but I think that is disappearing as the regulators crack down on it because regulators have been very firm as they are trying to make companies do more. UK regulator does look at the narrative reporting, does comment on it, will say things to companies, and if they believe the company has done something really bad they will make them do something about it and make them restate it, but as so far it has worked reasonably well*". (I23)

> "*I will be a much bigger fan of a collaborative approach with the regulator. I would love the regulator, for example, and shareholders to be very vocal about here is some really good examples of risk disclosure, here is what we find it useful, and then to use that approach as an encouragement for the rest of the market to achieve that practice*". (I22)

In addition, I24 explains how the FRC exercises pressure on companies and its impact on narrative reporting including RR practices commenting:

> "*The FRC has called for its Reporting Review Team; the guys who look at annual reports, are looking far more seriously at the front half of the annual report than they have done in the past and asking questions if they do not think that the risk reporting is up to scratch. So, I think there already is some pressure being exerted from the FRC and that will have an impact most definitely. If the FRC starts rating companies on a broad base making that kind*

> *of comment, then there will be a reassessment of principal risk disclosures, there is no question about that*".

There need to be a panel and a set of criteria to examine CRD practices against. For example, the Conduct Committee of the FRC supported by the Corporate Reporting Review Committee through the Financial Reporting Review Panel undertake reviews of the accounts and annual reports of large companies to ensure the quality of corporate disclosure in general in the UK. They highlight and acknowledge areas of improvement and identify areas of concern and non-compliance, take actions and provide suggestions for improving corporate disclosure quality. Although their responsibility implicitly involves reviewing CRD, it could be further extended to review and provide some feedback on CRD quality and informativeness.

> "*If there is a review panel which says to companies sorry you have not disclosed this information correctly please redisclose it…I suppose that would be an incentive for companies to disclose it properly first time if the regulator is going to be tough with companies on this*". (I2)

Regulations could be introduced to address some areas of concern that have not been considered before and missing disclosures. This comprises long-term risks, as indicated by some participants, such as global warming, climate change, water scarcity, resources exhausting, Brexit and other sustainability issues facing companies operating in particular sectors such as oil and gas, mining and coal industries. Some participants recommend that regulatory bodies place more emphasis on these aspects that may have detrimental impact on company performance. Disclosure regulations should also be updated and improved to address any changes in the business environment and meet users' information needs. I28 emphasises "*Policymakers should keep improving disclosure requirements; not necessarily introducing more*".

I20 also suggests that "*greater clarity in the regulations could perhaps simplify the reporting that we do*". I13 addresses an aspect not covered by current regulations remarking "*The regulation does not really require companies to think about the very long term, and if companies have a choice between talking about risks and not talking about risks they generally choose not to talk about them*". Furthermore, I16 suggests introducing a globally accepted accounting standard for RR arguing:

> "*The only incentive is the accounting policy incentive that I think accountants and risk people together have to define in policy terms standards. We want an equivalent IFRS for risk so that all institutions report their risk using standard techniques that are reported in a standard way*".

In addition, participants argue that introducing a legal protection or a safe harbour provision that protects management and companies against potential litigation for disclosing certain information could be effective in improving CRD quality. Managers may have concerns about

the disclosure of sensitive, anti-competitive and forward-looking RI that could expose companies and managers to litigation risks resulting from legal actions taken by investors against the company.

> "*The legal protection situation, so they feel it is better to have mentioned that fact that there is a risk even if you do not say anything very meaningful about it than to remain completely silent about it. Remaining completely silent it feels as like it is a very risky thing to do*". (I24)

> "*If companies knew that they could disclose the information and they wouldn't necessarily get into trouble or there would not be consequences if that information turned out to be wrong, so like the safe harbour provisions, then that would make them a bit more confident about their disclosure*". (I2)

The participants also draw attention to the legal protection provided by regulations, for example, the safe harbour provision in UK Companies Act 2006 regarding the disclosure of forward-looking information. Such a provision provides the legal protection for managers and companies and could mitigate their concerns about disclosing forward-looking RI in particular. Thus, companies should consider this as an incentive to provide high quality RI. A major concern regarding the safe harbour provision that may discourage companies from using this provision is that, according to I24, "*it has not been tested before in the courts in the UK*". I24 further highlights:

> "*They* (companies) *have got that protection as things are done. I think we tell them about it, then I think most of them realise that they have got protection more than maybe they could realise that because it is relatively new, it was only in the Companies Act 2006*".

Nevertheless, some participants raise some doubts about the extent to which this provision can contribute to better and more forward-looking RR. For example, I2 states the safe harbour provision is "*a possible incentive, but whether it has much impact in practice I am not sure*". Likewise, I4 indicates:

> "*We actually talk about the safe harbour provision and it is already there anyway for companies. So, I think it is not going to make a big difference to what companies are reporting at the moment, but it may be a safety net for companies that are concerned about any legal implications down the line*".

6.5. Conclusion

This chapter addresses the third research question. The chapter develops an understanding of managers' CRD decisions and behaviours. The chapter explores the different factors that might improve or undermine CRD quality and could help explain current CRD practices and suggest a way to improve RR quality.

The results reveal a number of factors that may discourage companies from reporting more and quality RI including the inherent uncertainty of risk and subjectivity of risk assessment, ongoing internal investigations and unresolved legal issues, potential misinterpretation CRD leading investor mis-reaction, and managers' personal incentives. The major disincentive for CRD is the sensitivity of RI that may increase the company's RE or lead to a loss of a competitive advantage. However, it should be noted that the participants do not suggest that companies withhold RI because of its sensitivity. Rather, they encourage companies to ensure transparency about their RE to avoid any potential unfavourable consequences of lack of CRD.

On the other hand, the findings show a number of incentives and benefits of better CRD that may encourage companies to improve their RR practices. These incentives can be divided into internal and external incentives. Internal incentives comprise financial incentives (for example, lower cost of capital), signalling effective RM practices, the existence of a proper risk culture, and good CG practices. External incentives encompass investors' feedback, investors and market reaction and pressure, peer pressure, recognition of good CRD practices, and the availability of information in the public domain.

The role of regulations was also discussed. The results show a greater tendency towards a rules-based approach where companies are generally required to disclose their RE, but at the same time managers can exercise discretion in disclosing their key risks considering the company's circumstances. Regulatory pressure instead of detailed regulations can also be effective as regulators review companies' RR and ask them to disclose more and meaningful RI. The findings also suggest the need for greater guidance and, therefore, developing a CRD quality framework is immensely important to provide such guidance. Therefore, the next chapter continues the analysis to discuss CRD quality and characteristics in more detail and suggest a CRD quality framework.

Chapter 7: Risk reporting quality: A stakeholder's perspective

7.1. Introduction

This chapter answers the fourth and fifth research questions respectively: What is quality and what are the characteristics associated with good quality CRD, and how can the FASB qualitative characteristics be operationalised to create a CRD quality framework and how can CRD quality be further improved to correspond with the framework?

Considering the relative lack of research on CRD quality and its particular importance to investors as discussed previously, this chapter addresses CRD quality from the perspective of stakeholders. The chapter defines quality from a multi-stakeholder perspective in the context of CRD and investigates the characteristics of quality/useful risk information (RI). The chapter also considers users' RI needs and management concerns about providing sensitive and forward-looking RI as discussed in the previous two chapters to develop a best practice framework for CRD quality that can be used to improve CRD practices.

In doing so, the chapter operationalises the FASB qualitative characteristics considering the unique context of risk and CRD. The chapter explores how companies can satisfy each of these characteristics when reporting on their risk exposure (RE) and hence meet users' information needs. Accordingly, the analysis in this chapter will be used to further inform and improve the initial framework developed in chapter 3.

7.2. CRD quality: A conceptual analysis

This section explores the views of the different participants regarding the concept of CRD quality to reach a broad consensus on its definition. The definition of quality of risk-related information and what it involves is challenging and problematic considering the nature and sensitivity of RI, however, it is particularly important as a starting point for developing a framework for CRD quality.

Beyer et al. (2010) emphasise the absence of a practical definition of disclosure quality, and further indicate that a measure of disclosure quality should be based on such a definition. Therefore, there is a need for an in-depth look into CRD quality in terms of its concept and characteristics through the eyes of the relevant stakeholders.

In addition, clear and unanimous definitions of risk and quality are necessary properly examine and assess CRD quality and usefulness to information users. Beattie, McInnes and Fearnley (2004) note that "researchers investigating the determinants and consequences of disclosure

quality could be wasting their effort if the primary variable of interest is not being measured with a sufficient degree of accuracy" (p. 233).

Such definitions are also needed so that companies can identify, measure, manage and ultimately report on risk properly whilst meeting users' information needs. Otherwise, the drawbacks of CRD practices and the information gap between investors and managers regarding investors' needs and expectations and RI currently being disclosed will persist.

7.2.1. Definition of CRD quality: A decision-usefulness approach

It was generally difficult to reach a consensus definition for quality in terms of CRD among the different participants. However, the responses centred around the decision-usefulness aspect of risk disclosures to information users. Participants acknowledge the difficulty of assessing CRD quality due to the lack of both a unified definition and comprehensive measure of quality among researchers and stakeholders in general.

Generally, the participants define CRD quality as providing adequate information on risks that could influence and enhance information users' ability to make better-informed decisions and assess managers' stewardship, although often participants provided some characteristics of quality disclosure instead of a specific definition of what quality means. A number of terms were mentioned by the interviewees as synonyms for quality including *informativeness*, *succinctness*, *usefulness*, *honesty*, *granularity*, *transparency*, *bespoke* and *frankness*.

Notably, there was significant discussion whether useful RI should ultimately be considered of high quality and vice versa. For example, I2 states "*Information which is useful is likely to be of higher quality*", and I7 comments "*If it is quality information it needs to be useful, and that is useful for any audience, it could be decision-useful for investors*". I19 also explains why usefulness and quality are synonyms stating:

> "*Usefulness, because it has got to be connected to the decision-making. Quality ties into the ability of the reader to understand the risk involved in the business going forward and can make rational decision based on that information. It heightens decision-making*".

On the other hand, some participants representing academics group made a distinction between the two terms arguing that quality is a more comprehensive term than usefulness. Thus, I1 states "*Usefulness is one dimension of quality*", and likewise, I4 argues "*If the management is making a prediction about the future performance of the company that would be useful, it is not necessarily quality information in my opinion*".

Participants highlighted particular aspects of quality as they gave a definition of CRD quality such as specificity, materiality (magnitude of risk in terms of its impact and likelihood of occurrence), and forward-looking nature of RI. They further emphasised the disclosure of sufficient and specific information that enables information users to gain an understanding of

the relevant company's RE, the impact of risk on achieving its strategic objectives, and how risks are being handled rather than generic RI, which appears to be their major concern as discussed in Chapter 5.

For example, I18 suggests that risks "*should be prioritised, so the one that would have the biggest impact on future performance should be first, it should be company-specific*". I8 also indicates that RI "*needs to be specific to the company and it needs to provide enough information for the stakeholders*".

The participants' responses were influenced by their approach to the concept of risk as discussed in Chapter 5. Whereas some participants call for focusing on disclosing downside risks, others advocate reporting both upside and downside risks. For example, according to I5, quality CRD "*has got to be business-specific information which is capable to affect my view of the prospect of the company, reflecting the potential downside is much more important than reflecting the opportunities*". Whilst I23 defines quality as honesty and transparency about both upside and downside risks stating:

> "*Something that is very clear and succinct that spells things out properly in terms of what the overall impacts will be, so not trying to hide anything and be quite open about what the positives and negatives will be, and then also beyond that what the company is actually doing about the risk*".

The participants underlined the importance for quality of disclosing forward-looking RI and information about the company's approach to risk management (RM) and mitigation. They further point out that such information should provide further reassurance to investors about the company's RE and RM strategies so that they can assess its risk position and future prospects. I20 states that CRD should "*provide an appropriate level of assurance as to how those risks are being managed*". I9 also highlights the importance of "*setting out management approach to mitigating those risks*".

Quality and usefulness may not be two completely synonymous terms in the context of CRD; however, usefulness could, according to the interviewees, be the more appropriate word to reflect the essence of quality in this context. This view also conforms to the FASB's conceptual framework which emphasises the decision-usefulness of financial information. The FASB indicates that quality disclosure should meet the information needs of the main users of corporate reporting. Therefore, the FASB uses the term usefulness instead of quality. Accordingly, it seems appropriate to conclude that we should understand that CRD quality means providing information on company's potential threats (downside risks) and opportunities (upside risks) that are material and specific to its business and could have either major negative or positive impacts on its future performance and the achievement of its business strategy.

In the discussion below, CRD quality is addressed in more detail in light of the FASB qualitative characteristics in order to develop a framework for CRD quality. This further discussion is important for just as quality may be difficult to define so is usefulness. In particular, usefulness also raises further questions because the degree of CRD usefulness may vary from one stakeholder to another as RI that is useful for one stakeholder may not necessarily be useful for another: "*usefulness is a characteristic, but again what would we mean by usefulness is a bit debatable. It is a bit dangerous because what is useful for one person may not be useful for someone else*" (I2). Thus, companies may need to consider these differences when disclosing their risks in order to meet the information needs of different users

7.3. Operationalisation of CRD quality characteristics

The next sections focus on contextualising (defining) and operationalising the FASB qualitative characteristics in terms of risk reporting (RR). These are both the fundamental characteristics of relevance and faithful representation, and the enhancing characteristics of comparability, verifiability, timeliness and understandability.

There was agreement "*The most appropriate method for approaching risk reporting quality is the FASB qualitative characteristics*" (I1). Likewise, I4 comments "*When I think of quality from an accounting point of view I would point to the qualitative characteristics of information*". However, the interviewees acknowledged the difficulty of meeting some of the FASB qualitative characteristics when reporting RI considering its inherent sensitivity and uncertainty. They also recognised that some characteristics are more relevant than others and indicated that some of these characteristics are inherently subjective and judgmental. Consequently, this draws the attention to the need for the FASB and other professional and regulatory bodies to adapt the FASB characteristics and develop a set of appropriate characteristics for CRD.

The participants emphasise that CRD quality is predominantly a combination of all these characteristics. For example, specific and quantitative RI may be useless if not disclosed in a timely and understandable manner. The FASB places more emphasis on the fundamental characteristics, but it also suggests that the enhancing characteristics can further improve the usefulness of corporate reporting.

7.4. Relevance

This section and the following sub-sections explore and operationalise relevance in terms of CRD. Relevance, according to the FASB (2010), is defined as providing information that "may be capable of making a difference in a decision even if some users choose not to take advantage of it or already are aware of it from other sources" (p. 17).

The participants identified three main aspects (sub-characteristics) of relevance to ensure this characteristic so that RI is capable of influencing users' decisions: specificity, forward-looking

orientation, and quantification and description of risks. Accordingly, they generally define relevance as the disclosure of information on the company's RE to both upside and downside risks to help information users assess the impact of risks on company's value, performance and future prospects. Therefore, RI in itself is not the ultimate gaol.

7.4.1. Specificity of CRD

A major limitation of current CRD practices highlighted by the interviewees as discussed in Chapter 5 is the disclosure of generic and boilerplate RI that is unhelpful for investors in assessing the relevant company's risk profile and exposure. For example, I8 indicates that relevance means "*actually relevant to that individual business not just some generic that has been taken from another set of accounts*", and I24 emphasises that CRD should be "*directly relevant to the circumstances of the particular company*".

Therefore, the participants place a particular importance on providing RI that is specific to the company's own circumstances including its business model and strategy, the nature of the business activities it undertakes, and the industry and market in which it operates. Some participants sum up CRD quality in one word: specificity. I22 emphasises specificity of CRD stating "*Good risk disclosure should be very specific and tailored. So, it should focus on which risks are most critical to the achievement of strategic objectives*".

Participants also emphasise the disclosure of RM processes and plans that the company has in place to manage and mitigate its risks to assess the impact of risk on company's ability to achieve its strategic objectives. Furthermore, they suggest that companies disclose information on how risk has changed over time. I25 demonstrates that CRD should address the following questions to ensure and enhance its relevance:

> "*What is the risk? What is the set of sub-risks related to that risk? What is the specific impact on our company? What is the context? Is the landscape changing? So, do you see that risk changing? And specifically, what are you doing to mitigate each of those areas? And what is your overall governance of risk management in that area*?"

The participants suggest that an important aspect of CRD specificity concerns reporting on company's risk appetite. Risk appetite is one of the key areas omitted in the prior CRD literature despite its importance in giving investors an indication of the amount of risk a company is taking or willing to accept, so that they can match it with its actual risk profile and their own risk appetites.

According to the interviewees, for investors to assess the company's ability to achieve its strategic plans and objectives, this can be achieved through linking a company's risk appetite to the its business model and strategy, and highlighting the risks attached to achieving its strategy. I19 comments "*If you do not know the risks that have been faced by the business model and the*

strategy, and you do not know the organisation's appetite to risk then you are effectively putting your money into a black hole". Thus, disclosing the company's risk appetite and tolerance in light of its business mode and strategy should enhance CRD specificity.

The participants recognise that defining company's risk appetite is challenging considering it can change over time, and the responses call for updating information users about any significant changes in company's RE and risk appetite over time. They, therefore, suggest that the company regularly reviews, reassesses and provides up to date information on its risk appetite. I24 comments "*Your appetite for a risk increases when you see more returns*".

The participants also acknowledge and emphasise the difficulty of measuring and disclosing a company's risk appetite with I16 highlighting this difficulty arguing "*There is no measurement system for risk appetite in any institution on this planet*". I20 demonstrates "*The appetite is an important area, but it is very difficult to explain*".

The participants representing annual report (AR) preparers group highlight that they currently address risk appetite in very broad terms in their corporate reporting. Some of these participants indicate they disclose their appetite for each individual risk rather than an overall risk appetite statement. Others indicate that risk appetite could be implicitly understood by reading through the first half of the AR that is written in general terms to indicate whether the company has a high or low appetite for a particular risk, which risks it is willing to take and/or accept and which risks it avoids. Therefore, disclosure practices in this respect vary across companies and the participants indicate that there is room for further improvement in this area in particular.

> "*A major focus of our efforts is to be able to drive greater clarity about what the risk appetite for each of those principal risks is…Through the chairman statement, through the CEO statement there will be an explanation about how we want to operate, which essentially is describing in broad terms our risk appetite, and then for our principal risks we look to explain our appetite for that risk...to help explain more clearly what that acceptable level is essentially, what the appetite of the organisation is*". (I20)

> "*There is a page in the risk management section which really sets out what our risk appetite is. The risks we prefer is how we describe it, and it is just a few paragraphs, but it can give you an insight into it. We like credit risk because we believe we have the expertise to manage it, we take major amounts of life insurance risk. We are seeking more market risk; we have a limited appetite for interest rate risk or an exchange risk and inflation risk*". (I27)

Therefore, the participants contend that companies should attempt to explain their risk appetite in general and qualitative terms to ensure simplicity and avoid anti-competitive effects "*as for some of these* (risks) *it is very complicated to explain an appetite other than in a very general way*" (I20). They also emphasise that it should be communicated in clear and concise language to reassure investors which may require "*giving a simple example because somebody who*

knows nothing about risk understands what you are talking about" (I11). This may require directors to refer to other company-specific characteristics such as company size and industry sector that affect the disclosure of risk appetite. The responses also highlight that an individual company can have different "*risk appetite for different risk(s)*" (I15), and these different appetites will need explaining in the risk factor section.

The participants also refer to the differences among companies; financial and non-financial companies, in terms of reporting on their risk appetites. Some participants attribute these differences to regulations and highlight the role regulations can play in this respect. These differences are also related to company-specific characteristics including its business model and strategy and RM capabilities.

> "*We are restricted by the UK Governance Code explications to provide a statement of our risk appetite. Elsewhere they are more explicit, so in the financial service industries where there is an obligation to do so, but in our industry we do not have that obligation. So, our risk appetite that is available or presented there is pretty broad*". (I25)

Accordingly, disclosing risk appetite is important so that investors can identify whether the company is operating within its stated risk appetite and tolerance as well as match their risk appetite against the company's risk appetite and make their decisions accordingly. For example, I6 states "*It is pretty important for the investor to know both the risk appetite and management*".

7.4.2. Quantitative vs qualitative CRD

7.4.2.1. Quantitative CRD

According to the FASB (2010) relevant information should have "predictive value, confirmatory value, or both" (p. 17), and, according to the participants, in terms of CRD relevance is concerned with predicting company's future performance whereas risk is a key indicator.

The participants were asked whether quantitative or qualitative RI is more relevant for decision-making. The interviewees had mixed views about which type of information is more appropriate. Some participants call for more quantitative RI to be provided and this is consistent with prior literature. Other participants place more value on qualitative risk disclosures taking account of the nature of risk as discussed in the next section.

The participants stating that risks should be quantified indicate it is necessary so that stakeholders can evaluate the company's RE based on the risks that are material to its business and are more likely to transpire in the future. They also highlight the importance to investors in particular in understanding a company's RE and making informed decisions.

"*The quantification in terms of potential numerical impact or range of numerical impact, but also the likelihood that the risk is going to transpire into an actual action. I need those two things really to be able to assess whether it is relevant*". (I7)

The participants who support more quantitative CRD argue that it is inherently more company-specific and, hence, more useful and relevant than qualitative information. They demonstrate that some risks are easier to assess and quantify than others in terms of their impact and probability of occurrence such as financial risks. They also acknowledge the difficulty of assessing the impact of some other risks particularly reputational risk and the risk of retaining key people.

Some participants further argue that without quantitative information on risk, CRD may become useless and irrelevant. I16 emphasises that CRD "*must be quantitative*". I19 indicates that CRD quality could be improved by attaching some numbers to risks arguing "*To get 10 out of 10 is to put some numbers around it. So…saying a 10% falling of oil price would impact our margin by X that sort of thing*". I17 also highlights the importance of quantitative CRD commenting "*If…there are no figures of possible risk or possible cost or probability of that happening that is not of use to me*".

Likewise, the interviewees recommend that such quantification/description of risk should take account of RM actions to calculate the net/residual risk arguing that this information should be helpful in evaluating the company's risk exposure over time and compare the risk profiles of different companies. This can also help information users evaluate the company's RM system. I16 states "*For a stakeholder it must be quantitative because they must have the ability to compare what is the residual risk of this institution versus that institution, how much risk this institution is accepting in aggregate*".

The participants highlight the inherent difficulties of quantifying RI and for this reason some state there may be a need for some assurance on quantitative information by a third-party independent body (external auditor/advisor) to ensure it is "a*ccurate and…auditable*" (I16). Moreover, they suggest considering qualitative disclosure as an alternative that could be helpful for investors to gain an understanding of the company's RE and particularly risks that are difficult to predict and measure.

"*Anything that is quantified is likely to be more useful than qualitative information…There is a lot of things that you cannot quantify, and there are a lot of things which are qualitative and fantastically important. So, I do not want to dismiss qualitative information comp*letely". (I5)

However, other participants refute the above argument and argue that companies already produce and have this information internally, and hence should be trusted to disclose it. Thus,

they recommend companies provide their best estimates of the impact and probability of risks where it is extremely difficult to measure a particular risk. As I17 suggests, companies:

> "*need to give their best guess because if they do not, then I am in no position to say what the probabilities are of the risks facing the butchery's industry in the north of England over the next five years. If there are estimates to be made then they need to be making them and putting them in there. They are the best one to judge*".

Likewise, I7 argues that companies:

> "*must have it because how they made the assessment. I do not really understand why they would not give a number because it is about putting it in context, and companies think that if they do not give the information it gives them some flexibility and it does not, it just adds extra questions*".

Participants also raise concerns about how companies can reveal quantitative RI in a more informative manner for the average stakeholder. For example, I5 refers to the issue of understandability stating "*People may find it difficult to understand because it requires specialist knowledge of what numbers mean, and perhaps also of a particular market to understand what the data refer to*". Participant I27 goes further contending that:

> "*It is just very hard to communicate it in a way that is well-understood by all of your stakeholders. It is quite hard to do the quantitative stuff without creating a massive book full of all numbers, and I think that is why you end up talking in qualitative language*".

Hence, this may suggest that qualitative information is needed in addition to quantitative information, and the next section discusses qualitative aspects of CRD.

7.4.2.2. Qualitative CRD

The vast majority of the participants are in favour of more qualitative RI being provided than at present and that there needs to be a mixture of qualitative and quantitative RI. This is unlike previous studies, which have almost always argued that it is more quantitative CRD that is needed without including any discussion of tendency towards an increased preference for qualitative CRD. It is both academics and practitioner participants calling for the disclosure of more qualitative information on risks, arguing that narrative CRD could be more appropriate and useful than quantitative CRD considering the inherent uncertainty and forward-looking nature of risk.

The participants demonstrate that providing quantitative RI is not necessarily more useful due to the inherent uncertainty of risk and the judgmental nature of its measurement. For example, I10 argues "*A qualitative description would be more valuable*". Likewise, I6 demonstrates:

"*Quantification does not make it more relevant. It just gives some scalability as to whether I need to pay attention or not to this issue explaining how risk has affected current performance. So even that actually may be difficult to quantify because you are making a judgment of attributing risk result*".

Furthermore, the interviewees demonstrate that the type of CRD in terms of quantitative or qualitative information depends largely on company's characteristics, its business model and strategy, and the type of risks it is facing. They consider the nature of business activities undertaken by the company that exposes it to particular risks. Some participants, therefore, suggest combining both quantitative and qualitative disclosures. They also emphasise that how risks are described and presented qualitatively determines CRD quality. I25 states "*when you cannot just report quantitative information you can try and create the algorithm that converts qualitative information into quantitative information*". I23 also remarks:

"*For some companies it is the qualitative side of thing that is more important, and the way that risks are described is just as important in terms of in words as it is the quantitative side of things, but again it depends on the kind of risks that are being faced*".

The participants discussed a number of reasons for supporting more qualitative CRD. First, the difficulty of assessing future risks makes it difficult to disclose risks in quantitative terms due to their inherent uncertainty. This uncertainty becomes even higher when it comes to measuring particular risks such as operational risks, reputational risks, and the risk of key people leaving the company. Likewise, long-term risks are extremely difficult to assess and disclose quantitatively. I24 points out "*It gets very difficult to do quantitative reporting if you are going into long-term really that really starts to be very much a very broad estimate*". However, this difficulty should not hinder companies from disclosing their risks. Therefore, qualitative CRD could provide an insight into the company's RE.

The participants encourage companies and information users to pay attention to qualitative CRD. They recommend companies to utilise qualitative CRD to address risks that are difficult to assess to reassure investors and avoid potential unfavourable consequences of non-disclosure. Investors are also encouraged to read and consider such disclosures when making their decisions. Qualitative RI could also enhance CRD quality by putting quantitative RI into the context of the respective company's business model and strategy.

"*Qualitative should not be underestimated; just because you cannot measure the potential impact on future performance of some risks, actually it does not interfere that they should not report it. In fact, it may be even more important to mention it even though they cannot measure it*". (I18)

Moreover, attaching numbers to future risks might be misleading and/or unrealistic considering their uncertainty and subjectivity. Hence, providing a qualitative description of risk, its potential impact and how the company is handling it could be more meaningful.

> "*The quantitative impact can vary, and it could actually be misleading so that is quite difficult to convey in quantitative way. So, I think you need to understand the risk, and you cannot understand it just from a number you need perhaps a qualitative description would be more valuable*". (I10)

Therefore, the participants suggest that companies provide their best estimate or a qualitative description of future risks that enables investors to assess the trend in risk to show whether it is increasing or decreasing and the company's plan to manage it. They argue that in such cases companies have no option but to address risks in broad terms. The participants do not completely dismiss the importance of quantitative CRD. They highlight that qualitative CRD is an alternative to quantitative CRD rather than completely withholding RI. Accordingly, they suggest combining both types of information depending on the circumstances and type of risk.

Some participants also recommend using scenario-based analysis and disclosure to report on long-term risks in particular, and address the possible outcomes of risk and what the company is doing to handle risk in each scenario. I28 demonstrates "*If there is a situation where you cannot quantify, although the quantification would be useful, but the point is that you are talking about the future outcomes that you cannot really quantify, qualitative assessments are as necessary as quantitative*". Sensitivity analysis can also be used to disclose risks particularly financial risks. I15 states "*What you would typically do for financial risks is to disclose what the impact of the 20% falling equity markets would be, what the impact of people living one year longer*".

Institutional investors are long-term oriented, and hence are interested in risks that could affect the sustainability of the business. They also acknowledge the challenge of assessing long-term risks, but they are interested in learning about what the future holds for the business in general. Such information gives investors some reassurance about the business prospects and how well it is managed. Therefore, they suggest using a scenario-based disclosure where companies can address their long-term risks and what they are doing to manage them in broad terms.

> "*If you are talking about what is going to happen in ten years' time, then we understand that it can be scenario-based…We understand it is not a precise science, but if you can talk about scenarios and how the risk is manged in those scenarios, then that is also really helpful*". (I13)

There is also a danger associated with disclosing imprecise quantitative RI that could raise more questions than providing answers and lead to further risks. Therefore, this is where using both quantitative and qualitative disclosures could be more helpful to companies and information users. I22 indicates "*Both are important…In my experience there are lots of areas where people*

just cannot find a good way to measure a risk and in which case they have got to give a good qualitative description".

Second, the inherent subjectivity associated with the assessment of future risks is another reason why qualitative CRD may be more appropriate. Risk assessment is highly judgmental and ultimately depends on management's view of key risks and their potential impact. This subjectivity and uncertainty may discourage companies from providing quantitative RI considering its potential implications. I26 comments "*You could provide precise information if you wanted to, the only thing you could say for certain is that would be wrong*". Thus, there is a preference for more qualitative CRD that gives managers discretion in addressing future and long-term risks.

> "*Those estimates are getting to be quite a bit of a guess. I think companies may be reluctant to do that, they may feel they are exposing themselves by saying well this is a 70% chance of this and the loss would be 20 billion or whatever. Quantifiable would be nice yes, but perhaps it is a bit unrealistic*". (I2)

Combining both quantitative and qualitative CRD could also improve the understandability of RI by providing more information on the assumptions underlying risk assessment.

> *"…quantitative is always subjective because it is very difficult to quantify the cost of risk…Qualitative but equally with quantitative you can hopefully see how they have got to that quantification. I would prefer qualitative because given the qualitative nature I can then explore it in my way of judgement*". (I11)

The participants further highlight that qualitative CRD should not be underestimated by both AR preparers and information users. Some participants rather place more emphasis on qualitative CRD.

> "*ultimately when you are assessing risks I think it is a qualitative judgement…You are deluding yourself if you think that just having quantitative information is actually going be telling everything that you want to know…You think about things that have not happened before*". (I5)

Third, the sensitivity and anti-competitiveness potential inherent in providing quantitative RI may represent a major concern for companies. Companies may be more reluctant to attach numbers to their future risks that could be commercially sensitive and increase their RE. I20 highlights "*We are not mature enough for that*". There are also litigation risks that companies may face because of revealing such information depending on how risks transpire in the future. Therefore, managers may be more inclined to disclose qualitative RI.

> "*I personally would go for the information rather than trying to put numbers on it. I think they will be reluctant to that and also it can open their company out up to all sorts of*

questions. So, I think it would be better just to provide the realistic description of the risks which face the company rather than putting those numbers". (I2)

"*If you start putting quantitative numbers on risk it may be commercially sensitive. You could run into the risk of putting out profit forecast which you should not be making. So, this is the scenario that people are going to be very careful about, and it is a lot easier to talk in more general terms than getting very specific around some of the risks*". (I8)

Furthermore, quantitative CRD represents a commitment of the company to monitor, reassess, manage and report on risk on a regular basis considering the changing nature of some risk. Accordingly, companies should revisit these disclosures and disclose information on how risks have changed overtime. I24 states "*When you start to give quantitative disclosures, then you are really committing yourself to over the long-term talking about how those quantitative disclosures are working on*".

Based on the previous discussion, the majority of the participants suggest managing the balance between providing quantitative and qualitative RI to enhance CRD quality whereas each type of information serves a different purpose. Therefore, while quantitative CRD may be more specific, qualitative CRD further enhances this specificity by linking quantitative RI to the company's business model and strategy. Likewise, using both types of information can help overcome the limitations of each type. While qualitative information may be hard to verify, quantitative information could be commercially sensitive. I4 indicates "*It is very difficult to faithfully represent qualitative information*". The FASB also emphasises the combination of words and numbers in representing a particular phenomenon so that it is faithfully represented.

I19 states "*It is a combination of both. I need the detail to give it colour so I can understand what it is telling me*". I8 also argues "Both are equally as important". Moreover, I21 comments:

"*I do like quantitative, but I think that you need some qualitative information to frame it… we are dealing with boards etc. a lot of that is qualitative, it is understanding what is the direction the board wants to go in, what are the chairman's attitude and approaches, what their background history is instead of how to put that into a number*".

Furthermore, qualitative information may be more appropriate to address some aspects such as the company's business model and strategy so that information users can understand and evaluate the risks attached to the achievement of its business objectives. The quality of qualitative RI depends on its presentation format and the language used as discussed later in this chapter. Likewise, the nature of CRD; qualitative or quantitative, is influenced by the type of risk and the business activities the company undertakes.

"*You want to provide information that allows others to make their own assessments, and that would make a quality of understanding the business and what it is doing, and the risks*

to which it is exposed. So, I think to equate using a number with accuracy and specificity is not appropriate link to make". (I28)

Likewise, qualitative RR could sometimes convey more information that cannot be communicated in quantitative terms. They can be used to give further reassurance on the RM processes and plans in place. Therefore, qualitative RI could further enhance investors' understanding and strengthen their confidence.

"*I would include in qualitative information things like information about your risk management, governance processes and the steps that you take to make sure that if you are Apple you do not suddenly get overtaken by a competitor…So that is risk you cannot guarantee the success, but you can talk abo*ut". (I24)

7.4.3. Time orientation of CRD: Forward-looking vs past CRD

This section investigates the relative importance of future and past RI. The FASB highlights the role of disclosure in helping information users make judgements about the company's future performance. Therefore, the FASB emphasises the importance of both future and past information in assessing a company's future prospects.

The FASB (2010) states that "financial information is capable of making a difference in decisions if it has predictive value, confirmatory value, or both" (p. 17). Accordingly, in the context of CRD relevant information should enable information users to assess the company's future RE based on both forward-looking and historical CRD. However, RI is different from financial information where attaching a value to risk is problematic as discussed earlier.

The responses reveal that relevance means providing information on company's exposure to either downside or upside risks. CRD should indicate the potential impact of risks on company's performance, financial position, and future prospects. The participants held mixed views on this aspect of relevance. Whereas the vast majority of the interviewees place more emphasis on future RI and call for more forward-looking CRD, some participants support the disclosure of past RI as well.

7.4.3.1. Forward-looking CRD

The FASB (2010) emphasises the particular importance of forward-looking information in reaching a conclusion about the firm's future performance. The FASB (2010) indicates that "financial information need not be a prediction or forecast to have predictive value" (p. 17). The FASB explains that information does not necessarily have to be a "predictive value" in itself, but it could rather be used by users to make predictions about future company performance.

The participants generally underline the significance of forward-looking RI. They indicate that information users are more interested in company's exposure to future risks that could affect its

profitability, growth and performance, and hence its ability to achieve its strategic objectives. They draw attention to one of the shortcomings of existing CRD practices regarding the lack of forward-looking RI. Information users also need some reassurance about the company's RE and RM plans to evaluate their own RE. Likewise, companies spend a great deal of their time and resources to identify, assess, monitor and manage potential significant risks.

> "*The risks that you want to know about are the future risks…which is far more important than companies are too focused on actually…One of the problems of the risk disclosures…is that they are about the here and now as opposed to the future*". (I24)

The participants' view is influenced by their perception of risk as predominantly uncertainty or volatility of future outcomes. Some participants claim that past risks are no longer relevant or considered as risks but rather business events that have already transpired and call for focusing on managing future and emerging risks that could threaten the achievement of the company's strategic objectives. For example, I27 states "*We focus most of our attention on future risks*". I18 argues "*Obviously future risk, we know the past that is not a risk…I regard the past as known knowns*". I10 also comments "*The past is the past that is already in the share price, that has already happened. I am more concerned about what this company is going to do in the future*".

The participants encourage companies to disclose more forward-looking RI to reassure investors about the sustainability of its business and the effectiveness of its RM system. Investors can use future RI to evaluate management performance based on the company's exposure to future risks and how they are being managed. I28 argues "*The fact that you are exposed to them* (risks) *today tells you something about the management today because…the way the company is being managed has created that exposure*". Participants also suggest that companies provide more information on the trend in risk over a time horizon. I23 remarks "*Where companies can be quite helpful is to put time horizons on some of the risks, so how far ahead they are looking in terms of what might happen*".

Companies should also focus their attention on current and ongoing risks in addition to future risks. The participants representing AR preparers group demonstrate that their key responsibility revolves around managing ongoing and future risks effectively to ensure continuity and growth of their company. I11 states "*The important thing is about reporting on present risks and potential future*". I20 indicates "*My job is helping the organisation manage the risk of today and the future more effectively*". Likewise, I22 highlights "*I think of risk as being the future-looking concept. Risk is whether something is going to be achieved, whether a target is going to be met in the future*".

In addition, some participants particularly investment analysts underline the importance of reporting on long-term risks and sustainability issues and their potential impact on the

survivability of the company. This depends on the nature of their investment and the companies they are investing in. For example, I13 emphasises:

> "*We are investing in the company for a long time. So, we want to think about what does the future hold for this company…Companies should think more about long-term risks, regulators should think more about long-term risks when they are designing a policy, and investors as well*".

I24 confirms the above view stating "*I agree with investors who say I want to hear about long-term risks. So, if you are BP and Shell I want to hear how are you going to make this business sustainable over the 30, 40, 50 years*". Likewise, I5 comments "*What matters even more are the long-term risks*".

Meanwhile, the participants acknowledge the difficulty of assessing and disclosing future risks. They, therefore, call for setting reasonable expectations in this respect. They also encourage companies to give their best estimate and/or a clear description of future risks, their potential impact and the plans in place to manage them. I26 states "*It is now impossible to sit in a particular business and say ok well the risks facing me in the future are going to be A, B and C*".

7.4.3.2. Past CRD

The FASB (2010) argues that "financial information has confirmatory value if it provides feedback (confirms or changes) about previous evaluations" (p. 17). The FASB emphasises the importance of historical information in addition to future information. Similarly, some participants suggest combining historical and forward-looking RI arguing that both types of information should help managers and information users improve their assessment of the company's RE. They recognise the particular importance of forward-looking RI whilst not dismissing historical risk disclosures.

Historical RI is an indicative of how risks have developed over time, and hence satisfies the confirmatory aspect of relevance indicated by the FASB. It is particularly important in providing reassurance to investors about the company's key risks and how they have been managed. Accordingly, investors may depend on past RI to understand a company's future RE. Moreover, companies can also highlight the effectiveness of their RM plans and gain investors' confidence by disclosing historical RI.

The FASB also demonstrates that "the predictive value and confirmatory value of financial information are interrelated" (p. 17). This view is consistent with the above argument about disclosing both future and historical RI. The participants recommend addressing past risks previously identified in terms of how they have changed, how they have been handled, and their

actual impact. They also suggest highlighting risks that are no longer considered material and ongoing risks that may continue to have impact on company's future performance.

Each type of disclosure; future and historical RI, serves a different purpose as explained above. The interviewees emphasise that the type of disclosure depends on the nature of risk and the degree of its seriousness. Both types of RI also complement each other particularly in the case of ongoing risks where companies need to explain the development of risk over time. For example, I25 states "*They are equally important. There are different purposes for different risks, different types and times*". Some participants also refer to particular circumstances where companies should provide more information on past risks that have had significant impact on the company and may still be detrimental to its future. I21 highlights this commenting "*If you do have a company that has serious legacy issues then they need to sort that first before they can move on. It could be a mixture of both*".

The responses also underline the need for past risk disclosures to assess the company's ability to meet its strategic objectives. Participants argue that investors can predict a company's performance and the change in its risk appetite through understanding its past RE and how it is managing risks. I15 states "*Past risks give you a view as to how the future may develop because you do not know what the future is*". I8 also emphasises "*Actually you can only understand the future risks if you understand what has happened in the past*".

The participants do not suggest addressing both types of information in isolation and argue that past risks have implications for the future. Whereas they recognise the particular importance of forward-looking RI, they indicate that past risk disclosures also show the change in company's risk appetite and exposure over time. They demonstrate that managers can use past CRD to explain any changes in the company's RE or volatility of its performance and its business environment in general.

> "*It has got to be a combination, as they can only base their estimation of the seriousness of future risks on the things that they know are going on now and/or bad things that happened to them in the past*". (I17)

> "*They are both important. You have got to know what your current exposures are. You have got to have a reliable source of complete and relevant and high quality historic data. You have got to have a basis in order to make predictions of probability and severity*". (I16)

Accordingly, the participants suggest that companies firstly address their past estimates of risks and how they turned out to be in order to confirm or disconfirm those estimates and indicate their impact considering RM actions. They point out that such disclosure is important for understanding how the business is well managed and its future prospects, and hence maintaining investors' trust and confidence. Companies can then discuss their future risks in terms of

ongoing and new risks. Hence, information users can predict a company's RE and evaluate the effectiveness of its RM processes and plans.

> "*It would be an interesting exercise for companies to look at what risks were identified five years ago, and to report on what has happened to those over the past five years, did those risks materialise, what happened if they did materialise, and what the company has done about them? And it would be I think interesting to investors to get a feeling for how good the company is actually working out what the risks are over a period of time, but also how the risks to their business have changed over a period of years*". (I5)

> "*If they provide information on what they said the past risks were, and then which risks actually transpired, and how those risks were dealt with, and what happened in practice so that the user of the information can see how things went on*". (I2)

I4 has a rather different view considering past RI more valuable because it can be verified. However, he is in favour of combining future and past RI commenting:

> "*I will attach perhaps more importance to the past ones at this stage so that it can be verified…I would like to see some kind of discussion on what historical risk was, but also based on the current information where is that risk going in the future*".

7.5. Faithful representation

This section and the subsequent sub-sections discuss and operationalise faithful representation in the context of RR. According to the FASB (2010), faithfully represented information should be complete, neutral and free from error. The FASB emphasises that economic events and transactions should be disclosed in both quantitative and qualitative terms so that they are faithfully represented.

The participants demonstrate that CRD should be fair, balanced and understandable to faithfully represent the company's RE. They indicate that faithful representation is an important characteristic to ensure CRD quality and reassure investors. However, they acknowledge the challenge of meeting this characteristic because of the uncertainty and subjectivity of risk and risk assessment.

For example, I5 states "*It is very difficult to do it in practice… because the assessment of risk is a subjective business*". Likewise, the FASB recognises the difficulty of completely satisfying this characteristic, but it encourages companies to strive to further improve the faithful representation of financial information. The sub-sections below look into the three aspects of faithful representation.

7.5.1. Completeness

Completeness, according to the FASB, means disclosing "all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations" (p. 18). The FASB stresses the importance of measuring the relevant phenomenon and disclosing quantitative information. It also recommends providing a description of the nature of the business transaction, the factors that might affect it, and how it was measured. Hence, the FASB advocates combining quantitative and qualitative information to enhance and ensure the faithful representation of information.

However, in terms of CRD and considering the fact that companies take and are exposed to various risks the participants present a different argument. They argue that completeness does not mean that companies should report every single risk they are exposed to. They further highlight that attempting to disclose all risks will affect CRD quality.

The participants also refer to the information overload resulting from disclosing all risks that may distract information users from focusing on the company's key risks and detract from CRD quality. They indicate that information users can gain a better understanding of the company's RE by disclosing its principal risks that could have a major impact on its performance and the achievement of its business strategy. Therefore, they define completeness of CRD as the disclosure of principal risks facing the company with a sufficient description of each individual risk regarding its impact and how it is being managed.

The participants emphasise that companies should draw the line between material and immaterial risks considering the nature of their business and activities. For example, I13 states that completeness "*does not mean everything because then it would have an enormous report*". Likewise, I28 indicates "*Completeness never means everything…because in that way you are just detracting from the information quality*".

The participants recommend both companies and investors to approach and perceive completeness in the same way by focusing on risks that could have a significant impact on company performance. Some participants indicate that companies may disclose generic risk information to satisfy completeness and avoid being criticised for not disclosing particular information.

> "*People have got to understand that it is complete only in the sense of a complete list of major risks not a complete list of all risks…but if you do not disclose these very important generic risks then you are not meeting that test of completeness which is why I think I have actually got sympathy with companies disclosing these generic risks*". (I5)

The responses further underline that companies should not conceal any risk that could have a major impact on company performance and may influence investors' decisions due to its

commercial sensitivity or anti-competitiveness. The majority of the participants demonstrate that companies should only disclose their key risks and uncertainties and suggest omitting immaterial risks. For example, I22 comments "*You should not miss out any big risks that might be important for investors to understand*". I9 suggests that companies ensure "*listing all the key risks to the business and you are not leaving areas out that you do not want readers to make decisions on*".

Some participants argue that disclosing all risks could detract company's attention from focusing on managing and mitigating the most critical risks. However, the responses refer to the difficulty of managing the balance between meeting completeness and giving investors a full picture of the company's RE due to the judgment that management has to make regarding its principal risks.

> "*Completeness means that you do not leave stuff out just because it is potentially damaging to the company…there is a difficult balance again to be here and this significant management judgement around what are the principal risks because clearly you would not want to repeat the entire risk register in a company's annual report, and management need to help investors understand what the principal risks are*". (I26)

The participants also draw attention to ensuring specificity and relevance of CRD whilst meeting the completeness aspect by focusing on company-specific risks. I24 points out "*Completeness in the sense of complete and relevant to the particular circumstances, reporting your principal risks*".

Conversely, I1 calls for reporting all the risks facing a company arguing that RI is of particular importance to information users. I1 states "*Focusing on key risks will be bias…companies should disclose all systematic and unsystematic risks they are exposed to and how they are being managed*".

7.5.1.1. Materiality

The FASB defines materiality stating "information is material if omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity" (p. 17). The FASB considers the significance of the relevant activity or transaction on company's financial position in determining its materiality. This definition is consistent with the participants' view of materiality in the context of CRD as discussed below. Therefore, companies should focus on disclosing risks that are most relevant and specific to their business model and strategy.

Materiality is considered an important aspect of completeness in the context of RR as highlighted by the participants. Materiality revolves around the impact of risk on company performance and users' decisions. So CRD should include all material risks that are most

relevant to information users and could have a significant impact on company's performance. Consequently, companies may not be expected to disclose risks that could have a material impact but with a very low probability of occurrence and vice versa, but it might be worth mentioning them to reassure investors about their impact and likelihood. For example, I8 and I19 define material risks as "*Those that keep you awake at night*".

A material risk is a risk with a potentially significant impact and high probability of occurrence that could prevent the company from achieving its strategic objectives. Therefore, risks should also be company-specific as discussed previously. It is worth noting that the participants focus predominantly on downside risks and their potential negative impact as they address materiality. For example, a material risk is defined by I25 as "*Anything that can have a significant adverse or material impact on the company*". The responses highlight that companies are exposed to many risks that they should prioritise them in terms of their impact and likelihood of occurrence and disclose the most significant ones. I20 states "*We have thousands of risks that we identify and raise everyday around the organisation*".

Likewise, I21 indicates "*What I am looking at are social and environmental externalities that could have a material financial impact on the bottom line of a company*". I27 suggests reporting "*key risks which are the ones that could really cause damage to the company*". Similarly, I22 defines a principal risk as "*A risk that if it crystallises could cause the company to not meet its strategic objectives*".

In addition, I15 defines materiality from a company's point of view stating "*We would not report everything because we are a big company. We would not report anything that has less than a £100 million impact on our balance sheet or our profit*".

Materiality from the perspective of information users is any information that could influence their decisions whether the information is disclosed or undisclosed. This is also interrelated with the relevance characteristic as discussed earlier. I18 states "*I would like to know about anything that might have a material impact, but at least it has to be prioritised*". I10 comments "*You should be reporting risks to the extent they might affect someone's decision to invest in a company*". I19 also demonstrates "*If the disclosure around this risk was omitted it would impact the decisions made by readers*".

It can be noted that the interviewees place particular emphasis on the downside risks and their impact on the successful implementation of the business strategy regardless of their prior definition of risk as discussed in Chapter 5. So even the participants who perceive risk as both upside and downside outcomes focus only on the negative impact of risk as they address materiality. Hence, the participants define material risk as a function of its significant negative impact and likelihood of occurrence that may not necessarily be consistent with their perception

of risk, and understandably so, since they are more concerned about business failure. However, it can be assumed that materiality encompasses both key threats and opportunities.

For example, I26 indicates that materiality "*needs to be a balance between those two: likelihood of occurrence and significance of the impact on performance where it to occurs*". I5 also suggest considering "*the materiality of the risk in terms of if things actually go wrong, how serious would it be for business. The other aspect is how likely is this thing actually to go wrong*".

Some participants approach materiality from a slightly different perspective. They are more concerned with how companies address their key risks and manage them to an acceptable level. Therefore, they suggest that companies describe all the material risks they are exposed to due to the nature of their business activities and how they are mitigating their impact to match their risk appetite. They also consider RM activities and how effective they are in minimising any potential negative impact of a risk, and hence call for reporting material risks in terms of their net/residual impact. I24 recommends disclosing "*the net impact of magnitude and likelihood, the residual principal risk to the organisation*". Likewise, I20 comments:

> "*We describe risk areas that we are exposed to, the impact and the likelihoods we are manging to an acceptable level, and what we are doing here is helping our investors understand the risks that we are exposed to and…reassure them and confirm to them we are managing those effectively. Plus, to include risks with high likelihood and high impact I do not see a place for that in the annual reports because…they are risks that we would want to be addressing and bring them down to a lower state essentially*".

Regulations generally do not oblige companies to disclose a particular number of risks. They require companies to disclose their principal risks and uncertainties. Disclosure regulations in the UK, for example, give managers discretion to identify and report their key risks depending on the nature of their business and the sector and market they operate in to ensure the relevance of CRD.

Nevertheless, a number of participants suggest disclosing a number of the most significant risks facing the company that represent a major concern for managers. They argue that it could help focus managers' attention on managing their key risks and ensure RI understandability. I2 states "*The list should be comprehensive and properly described, but not so many risks as to confuse the reader*". Participants further indicate that a company cannot be exposed to or capable of handling a large number of principal risks. For example, I10 demonstrates "*Top ten risks that is going to be more useful than 20 you have got and not described very well*".

I11 also suggests disclosing risks "*that are on the board's top ten. In my opinion, at a board level you cannot really address more than ten to fifteen risks. If you had more than that there is too much to focus on".* I20 comments "*We describe our ten principal risks, and we describe*

how we manage those risks which include explaining the impacts and likelihoods of events that might cause those risks to manifest. This specific number is appropriate for us".

In addition, completeness also means providing sufficient or complete information on each key risk. Companies should provide a clear and understandable description of every key risk in terms of its impact, probability of occurrence, and how it is being managed. I8 defines completeness as "*giving sufficient information that allows users of the financial statements to understand what the risk is*". I7 also states:

> "*Completeness of how it has described the individual risk rather than completeness across the risks…What you should not ever have is a complete list of risks. In the context of external reporting we are talking about our principal risks…So what complete means am I telling the whole story for those individual risks*".

Every company maintains a record of its risks in the form of a risk register listing all the risks it faces. Consequently, managers have to make a judgement regarding their key risks considering the circumstances of their business and disclose them accordingly. This judgement can be challenging given the uncertainty attached to risk. I4 points out "*It is difficult to faithfully represent the future*". I10 emphasises "*You have to draw a cut off and say there is a level of materiality*". The FASB also acknowledges this issue stating that "the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation" (p. 17). Therefore, a judgement has to be made regarding each individual risk.

The participants argue that risks that are discussed within the company at the board level can be deemed the most significant risks that should be disclosed externally. They further recommend that companies determine their top risks based on impact and likelihood, and after accounting for the RM actions taken to mitigate risks resulting in post-control risk.

> "*A major risk is something that is potentially going to change the view of somebody looking at the organisation, but it is one that management are focusing on because they see its criticality to the success of the organisation or potential criticality to its failure*". (I23)

The participants further refer to the difficulty of faithfully representing forward-looking information due to the inherent uncertainty and subjectivity associated with identifying and measuring risks. I2 emphasises "*We would expect the list of risks to be complete, now we won't be able to assess that until the following year when we see what actually happened in practice...It is only complete at a moment*". I19 also states:

> "*There is obviously a judgment ought to be made here because you cannot and I think you should not list every risk…but if you determine that these ten risks are your significant risks, then you have got to report the ten*".

There are differences among companies regarding their risk profile, appetite and exposure due to the nature of their activities, and hence their key risks are different. Therefore, each company should identify its key risks according to its business model and strategy and risk appetite. Companies should not withhold any principal risk, yet it is difficult to verify unless assurance is provided by an independent third-party as discussed below.

7.5.2. Neutrality and freedom from error

The FASB (2010) states "A neutral depiction is without bias in the selection or presentation of financial information" (p. 18). The FASB emphasises that disclosure should not be prejudiced or manipulated to influence investors' reaction to or perception of certain information. However, the FASB highlights that neutral information should still be capable of influencing users' decisions.

In addition, FASB states that "free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process" (p. 18). The FASB explains that it does not, however, mean that the information is completely accurate particularly when addressing future events and disclosing forward-looking information that is inherently uncertain. The FASB further argues that future information can be faithfully represented by providing a clear description of the estimate and how it has been calculated, selecting and using an appropriate process without errors, and describing the nature and limitations of the process that could affect the estimate.

In the context of CRD, the participants address neutrality and freedom from error together arguing that the two sub-characteristics are closely interrelated. They generally emphasise that RI should be fair, balanced and understandable. I19 states "*When you talk about neutral I am immediately thinking of things like fair, balanced and understandable*". They also highlight that CRD should be free from material errors that could influence investors' decisions, and present the company's factual RE without manipulation of RI.

The participants underline the particular importance of meeting these two sub-characteristics and draw attention to the potential adverse impacts of manipulating RI to give a false picture of a company's risk position. I28 demonstrates that CRD "*should be free from material error*". I7 addresses neutrality and freedom from error stating "*The information that is reported is correct, you are not spinning it, and neutral you are presenting the facts as they are, not as you would like them to be*". I19 argues "*Free from error has to be read as free from material error where erroneous information would impact the decisions made by users*".

Furthermore, the participants highlight that management should focus on reporting key risks both upside and downside and explain their impact on company's performance. Hence, companies should disclose significant threats or opportunities that are critical to the failure or

success of the business without understating threats or overestimating opportunities to ensure RI neutrality. I19 remarks "*Let's not put all our eggs in the nice sexy opportunity basket, but talk about the ones that are really worrying as well*". I19 further wonders:

> "*Why was the one* (risk) *that we spent 90% of our board time is the one that just got one and half lines in the annual report, and the ones that did not get any board time got five paragraphs? Does the disclosure really reflect not just what the risk is but the seriousness of the risk and potential impact of the risk?*"

However, ensuring neutrality and freedom from error in RR is problematic considering the inherent nature of risk where also some judgement regarding the impact and likelihood of risk is inevitable. Another issue is the qualitative nature of CRD that makes it more difficult to ensure and verify these two sub-characteristics. Therefore, the interviewees emphasise that CRD should be worded carefully without misleading information. Accordingly, it is difficult for companies to disclose completely neutral and free from error RI because it ultimately represents management's view of a company's RE.

> "*It* (CRD) *is more of a judgmental area. The neutral point is applicable in the way that the wording is outlining the way that risk disclosure is laid out. You do not want to necessarily be persuading people this is a less or more of a risk. You just want to lay out the details and the facts behind it and the approach that has been taken by management*". (I9)

The participants share the FASB's position regarding the inherent difficulty of faithfully representing forward-looking and qualitative RI and underline the subjectivity of management in approaching risk. They argue that managers are inherently biased in their identification and assessment of risk. I4 states "*It is very difficult to faithfully represent qualitative information*". I5 also indicates "*it is very difficult to do it in practice…because the assessment of risk is a subjective business*". I18 strongly argues "*It* (CRD) *is never going to because managements are not free from bias*".

Therefore, some participants do not place more importance on these two sub-characteristics as they cast doubt on the possibility of meeting them in practice. I2 comments "*Free from error is very difficult to say about something that will happen in the future*". Similarly, I4 demonstrates "*Free from error part is difficult. It is difficult to be neutral also when you are giving an opinion about the future*". Likewise, I3 emphasises "*I would never say neutrality is one of the criteria. It is incredibly difficult for risk information to be free from error given the nature of risk*".

Neutrality of CRD is also related to the participants' perception of risk as discussed in chapter 5 that should also be taken into account. Participants call for considering the tone of CRD and managing the balance between disclosing downside and upside risks to present a fair and balanced picture of principal risks rather than focusing on upside risks or manipulating information on downside risks. Likewise, neutrality is associated with the company's approach

to risk and its risk appetite that should be disclosed in a clear manner as discussed in chapter 5. I17 states "*I am looking for honest chief executives who will tell me the bad news if there is bad news*". I26 also emphasises "*Neutrality means not painting them* (risks) *either with overly positive or overly negative view, but actually just painting them as management sees it*".

Moreover, participants underline the way management perceives risks and the need for adopting a comprehensive definition of risk and addressing both upside and downside risks without bias. I1 highlights "*There should be a balance between good and bad news*". I9 suggests "*Giving a fair and balanced view of the positive and negative sides of risks and the implications of the risks*".

While the participants recognise the subjectivity associated with RM and RR they encourage managers to be neutral in addressing risks and their impact. Participants also recommend that companies consider users' information needs particularly individual investors in ensuring these two sub-characteristics and CRD quality in general. I10 defines neutrality as "*The management trying to put any dispassionate view, trying to be objective about the risk. They need to try and put themselves in the investor's shoes as well*". Similarly, I23 comments:

> "*I do not really want to see management disclosing a risk that they are not thinking about, they are not dealing with…they do not downplay the down side, but they do not up-play the upside either. They give a rational and reasonable view to what that risk consists of and what they are doing about it, so they are not being biased in their description of it*".

Some participants refer to other challenges related to management concerns about providing particular RI that could affect company's performance as discussed in chapter 6. They argue that these disincentives could discourage managements from satisfying the neutrality and freedom from error aspects considering the potential unfavourable consequences of reporting certain information, and hence they may tend to manipulate or withhold such information.

> "*By reporting the risk, you might expose yourself to the risk. So, I guess they are going to be perhaps a little bit biased in that….but again I think neutrality, unbiasedness is quite a big thing to ask in risk*". (I2)

7.5.2.1. Suggestions for improving neutrality and freedom from error

Some participants argue that neutrality and freedom from error could be ensured to some extent. For example, I19 states "*I do not think neutrality is difficult to achieve*". They suggest a number of factors that could enhance these two sub-characteristics. First, reviewing the risk factor section by an external auditor and/or an independent third-party could provide further assurance and improve the faithful representation of CRD.

Participants emphasise the role external auditors can play in this respect considering the fact that auditors have access to company's internal documents including risk register, board and

audit/risk committee minutes. Thus, external auditors can assure information users that external CRD reflects company's actual risk position and risks discussed internally, and is consistent with their overall knowledge of the company's performance and financial position. I10 states CRD is "*one of the areas where I think the auditor's opinion will be particularly valuable*".

Accordingly, auditor's opinion should give further reassurance not only about these two sub-characteristics but also about CRD quality in general. External auditors can also ensure that material risks that managers are most concerned about are disclosed to investors and no significant risk has been omitted. Consequently, this kind of assurance could enhance users' reliance on RI and reduce information asymmetry. I18 emphasises auditors' role in "*making sure that what is set out by the management is not out of line with what they have discovered in the course of the audit*". Similarly, I10 remarks "*The auditors have a valuable perspective that helps make sure you are telling the truth, not being too biased*". I20 also highlights "*external auditor has an important role with the audit and risk committee chair to help provide that independent external view*".

The participants further underline the pivotal role of external auditors in challenging management regarding external CRD practices and ensuring that RI is faithfully represented. Thus, auditors can ask managers to disclose more or certain RI and provide further clarification; otherwise, they can report their findings in their audit report. Therefore, the auditor's role and responsibility in terms of CRD should be communicated to information users to reassure them and enhance their confidence.

The participants representing external auditors group demonstrate that their responsibility involves reading narrative disclosures including CRD and ensuring that they are in line with the information presented in the financial statements. For example, I22 states "*If I found anything in my audit process that would cause me to disagree with the directors' assertion that the accounts give fair balanced and understandable view then I would need to report it*".

I26 explains the auditor's role as follows:

> "*External auditors could review the risk register, the board minutes and description of risks which will give them some insight into were those risks actually the ones that management talked about. Equally, if the timing of the reporting internally was different from the timing of the reporting externally you would be able to make some comments as to the objectivity with which those disclosures have been produced, and to the extent that we become aware of anything that is inconsistent with our work we do have a reporting requirement*".

Although participants indicate that external auditors read narrative disclosures to ensure that they are consistent with the financial statements, some participants argue that CRD is not properly audited and auditors' responsibility is insufficient to ensure that it faithfully represents a company's RE. They indicate that auditors are not required to audit CRD and therefore

recommend extending auditors' responsibility so that their opinion can cover CRD. They justify this by arguing that the annual report cannot be understood in isolation from narrative disclosures and CRD in particular.

> "*As external auditors, we do not audit the risk disclosures, but we will have read the risk registers, board minutes, audit committee paper, and we will have talked obviously to management and audit committee and perhaps risk committee people…and we would report if the risk disclosures were inconsistent with our knowledge. Let us say half a hundred pages is not subject to any external assurance, which I think is a bizarre thing*". (I19)

Therefore, participants call for regulatory reforms to reinforce and expand external auditor's responsibility regarding CRD. They suggest that regulatory bodies such as the International Auditing and Assurance Standards Board introduce a framework or a standard to assist auditors in reviewing and providing assurance on CRD. I26 states:

> "*Our framework of auditing standards is very much based around the financial statements, and so we do not have a readily available framework to be able to…provide a level of assurance that the market as a whole would generally understand*".

However, I26 refers to the recent regulatory changes in the UK in terms of the auditor's responsibility and expects some improvement in the future regarding the assurance provided on narrative disclosures in general.

In addition, participants raise concerns about the extent to which external auditors can contribute to ensuring CRD quality. They indicate that auditor's opinion is also a subjective judgement considering the nature of risk and CRD. The participants argue that while external auditors can examine internal documents and match internal RI with external CRD, they may still be unable to review and provide assurance about the RM systems that produce this information. They further emphasise that auditors are not in a position to challenge managers regarding their identification and assessment of key risks as they may not be as fully aware as managers of the risks facing the company. I11 also states "*the judgement as to the risks to the business must rest with the board…because it is very difficult unless you know the business*". Furthermore, I19 comments:

> "*What it does not get at is if the process for assessing these risks is robust in the first place, because we would not test that. We would test to the extent we understand the process, we would not comment on whether that is a good process or a bad process…that will be missing from an assurance perspective*". (I19)

Participants also emphasise that external auditors may lack the knowledge and expertise to be able to examine risk management processes. They further highlight that auditing CRD is more difficult in the absence of an accounting standard. Some participants argue that external audit

could rather have negative implications for CRD quality because CRD should reflect managers' perspective on the key risks facing the company. I26 states "*I do not think they* (auditors) *would ever be in a position to certify that it was objective*". I5 also confirms "*I do not think there is a way of objectively verifying what key risks are because I think ultimately that is a subjective judgement*". Further examples are as follows:

> "*It is management's view of risk that is important, that it is supposed to be portrayed, and I think if you were trying to audit that it would just start to take that away. Auditors would actually move to a more boilerplate*". (I23)

> "*Auditors really struggle. I do not think audit has necessarily grown relative to the way concentrations of risk have increased exponentially. It is very difficult for an auditor to audit something where there are not standards. So, I am very sceptical about external auditors' ability to effectively audit risk given the general state of things*". (I16)

Second, some participants are in favour of an independent third-party in addition to the external auditor who can provide some assurance on internal RM and internal control practices. Such an independent third-party may be helpful to both companies in identifying and assessing their key risks and information users as an additional source of reassurance. Accordingly, companies should disclose this information to further reassure investors about their RM and RR.

I13 argues "*If they get external advisors to review what they said in it, then that might help with the independence. So, I am not thinking really about the auditors*". I28 also suggests "*It might be a statement on whether a third independent party they believe that this is a proper representation for risks they would expect this company faces*".

Third, participants also highlight the role of corporate governance practices and mechanisms as discussed in chapter 6 including the existence of an audit and/or risk committee that has independent members with relevant financial and industry expertise in ensuring CRD quality. I23 explains her role as an independent audit and risk committee member in terms of RM and RR remarking:

> "*The executives identify risks and run risk registers within the organisation, and we monitor those risks, and we look at the risk registers, and we think about whether we think they have identified all the right risks, whether we think there are things missing, whether we think they have got their assessment wrong about how serious risks are and so on. And then our other major input is when you come to the disclosure in the annual reports and the accounts about risks how we track across from the overall risk register which is bigger and it has got more risks on it to what the key risks are that ought to go into the annual reports to give people a clear picture of the major risks that the organisation is facing and what we are doing about them. And it is to make sure that we have got a proper audit trap between the*

two, so we understand why we have left things out from the register when we were actually disclosing in the annual report".

Fourth, some participants recommend reporting sufficient information on the RM process including the assumptions and principles used to identify and measure key risks and the plans in place to manage them. For example, I28 states:

"*It is not just about making a statement about risk. It is about explaining what your processes of assessing the risks are, what your processes for identification and mitigating the risks. So, all of those provide the context, and that helps them to understand to what extent it is complete or accurate or neutral*".

However, other participants contend the previous argument indicating that such information is more likely to be generic and hence not useful for information users. I5 raises concerns about the relevance of such information stating:

"*It is too far away from what the actual risks are, and it is too easy to describe a process without anybody actually knowing whether it is doing a good job or not…That kind of disclosure is easy for firms to make, and therefore they make it, but I suspect it is the least useful*".

Fifth, participants recommend that companies disclose and explain their risk estimates, how risk has been managed and its actual impact. They argue that such disclosures could improve the faithful representation of RI, enhance management credibility and increase investors' confidence. I2 demonstrates "*It would be useful if companies do state what a particular risk is and then to discuss the experience of that throughout the year. We can discuss what actually happened and compare with what was predicted*". I5 also suggests:

"*Having some kind of track record, I will be looking at how you reported risks in the past, and then how that actually matched to any risk that you have encountered in the past to see how faithfully you are representing your risks*".

Participants also encourage information users and investors in particular to trust management and the information disclosed in return and act rationally. However, management should firstly build investors' confidence through maintaining transparency about their RE and RR practices over time.

"*Investors have got to have some trust in their committees who look at the information, and partly through understanding how they reported things previously and how those things then turned out that is how you get confidence in a company*". (I7)

Furthermore, participants encourage managers to provide their best estimates of future risks as discussed before. This argument is consistent with the FASB's view that "if there is no

alternative representation that is more faithful, that estimate may provide the best available information". I6 states "*I kind of rather have things in a range almost rather than having something that seems to be overly precise and unbiased than number*".

Sixth, other participants discussed to the role regulations and regulatory pressure can play in ensuring that CRD faithfully represents a company's risk position by asking companies to disclose more and certain RI. However, there are concerns about the extent to which regulations can contribute to CRD quality as discussed in chapter 6.

> "*Regulatory action can help where regulators say we do not disagree with the risks you have identified, that is your view, but you have not done it very well, and you have not done it in a very objective fashion, and you look like you are downplaying the way that risks might play out*". (I23)

7.6. Comparability

This section and the subsequent sub-sections address and operationalise comparability in terms of CRD. The FASB defines comparability as the ability of information users to compare financial information across companies as well as compare the disclosure of a particular company over time. Accordingly, comparable disclosure should enable information users to compare the financial performance of companies.

However, comparability does not mean complete similarity or consistency. The FASB makes a distinction between comparability and consistency and indicates that using the same measurement and presentation methods across companies and within the same company over time consistently should enhance disclosure comparability. The FASB also emphasises the inter-relationship between the fundamental and enhancing characteristics arguing that relevant and faithfully represented information is likely to be comparable. Hence, comparability should not be interpreted as complete similarity, otherwise it could lead to producing generic disclosures across companies and overtime that is not useful to information users.

The participants indicate that comparability in the context of CRD means being able to track the changes and development in the company's risk exposure and appetite over time as well as the differences among companies in terms of their risk positions. Their view is consistent with the FASB that ensuring relevance and faithful representation of CRD should enhance its comparability.

Participants also emphasise that comparability does not mean providing similar RI over time and suggest tailoring risk disclosures to the company's circumstances. They argue that companies can address their sectoral and market risks (systematic risks) relative to their competitors and take advantage of highlighting the effectiveness of their RM plans as discussed

in chapter 6. So, comparability should highlight the changes and differences in RE over time and across companies.

For example, I28 states "*Comparison does not mean to have an identical statement or an identical format or using exactly the same words, it just means capable to comparison not identical*". I18 comments "*I am probably just as interested in the differences between companies even similar ones within sectors that I am interested in or investing in*".

Some participants demonstrate that comparability is an important characteristic that companies should strive to meet so that investors can make informed decisions. I8 states that comparability is "*very important because if you have benchmarking to companies in the same sector that the information needs to be comparable for you to be able to make a fair decision*". Sophisticated investors acknowledge the importance of comparability, yet they are not too concerned with considering their investment experience and skills in analysing and comparing the risk profiles of different companies. I13 highlights:

> "*It is quite important, but it also my job to be able to compare them, that is part of the skill of being an analyst. It is helpful, but if it is not easy to compare then it is not the end of the road*".

On the contrary, some participants do not attach more importance to comparability claiming that risks do not significantly change over time. They also refer to the generic and qualitative nature of current CRD practices that makes it difficult to ensure this characteristic. I18 argues "*I am not sure whether comparability is such a helpful concept really for risk reporting*". I24 indicates "*I think comparability is a less of problem than you might think really in that sense year on year within the same company*".

Accordingly, comparability encompasses horizontal and vertical comparability: the former refers to comparability of a company's RE over time, whereas the latter refers to comparability across companies, and both are discussed below.

7.6.1. Horizontal comparability

Participants place particular importance on horizontal comparability that refers to the ability to compare a company's RE over time. They emphasise that companies should explain how risks have changed and developed over time. They also highlight the importance of discussing the difference between an estimated risk and its actual outcome and how it is being managed. They caution against complete comparability and providing RI that may seem more comparable, but rather less useful. They further recommend companies to disclose ongoing and future risks and explain why particular risks are no longer considered material to their business.

For example, I28 emphasises "*The year on year is very important. Users can understand how the assessment of risk has changed; while new risks have now been promoted others are*

considered to be immaterial". I23 point out "*If the risks change you need to understand why the risks have changed*". I19 also recommends:

> "*Addressing risks that are sort of popping into your top 10 or dropping out of your top 10 or indeed shifting within that top 10. So, giving some indications to whether the risk is becoming more likely or the impact will become greater or not*".

Accordingly, the interviewees suggest that companies provide information on how key risks have evolved over time in terms of their impact and probability of occurrence. This could also give investors an understanding of RM practices and plans and how effective they are. Participants also recommend disclosing risks within one particular section of the annual report and presenting RI consistently over time to improve horizontal comparability.

> "*It would be good if the data was disclosed…laid out in the same sort of way, and may be any differences from one year to the next. So, we could say that this item is no longer thought to be a risk for the company for the following reasons, well this item has now become a risk to the company for the following reasons*". (I2)

7.6.2. Vertical comparability

Companies operating in the same sector or market may be exposed to the same systematic risks; for example, cybercrime risks to technology, telecommunication and banking sectors. However, the impact of such risks could vary significantly from one company to another depending on company-specific characteristics and its RM processes and plans. For example, large companies may be exposed to higher risks, but they may also be implementing effective RM processes to reduce their RE. Investors might be interested in understanding the exposure of each company to those risks, how each company is handling them and their net impact on company performance to make informed decisions.

> "*You could see a small operator in a particular industry may be particularly exposed to key man risk, whereas a larger organisation with more formalised procedures and processes may not be so exposed. So, you may not expect 100% comparability between principal risks*". (I26)

The interviewees indicate that the company may address its exposure to systematic risks relative to its competitors to gain an advantage by highlighting its effectiveness in managing risk. However, participants emphasise that the disclosure of systematic risks should be company-specific and tailored to the company's own circumstances. They caution against reporting generic RI that detracts from CRD quality as companies attempt to satisfy this aspect of comparability. For example, I19 highlights "*Comparability across sectors this where I might be a bit controversial*". I5 also emphasises that vertical comparability is "*very difficult for companies to do in terms of their risk reporting*".

Participants demonstrate that vertical comparability is difficult to achieve due to the qualitative nature of CRD which makes it more difficult to compare the RR and RE of different companies. They also highlight the differences among companies in terms of their approach to risk and RM which is another obstacle to ensuring vertical comparability. I23 argues "*You would not necessarily expect them to be directly comparable because management will be looking at things in different ways*". Similarly, I19 emphasises "*Just because we are in the same business does not mean we necessarily see that risk the same*".

Therefore, they argue that vertical comparability is not significantly important or applicable. They rather encourage companies to focus on their key risks and provide company-specific specific RI. Likewise, participants indicate that CRD should highlight the differences among companies in terms of their RE and RM approach which may also be problematic. I5 states "*Because of the subjectivity involved in risk reporting it may be that the most important stuff we cannot make comparable because every company is going to have its unique set of disclosures*". I18 emphasises the specificity of CRD commenting:

> "*When you say the whole sector faces this risk and we are doing our best to tackle it that is not very helpful. What does it actually mean for you as a company? And what are you doing about it which might distinguish you from other business sectors or companies?*"

Other participants share the previous view. I22 indicates "*Specificity of risk disclosures is so important to me that overrides comparability*". I25 also argues "*I do not think a comparison between one company and another is appropriate…in your risk reporting in most cases*". Moreover, I4 highlights "*You can compare between companies when it comes to numerical information. When it comes to qualitative information it is difficult because it is very open ended in nature*".

Some participants, however, argue that comparability between companies that operate under similar conditions could be easier to achieve. So, companies operating in the same industry and market are expected to provide some comparable RI. I2 argues "*Mining companies located in the same industry and in the same location maybe you can make some sort of comparison, but otherwise it is going to be difficult*".

However, participants encourage companies to consider their competitors' RR. I8 suggests "*You have to look at what others in your industry and what others in similar sectors are providing, and then provide comparable information with others*". They caution the company against withholding risks that competitors have disclosed which may increase its RE as discussed in chapter 6. They argue that a company that conceals certain RI may be exposed by competitors that disclose this information. They draw attention to the consequences of concealing such information for investors who might lose confidence in managers and raise concerns about their

RM plans. Consequently, investors may take adverse actions that could affect company stock prices and market value.

Therefore, participants recommend that companies ensure specificity when discussing systematic risks and explain why they are not exposed to a particular systematic risk or why a particular risk is considered immaterial to their business to reassure them and avoid any unfavourable outcomes. I24 states "*If there is a risk which affects everybody in that industry, then you would expect to see each company telling you how it is affecting them specifically*". Participants further indicate that managers may take advantage of such disclosures by signifying that they understand the business environment and identify and manage risks effectively.

> "*If there are ten companies in your sector and three of them are reporting in a particular way that seems to make sense and you are not, you have to say would it be helpful if we adopted the same kind of format*". (I10)

> "*If I as a retailer did not report that* (risk) *then the market would make a decision based on that, they would say they are not reporting a key metric. Then investors might divest my shares and would lose trust in me, and my share price would go down. If there is a good reason why I am not reporting that particular metric I would say to them the reason…and therefore I do not think that is one of my risks*". (I19)

In addition, participants suggest that disclosing RM methods could contribute to enhancing comparability. Some participants also claim that introducing some guidelines or a best-practice framework to help companies assess and disclose their risks could improve this characteristic. They call for addressing similar risks in the same way by different companies and considering each company's circumstances. For example, I13 suggests "*Voluntary guidelines that if you are talking about carbon emissions, for example, use the same methodology to determine what your carbon emissions are, that is really helpful. At least disclose which method they use*". I9 also recommends:

> "*There should be a framework laid out to make sure that the disclosure is comparable and in a similar format. So, look alike companies, companies in the same industry are not showing significantly different disclosures…There should be a method and place to apply that across businesses*".

However, other participants are sceptical about the impact of guidelines and regulations in particular as discussed in chapter 6. They further assert that regulations may possibly lead to more comparable, yet generic and less informative risk disclosures. I6 highlights "*Forcing them* (companies) *we can miss the differences because everybody has been forced to look alike, and we have got to somehow keep that ability to see the differences as well as see some of the same things*". I26 also underlines the consequences of guidelines/regulations remarking:

"*The risks will be different for different entities, and if you increase regulation around that I think what you will find is a move towards more boilerplate. So, you will move away from information which I think is useful to the information which is more comparable*". (I26)

Generally, horizontal comparability is more achievable than vertical comparability. Horizontal comparability is also more relevant and practicable to present the trend in risks and how they have developed over time which is of interest to information users. Hence, RI is more company-specific and more useful for investors. Therefore, disclosing past and forward-looking RI should enhance horizontal comparability of CRD.

7.7. Verifiability

The FASB (2010) defines verifiability as "different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation" (p. 20). Accordingly, different users should reach a similar conclusion based on the same information.

Considering the differences among investors in respect of their risk appetite and preference, and the nature and amount of their investment portfolios, it could be assumed that it is more difficult to meet this characteristic in terms of CRD. Another issue which makes this characteristic problematic is the information asymmetry between investors particularly institutional and retail investors as well as between investors and company management. Generally, different information users have various information sources and needs. They are also different in terms of their investment expertise and knowledge. Accordingly, information users may well have different interpretations of RI considering its qualitative nature as well.

The FASB recommends providing quantitative information and/or the potential outcomes and probability associated with each individual outcome so that the information can be verified. The FASB classifies verifiability into direct and indirect where the latter can be achieved by providing sufficient information that enables information users to reassess the transaction value following the same method.

While some participants argue that verifiability is to some extent applicable to CRD, they highlight that meeting this characteristic is related to satisfying the other qualitative characteristics and ensuring clarity, specificity and understandability of CRD. They also demonstrate that companies should provide sufficient RI to help information users gain an understanding of their RE. Participants recognise the importance of meeting this characteristic to reduce investor's confusions and avoid potential unfavourable consequences resulting from different interpretations of CRD. I8 states "*any statements have to be verifiable; otherwise their own risk is not being fair and balanced*".

Some participants also suggest providing more company-specific and quantitative RI to enhance verifiability of CRD, yet information users may still perceive it differently. I18 comments "*Verifiability is actually right at the heart of assessing risk, and the more difficult it is to verify something the more discussion you need of the range of possible outcomes*". I3 argues that "*specific and quantitative risk information should enhance its verifiability*".

The FASB acknowledges the challenge of verifying forward-looking information in particular. Therefore, it states that "it normally would be necessary to disclose the underlying assumptions, the methods of compiling the information, and other factors and circumstances that support the information" (p. 20). Some participants also emphasise that disclosing more information on the overall RM process including risk assessment methods could be helpful as evidence to support risk assessment and disclosures.

Therefore, they argue that verifiability is applicable given that companies provide sufficient RI. For example, I9 indicates "*Risks should be outlined and detailed enough to make sure that different readers will obtain the same understanding of the risks themselves and what has been done to deal with the risks*". I2 states that disclosing "*how they* (risks) *are managed and how they are assessed would be very helpful definitely*". I22 also argues "*If there were disclosures setting out how the analysis of risk has been performed that might enhance the degree of verifiability*".

However, other participants cast doubt on the impact of providing such information and its usefulness for information users. They argue that such disclosure is a subjective description of a process rather than risks and their impact on company performance that could detract from CRD quality. I16 argues "*the section on risk management it is still boilerplate…The board of directors or executives feel they have discharged their responsibility for risk if they make narrative description as of how good their risk management processes are*". They also demonstrate that RI can only be verified after risks have materialised. I26 wonders "*Do we want to provide even more information? I am not convinced*". I10 also comments:

> "*Sometimes providing more information can make it less clear because you are telling people more than they need to know…It is a judgement really. I think you have to think in that example how much does the investor need to know about this risk, probably you want to quantify the risk firstly*".

Accordingly, managers should decide on the appropriate level of CRD and present their RI in a clear and concise manner by managing the balance between providing concise RI that enables information users to gain an understanding of their RE, whilst not revealing too much details that could confuse users or increase their RE.

The majority of the participants underline the difficulty of satisfying verifiability considering the inherent subjectivity of risk assessment and qualitative nature of CRD that makes it

problematic to verify, and therefore contend that it is not a very important criterion. I4 states that verifiability is "*very difficult to implement it when it comes to qualitative reporting*". They indicate that verifiability is more applicable to financial information, quantitative RI and historical information in particular that can be verified. Participants further assert that investors may interpret RI differently considering their knowledge and expertise, and reach their conclusions about the company's RE influenced by their risk appetite and preference: risk taker or risk averse. Therefore, they demonstrate that it is extremely difficult if not impossible that different users reach the same conclusion in terms of their assessment of a company's RE.

I28 states "*Verifiability seems to me a less important characteristic…It is incredibly difficult… Risk assessment is inevitably judgmental and subjective. I think it is too hard to say that two people would reach the same conclusion*". I22 also confirms "*It is impossible to say that different readers are going to reach the same conclusion because different readers will each have very own risk appetite, and so they will…make different decisions*". Similarly, I13 states "*Different investment analysts care about different things. So, it is quite possible that you could say something and traders might think something completely different. Each investment analyst has their different views and approaches*". Likewise, I23 remarks:

> "*There are some people who will look at an oil company and think this too risky I do not want to be investing in a big sum because I am too worried about the oil price, and there are other investors with different risk appetites themselves will come along to say no we want that risk. But they have still seen the same risk, and still understand the same risk but they are going to take a different view because of their own personal situations*".

Some participants approach verifiability from a different perspective highlighting that external assurance on CRD and RM from an independent third-party as discussed previously could enhance verifiability of RI. They further point out that investors can then make their own decisions based on their risk perception. I1 recommends "*providing more information and evidence on how risks have been measured, and being audited by the external auditor*".

However, other participants argue that such assurance cannot guarantee verifiability of CRD because it is ultimately a subjective judgement whether it confirms or opposes management's view. They further emphasise that risk is by definition unknown and/or uncertain, and hence is extremely difficult to audit and verify. I5 remarks:

> "*That is an entirely subjective assessment which nobody, an auditor or any third-party, can comment on it and say yes you have got it right because everybody will have their own particular assessments of those risks. All you would have is another subjective point of view which may be worthwhile*".

In addition, information asymmetry may also make verifiability of CRD challenging where some information users have access to more information than others. For example, institutional

investors and investment analysts can obtain more information on the company's RE that is not available to retail investors as discussed below. Hence, the information asymmetry problem can affect verifiability unless all users have access to the same information at the same time, which does not always hold in practice.

7.8. Timeliness

Disclosing financial and non-financial information on a timely basis is particularly important to information users to make informed decisions. The FASB (2010) defines timeliness as providing information that could make a difference in the decisions made by information users; otherwise, the information may become useless. It further argues that timely disclosure means providing information that is capable of influencing users' decisions. Therefore, the FASB calls for disclosing any information as long as it is relevant to information users.

Information users also need timely information on the company's RE and any significant change in its risk position. The dynamic business environment in which companies operate imposes new and changing risks, which necessitates reassessment and disclosure of risks in a timely manner to keep investors informed about changes in their RE and any emerging risks. Moreover, timely CRD may be indicative of effective RM in terms of identifying and handling risks in a timely manner, and hence could increase investors' confidence.

This section and the following sub-section discuss timeliness and explore the most appropriate disclosure channel for providing timely CRD. There are a number of different disclosure channels that companies use to disseminate corporate information including annual reports, corporate websites, interim reports and press releases. Therefore, the participants were asked which disclosure vehicle could satisfy this characteristic.

Participants emphasise the particular importance of reporting timely and accurate RI. They indicate that timeliness means reporting any price-sensitive RI in a timely manner so that investors can take it into account when making their decisions. They indicate that the appropriate disclosure channel largely depends on the type of risk, its nature, and whether it is in the public domain or not. They also recommend that companies promptly disclose significant changes in current risks and emerging risks that could affect company's future performance. For example, I18 defines timeliness as "*A prompt disclosure of changes in risk that will affect company's cash flow, and therefore move the share prices*".

Participants address timeliness in terms of disclosing estimate of future risks and risks that transpire or significantly change in a timely manner. They highlight that companies should identify, assess/reassess and disclose their exposure to future risks and uncertainties on a regular basis. They also encourage companies to provide information on the development of risks over time. Participants representing investors group are mainly concerned with RI that could affect

share prices and call for prompt disclosure. For example, I18 indicates "*As soon as something happens that might move the share price it should be announced*". I19 also comments:

> "*Timeliness is about having that sort of radars getting to the horizon and picking things up in plenty of time, and then of course the external reporting piece is just capturing that. So, I think timelines is important in that you should be reporting all those risks that are considered significant at the time which the report has been made*". (I19)

Other participants argue that there is an element of subjectivity and judgement associated with prompt CRD. They refer to the disincentives of providing timely RI that may lead to unfavourable consequences as discussed in Chapter 6. I24 states that there is "*a judgement about whether a piece of information really is very sensitive and also whether it is going to be fulfilling prophecy if you put it out*". Some participants suggest that external auditors can play a role in ensuring timeliness of CRD and encouraging companies to disclose timely RI. I26 demonstrates "*If the timing of the reporting internally was different from the timing of the reporting externally you* (auditor) *would be able to make some comments*".

The participants hold mixed views regarding the applicability of timeliness to CRD. Some participants attach a particular importance to reporting timely RI, and others argue that it is difficult to satisfy timeliness due to the particular nature of risk. Whereas I3 states "*I would put timeliness as the top characteristic*", I2 argues "*That is a good characteristic to describe for accounting, but for risk reporting is it reasonable to expect timeliness? I am not sure*".

The participants who cast doubt about timeliness of CRD consider the uncertainty inherent in risk and the limitations of the traditional disclosure channels including the annual report that lack timeliness. Accordingly, they recommend that companies scan their business environment to identify potential key risks and disclose them in advance. I7 argues that timeliness is not "*applicable because it is about the future. So, what is timely when it is about the future?*" I19 also demonstrates "*Timeliness is difficult for the very nature of risks being forward-looking*" and, therefore, suggests "*At the time of the report you have got to be thinking far enough ahead to identify all those risks that you consider to be significant*". Likewise, I2 comments "*risks and opportunities will be reported well in advance…there is too much uncertainty to be sure about them being timely*".

Furthermore, participants argue that providing timely RI is more difficult than disclosing future risks in the annual report. They demonstrate that reporting ongoing risks is also more problematic for companies. I24 states "*Talking about risk in real time is going to be even more difficult than talking about it in the annual report*". I2 explains why timely CRD is challenging stating "*You could only assess that by seeing how the risk reporting changes from one year to the next because otherwise it is going to be too late or too general or not helpful enough*". However, this may hold true if risks are disclosed only in annual reports.

7.8.1. The appropriate disclosure channel for CRD

The previous discussion leads to the question of which disclosure vehicle is more convenient for CRD and capable of satisfying timeliness. The participants hold different views on this question. The participants underline that there is no single most appropriate disclosure vehicle for CRD that could meet the different qualitative characteristics including timeliness, but rather it is a combination of channels. However, the majority of the participants emphasise that the AR is more appropriate for CRD for a number of reasons as discussed below. They consider the AR the key source of corporate information, whilst recognising the importance of other disclosure vehicles in terms of timeliness.

For example, I9 states "*The annual account is the best option*". I21 comments "*Annual reporting account is the most useful to me…that I go to firstly*". Similarly, I22 indicates "*If there has not been any material change…it is absolutely fine to say the annual report should be the principal source of risk disclosure*". Conversely, I14 presents an opposing view calling for a standalone risk report/statement arguing "*It needs to be separate from an annual report…then I could just focus on the risk report rather than reading the whole of the annual report or the interim report*".

First, the AR is reviewed and examined by external auditors who provide independent assurance on the information disclosed that should enhance CRD credibility. Participants further indicate that the AR is being approved by the board of directors which gives investors further assurance. For example, I18 states the AR "*is where you get some assurance from the auditor because all are linked to the numbers that have been audited*". I7 also comments:

> "*…Assurance from external suppliers either the auditors, but also assurance activity of the board themselves and the process that they go through…it is very unlikely that you are going to have it on the website and change it all the time because you are not going have the governance around that information to make sure that it is the most correct. So annual report is probably a good place*". (I7)

Second, the AR is the channel where information users can gain an understanding of the company's overall performance including its financial performance and risk position based on financial and non-financial information. Risks, according to the participants, are basically inherent in the company's business model and strategy. Therefore, investors can better understand a company's RE in the context of its business model and strategy and assess the impact of risk on achieving its strategic objectives. I10 emphasises "*The annual report is the first place because that is your story that is the starting point for someone that wants to understand the company*". I26 also argues "*investors actually quite like the one-stop shop of that document, rather than having to give them piece together the bits of information and try and make sense of it*".

Participants further draw attention to the danger of reporting risks as a standalone report that could detract from CRD quality and affect its understandability. Hence, they support integrating and linking RI to other corporate financial and non-financial information in the AR so that investors can gain an insight into the company's performance and prospects.

> "*I prefer it to be in the annual report because there should be a clear linkage between the risk disclosures and the rest of the strategic report…So, to me it makes absolute sense to have one coherent integrated disclosure, here is my strategy, here is what I am trying to achieve, and here is the risk that I would not make it*". (I22)

> "*The annual report by in large includes everything that investors need to understand the business…It is at least updated once every year and preparers take it seriously. The annual report also tells a story of course. So, you are not just looking at risk in isolation, you are looking at the business model, the strategy…and the financial statements, and it should all be linked*". (I19)

Third, some participants suggest disclosing risks through annual reports and interim reports; quarterly and/or semi-annual reports, in case of any emerging risks or changes in ongoing risks. They indicate that these reports should be appropriate arguing that risks do not change so frequently. However, they highlight that significant emerging risks can be disclosed through other channels to provide timely RI. However, there are concerns regarding interim reports not usually being reviewed by external auditors.

I8 argues "*You are reporting to the market every six months. So, I do not think the risks of most businesses would materially change in that time period. Some businesses report quarterly. So, I think that is more than sufficient*". Similarly, I24 remarks:

> "*Risks do not change every day…reporting on them once a year and updating that reporting in the interims is probably sufficient for the time being. But if a big risk emerges during the year and that risk really is very sensitive, then a company needs to be doing a regulatory news announcement*".

The participants representing AR preparers group support the previous argument indicating that companies are obliged to report their principal risks in their annual reports. They also underline the need for using different disclosure mediums to communicate with investors and other stakeholders. They point out that each disclosure vehicle serves a different purpose, whilst recognising that the AR is the main vehicle. I27 states "*To me it is a mixture. So, we will talk about that when we do investor days, analyst presentations, and then we have obviously…our report and accounts*". I12 highlights "*if it is a newly emerging risk then you might need to do a press release on it or in your interim report*". Likewise, I15 comments "*We would disclose on a six-monthly basis, but I do not even think you are going to get more disclosure than that. Risks do not actually change that quickly*".

Fourth, the AR can be used by information users and investment analysts in particular to verify information about the company's RE and check its consistency with their prior knowledge and assessment of the company's risk profile. The AR presents the company's performance and RE over a particular time period and at a particular point in time as well as its future prospects.

> "*Good companies give their description about what has happened in the last year… and then they use that base position to look forward into the future, then look at the risks that are facing the company, and they look forward from the perspective of going concern and viability issues*". (I23)

Fifth, considering that forward-looking nature of risk the AR is considered the most appropriate platform for providing future RI that the interviewees regard as more relevant. So, companies can report on the timeframe, potential impact and management of risks in their annual reports. I10 states "*Your annual report should be in first place…then you can also do press releases*". I24 also highlights "*Actually what you want in those annual reports is information about the future, not information about the past*".

Moreover, the preliminary announcements can provide early RR so that information can become available to users before the AR is published to improve timeliness. I19 recommends disclosing risks "*in the back of preliminary announcements which do not include any of the risk information at all, and the risk information and all the rest of it comes out two months later, three months later sometimes*". Similarly, I6 also argues "*The preliminary announcement of the results that is the news and people look for that and know what is going to happen and analyse*".

Meanwhile, the participants emphasise that companies should disclose any significant emerging risks and/or changes in current risks via alternative mediums for more timely CRD. Using other communication vehicles can overcome the delay in publishing the AR and its lack of timeliness. For example, I8 suggests reporting risks "*in the financial statements. If then an event happens you have to put out an announcement to say it happened*". Similarly, I19 states "*Anything that will be really material would get picked up to a stock exchange announcement*". Moreover, I22 highlights "*If there are material changes, then I would expect it making a press release*".

Sixth, the AR is a referential document and a rich source of historical information that users can depend on to evaluate a company's performance and RE over time and make predictions about its future as discussed previously. The FASB also recognises the importance of historical information. Hence, this information can be used by investors to understand the evolution of risk over time and evaluate stewardship in terms of how managers assess and manage risks.

I4 states "The *annual report serves as a useful reference document for risk reporting*" and continues to suggest using "*other forms of risk reporting channels like the stock exchange*

announcements, results presentations and the face to face meetings". Likewise, I20 demonstrates:

> "*The annual report is the primary place and that is the most stable sort of referential channel…We would use interim reports or quarterly updates to highlight any changes in the risk that we have reported. And I guess a press release would be where we have some sort of a sudden or dramatic change in risk exposure that we would need to alert the stock market to or the investors to*".

It is worth noting that institutional investors and investment analysts have additional information sources including private meetings with the company's senior management where they can obtain more and higher quality RI. I13 states "*We are lucky because (X) investors are so big, and so you can pick up the phone and just say we would like to meet with the chief executive. They give you whatever you ask for*". I5 also confirms this view remarking "*Major investors will be having private conversations with the managers anyway and they will learn more about risks in that way than they will from public reporting*".

I13 who supports disclosing risks in the AR demonstrates that the AR represents 10% of the information sources they use to evaluate a company`s risk exposure and profile. However, the AR serves as a source of assurance to institutional investors that can either confirm their own risk assessment or highlights further issues that they may not be aware of, and hence can discuss them further with management. I13 states "*The annual report is not that important, but if it was missing then I would be concerned*". Accordingly, it could be argued that institutional investors are less concerned about external CRD in annual reports. Furthermore, they may support withholding some potentially prejudicial information and take advantage of accessing this information in private meetings and discussions with management.

On the other hand, some participants disagree with the above argument highlighting that the AR lacks timeliness. This lack of timeliness could worsen the information asymmetry problem. Therefore, they encourage companies to use other disclosure channels including websites and press releases to provide timely RI and reduce information overload and repetition in the AR. I18 states "*I would not think of that so much in the context of an annual risk reporting, it is not timely actually*". I1 also comments "*The suitable time for reporting a risk is when it occurs and throughout the risk management process and the annual report cannot fulfil this purpose*". Moreover, I5 emphasises:

> "*I would do it online on the company's website. You can both keep it constantly up-to- date as you run through risks that you need to report, but also you do not need to repeat it every year…The annual report is probably an inferior way of doing it to having it on the internet*".

7.9. Understandability

Considering the above characteristics, RI should be presented in a clear, concise and understandable manner in order not to lose its informativeness. Understandability is particularly important considering the concerns about CRD quality as discussed Chapter 5 and to avoid RI being misinterpreted by information users, which could lead to unfavourable implications. Ensuring understandability should also lend credibility to CRD and RM.

Understandability is closely related to satisfying the above characteristics. In other words, meeting the above-discussed characteristics should enhance understandability of RI. This section and the subsequent sub-sections address how CRD quality can be further improved by ensuring its understandability. The participants were asked to suggest aspects of improving understandability.

The FASB (2010) emphasises a number of sub-characteristics to ensure understandability of corporate reporting including classification, clarity and conciseness. The FASB states that "classifying, characterizing, and presenting information clearly and concisely makes it understandable" (p. 20).

The participants emphasise CRD clarity and conciseness, linkage between RI and the company's business model and strategy and the use of jargon-free and plain English to ensure that RI is understandable to the average investor. They call for clarity in articulating the impact risk might have on company performance and how it is being managed. They also indicate that insiders should ensure providing a clear and understandable picture of the company's risk profile to the outsiders to reduce information asymmetry.

For example, I28 states "*Corporate reporting is just communicating the story from those with inside knowledge to those without it*". Lack of understandability could have unfavourable consequences as discussed in chapter 6. Therefore, companies should endeavour to ensure clarity and understandability of RI. I8 emphasises "*Financial statements should be fair, balanced and understandable that is equally applicable to the risk section*".

Whilst participants encourage companies to disclose understandable RI considering its inherent complexity, they highlight that investors should also be aware of the business they are investing in and the risks it is facing. The FASB opposes withholding information due to its complexity because it may affect the understandability of the overall AR and could be misleading to investors.

> "*Quantitative information on risk…people may find difficult to understand because it requires specialist knowledge of what numbers mean, and perhaps also of a particular market to understand what the data refer to. But it is reasonable to put an obligation on the company to make it as understandable as possible*". (I5)

Accordingly, companies should firstly identify their primary intended user(s) and ensure that the above criteria have been met to make RI understandable. Companies should also disclose sufficient information that enables information users to understand their RE and what they are doing to manage and mitigate risk.

> "*It is really hard to pull out one of those three terms* (Fair, balanced and understandable) *and explain it without having to get into the other ones as well and that is why the FRC actually put them all together. That is a coherent overall set of criteria*". (I24)

Understandability of RI depends also on investor's skills, experience and knowledge. So, this raises the question: for whom CRD is most needed and intended? For example, I24 emphasises that companies and regulators should consider the following question "*The first question is understandable to whom?*" Similarly, I19 points out "*The first step, understandable by whom?*"

Participants emphasise that average investors should have proper knowledge of investment in general and particularly the market and company they are investing or intending to invest in. They further demonstrate that investors have the responsibility for understanding the nature of the business activities the company undertakes and the risks associated with these activities; otherwise, they should not be investing. I18 states "*As an investor, if you do not understand it do not invest in it. If you understand a sector or a company you will have got a pretty good idea of what the risks are*".

The FASB also assumes that information users have some investment knowledge and experience. Moreover, the FASB suggests that users can seek advice from investment professionals concerning complex information. Investors are assumed to have a reasonable level of knowledge about investment and commercial awareness of the business and the market they are investing in. However, they are not expected to be experts in business and financial reporting to understand a company's RE, financial performance and future prospects. I24 underlines that average investors "*should have a general level of what the stock market is and what the company is*".

Likewise, participants indicate that CRD understandability depends on the nature of the business and the types of risk it faces, which requires investors to gain some knowledge and understanding of the respective company and the market it operates in. I19 demonstrates "*Certainly the risk disclosures of HSBC will not necessarily be understood by the same person who understands risk disclosures in United Utilities because their average reader is a very different person*".

Accordingly, some participants recommend that companies examine the complexity of their CRD and ensure its understandability using some online sources and software. They encourage companies to tailor their CRD to meet the information needs of their mainstream audience and communicate a clear message about their RE. I25 demonstrates "*It is unfair to expect the*

readers to be experts". I17 highlights "*There is a campaign for clear English, which should be involved…It (CRD) needs to be carefully written so that it is useful to people who are not getting paid to read it*". Similarly, I13 suggests using the Crystal Mark test to examine and ensure clarity and understandability of narrative disclosure and CRD in particular remarking:

> "*There is something that we have in the UK called the crystal Mark, which is all about writing things in a kind of clear way. So, I mean potentially thinking about what would pass the Crystal Mark test and just try to ensure they are as concise and clear as possible*".

Participants expressed concerns about current CRD practices particularly in terms of the language used and the wording of CRD. They refer to the frequent use of jargons, technical terms and acronyms that are difficult for an average investor to understand. Therefore, there is a need for careful phrasing of CRD and explaining technical terms. I4 suggests that "*providing more details would make it understandable*"; nevertheless, he argues "*It depends, understandable to whom. If it is understandable to a sophisticated investor, then the details would help, but if it is a retail investor then it is probably going to be simplistic information*".

Ultimately, understandability depends on the skills and expertise of information users. Investors are also different in terms of the nature and amount of their investment and risk preference and appetite that may affect their interpretation of CRD. Furthermore, investment analysts and institutional investors invest their time and money in analysing companies' performance and RE, and have access to other information sources where they can obtain more information. This might discourage companies from reporting more and/or informative RI externally. Therefore, it could be argued that CRD should be tailored to serve the information needs of average investors.

The findings highlight three major aspects discussed below to enhance understandability of RI: the language of CRD, CRD structure and presentation format, and CRD location.

7.9.1. The language of CRD

Participants emphasise that companies should use plain English when reporting their risks and avoid jargons and technical terms as much as possible that may be difficult to understand. Hence, risks should be articulated in a jargon-free manner in terms of what the risk is, its potential impact, and how it is being managed to enhance CRD clarity. Participants further recommend using appendices to provide explanation of technical terms and acronyms in the AR. Likewise, they suggest using shorter sentences and highlighting particularly relevant and important RI.

Participants draw a particular attention to the inherent difficulty of understanding CRD due to the lack of readability and clarity. They argue that this lack of understandability is one of the reasons that discourage investors from reading risk disclosures. For example, I2 states "*Annual*

reports are sometimes very difficult to read because of the language in which they are constructed". I6 also argues:

> "*There are so many things you read and you just really cannot tell what they are talking about, you cannot get the links that is it a big or little thing for the company….the better ones are quite clear in how they write*".

Some participants call for more disclosure whilst ensuring its clarity and readability. However, there needs to be a balance between providing more information that could be confusing or detract from CRD quality and disclosing concise, yet clear and understandable information. I17 states "*I would rather more information than less information…but it is also the wording of the risk report, it needs to be in normal English not in legalese that just turns people off*".

Therefore, participants suggest using a simple language in describing risks and the actions and plans in place to mitigate them. However, they emphasise that readability is unlikely to enhance understandability if information users lack sufficient experience to interpret the information provided. So, while I2 suggests that risks "*should be described in everyday terms without jargon, and the actions to mitigate the risks should also be written in a clear way*", I3 demonstrates "*Understandability depends on what type of investors you are talking about; sophisticated investors or retail investors*".

Some participants also refer to some readability aspects such as the length of the sentence and the relative length of the risk factor section to the entire AR. They further underline the importance of satisfying the abovementioned characteristics with regard to, for example, disclosing company-specific RI to enhance understandability.

I26 recommends disclosing risk in "*plain and simple English and that means concise simple language and not trying to hide risks through the use of complex language*". I28 suggests "*Clarity in language, not using jargon, being specific…information that can be understood*". Similarly, I24 comments "*use reasonable language and reasonable terms that are going to give people a chance of understanding what the point you are making is*". Likewise, I23 emphasises that CRD should be "*jargon-free particularly in some industries where there is a lot of jargon*".

Participants representing AR preparers group also highlight the importance of relevant and concise RI. They emphasise that the existence of a framework to help companies approach and phrase their risk disclosures could further enhance clarity and understandability. They also point to the characteristics discussed above to enhance CRD quality. I10 states "*They should write it in plain English, avoid using jargon, quantify things where they can, probably explain in a qualitative way the nature of that risk*". I20 also comments:

> "*They* (companies) *could highlight the foundation about where their language or philosophy comes from. So, ISO's standard 31000 is a great place. So, another such framework is*

useful as a starting point to help recognise that is where the approach has been taking from. So, I think simple short section is helpful".

Furthermore, the participants representing retail investors group raise concerns about the disclosure of boilerplate RI, the length of CRD and the language of CRD that may hinder its understandability. They further claim that companies may intentionally use complex language to obscure particular information and distract investors from their actual risks, whilst appearing to comply with regulations.

> "*Any company can employ a lawyer who specialises in that making it so opaque to the reader that is effectively useless. In the UK, they are just making it becoming as boring as possible so that people do not read it*". (I17)

Therefore, they call for more simplicity and conciseness in addressing risks and emphasise the need for clear RI that helps them estimate the impact of risk on company performance. They suggest avoiding technical terms; otherwise companies should explain these terms. I18 suggests "*not using boilerplate language or jargons…For something to be clear it should be concise, company-specific, free of jargon*". However, I17 supports disclosing more information and places more emphasis on the language of CRD arguing "*The length of the paragraphs or how many Latinate words rather than Anglo-Saxon words can make a big difference to how useful it is*". I14 also demonstrates:

> "*For an average investor, they need something that is simple and easy to understand and you can within a few hours of reading it make some decisions on whether it is high risk, low risk or medium risk…rather than to put it in difficult language with technical jargon*".

The participants representing the FRC group share the same view and highlight the importance of clarity and conciseness of CRD. They indicate that conciseness does not mean providing little disclosure or omitting relevant information, but rather understandable disclosure through avoiding acronyms and technical information to help information users gain an understanding of the nature and impact of risk.

> "*Clear and concise which it really needs to be as long as it needs to not be overly technical. It needs to allow reader to be able to read and understand the nature, the possible magnitude and the likelihood of the issue. So, it just needs to be in approachable language and that would probably make it understandable*". (I7)

Participants also encourage companies to provide sufficient quality details, but not too much information that could be commercially sensitive or distract information users. I8 states "*The more granular the level of detail of the risk can be the better*". I9 also remarks "*Making sure that they disclose the level of detail around the risk as how it applies to the business*". However,

the problem that arises is defining the appropriate level of RI for companies and information users.

7.9.2. CRD Structure and presentation format

Participants demonstrate that understandability can be significantly improved by presenting RI in tables, charts, and graphs. Some participants recommend using heat maps to display a company's RE in a simple visual manner highlighting key risks that need to be monitored, managed and mitigated based on a risk score representing the outcome of the impact of risk and likelihood of occurrence. They suggest that companies can achieve more clarity and conciseness through using tables and heat maps whilst highlighting material risks and the development of risks over time.

Furthermore, participants emphasise that RI should be easy to find arguing that RI is currently scattered throughout the AR. Therefore, some participants indicate that it could be more appropriate to disclose risks in one section within the AR to give a full picture of company's RE. Other participants highlight that it may be necessary to disclose RI in different sections of the AR, and therefore recommend integrating and linking risk disclosures throughout AR, and ensuring linkage between CRD and other relevant disclosures particularly the company's business model and strategy to improve the coherence and understandability of CRD. Hence, investors can gain a better understating of the impact of risk on the achievement of the company's strategic objectives.

Accordingly, risks could be primarily discussed in a section within the AR under a relevant subheading. Cross-referencing can then be used to link risk disclosures throughout the entire AR and guide the readers to more relevant information. Cross-referencing could be an effective way to navigate the AR and ensure conciseness through avoiding unnecessary repetitions. Some participants also suggest classifying risks into two groups: systematic and unsystematic risks, and/or in terms of the different types of risk. Likewise, they recommend ranking and highlighting principal risks in respect of their potential impact.

Participants also advocate presenting CRD in tables and/or graphs to ensure its conciseness, clarity and understandability. They suggest using a table with a number of columns to present risks in terms of what the risk is, the company's appetite for risk, its impact, how it has developed, how it is being managed, and what the residual risk is. Others recommend presenting risks in a table where each risk can be disclosed in terms of its type, potential impact, likelihood of occurrence and the actions taken to handle it. Heat maps could also be an informative way for visualising risks in terms of their significance; impact and probability, and their evolution. For example, I2 states "*Tables that are showing what the risk is, and how that risk is dealt with, and what the resulting risk is…that is the beginning of the start of better risk information*".

Furthermore, presenting RI in tables makes it findable and more concise. Some participants recommend that companies use a clear structure for their risk factor section by using headings, highlighting important information and any changes in risk and/or using different colours. They argue that pictures, graphs, infographics and tables are generally more understandable and engaging than narratives. For example, I2 emphasises "*If you put it* (RI) *in a table that makes it easy to find*". I23 also demonstrates "*Having a very clear structure in the way that companies disclose these things. Companies are very helpful if they do highlight where things have changed from the previous period's disclosure*". Moreover, I19 suggests "*Using different colours for strategic themes, it could be using icons*".

Participants further refer to a number of advantages of using tables and diagrams as they generally support fewer narrative details. I27 indicates that CRD is "*not necessarily all words and numbers…So more diagrams or pictures, fewer words, more stories that you can get your head around*". Using tables could encourage companies to ensure clarity and understandability of CRD whilst enhancing its comparability as well.

> "*A table generally encourages a clear and concise approach to reporting, and it also means that from the comparability point of view that these two have done the same thing in respect of each of the risks as well. If you have a heading on each column which says what is the risk, what the impact, how has it changed, what is my appetite for this, what is my management and mitigation for this etc.*" (I24)

Retail investors also emphasise that tables and charts encourage them to read risk disclosures. For example, I17 demonstrates "*It should be broken up into nice subsections with tables and charts to leave the average investor with as much information as possible. It helps break up the text and encourages you to read it*."

The only drawback of using tables, according to I24, is that it could result in a lack of linkage between CRD and other relevant disclosures in the AR arguing that "*It is equally important that there is this integration with strategy and business… I would not want the use of principal risks table to make it more difficult to achieve that integration*". However, tables can be used whilst maintaining linkage through cross-referencing and signposting.

7.9.3. CRD Location

UK companies, for example, are required by the Companies Act 2006 to prepare and publish a strategic report that addresses, among others, their principal risks and uncertainties and how they are being managed. Companies are also required by the UK CG Code to include a viability statement as part of their strategic report where they can explain their RE and internal RM and control systems. This section discusses the appropriate place for CRD within the AR to ensure its understandability.

The participants were asked whether risks should be disclosed in a stand-alone section/statement or throughout the AR as appropriate. Some participants highlight that risk disclosures are hidden or difficult to find as they are scattered throughout the AR. For example, I17 states "*There are other things that are not in the risk disclosure report, which are elsewhere in the annual report that seem major risks to me*". (I17)

Some participants support reporting risks in a separate statement or a particular section within the AR claiming that this should give the readers a better insight into the company's risk profile. I14 argues "*It needs to be separate from an annual report*". Other participants recommend disclosing risks in a separate statement/section within the AR and argue that it should focus investors' attention on gaining a comprehensive understanding of a company's risk position. They also underline that comparability could be further enhanced by reporting risks in one place. For example, I3 demonstrates "*Disclosing the risk information in one place increases its credibility instead of distracting the readers. It should also improve comparability*". I4 also comments "*It does give you one centred location to focus on what management thinks to be the key risks…it will make it more understandable to perhaps a basic investor*". Some participants suggest particular sections in the AR for disclosing risks to enhance understandability. I8 states "*Normally it pitches somewhere in the corporate governance section or the directors' report*".

Nevertheless, the majority of the participants suggest reporting risks within the AR for the reasons discussed above and emphasise that the AR should present the full story of the company's overall performance including its RE. They further indicate that it may be necessary or more appropriate to provide RI in different sections of the AR. Therefore, they recommend maintaining linkage between risk disclosures, and between CRD and other relevant information. They argue that disclosing RI in different sections of the AR should not be a major issue as long as the information is findable, highlighted and linked.

> "*I would rather it being within the annual report not kept separate. If you put it separately then users have to look in different places to get the full story, and there is a danger that preparers do not take it seriously and it is not updated properly unless attention is paid to it, and the quality I guess will go down*". (I19)

Moreover, participants place particular importance of discussing a company's RE in the context of its business model and strategy for understanding its impact on the company's ability to meet its strategic objectives. They also highlight the danger of addressing risks in isolation from the rest of the AR that could affect understandability. Therefore, they indicate that companies should ensure that the AR tells a full and coherent story of their financial performance and RE.

For example, I24 encourages companies to ensure that CRD is "*integrated with business model and strategy*". I28 also states "*Clarity of linkages between different information in the annual*

report so there is a clear coherent pitch…a separate section means it (CRD) *then becomes disconnected from the full picture*". Likewise, I22 demonstrates:

> "*It gets inherently much more understandable if you can link the risk disclosures back to the other elements of the accounts, the strategy, the business model. I think where it is isolated it makes it much more difficult to understand*".

Participants are more concerned with risk disclosures being clear and integrated with other corporate disclosures than their place in the AR. Some participants rather argue that CRD could be disregarded by information users if it is disclosed in a separate statement. I6 states "*It should be linked to performance measures, then linked to compensations, the business model, has the business model changed? All of these things should be linked*". Similarly, I7 argues:

> "*If you put them* (risks) *in a separate statement then arguably you lost all kind of connectivity too with company's business, with what the market is doing, the strategy of the business, and the impact on the numbers. If it is separate, I think no one will read it*".

Understandability is also related to ensuring that RI is specific and tailored to the circumstances of the respective company. Accordingly, linking CRD with information on the company's business model and strategy should enhance specificity of RI as discussed above. I28 emphasises. I20 comments "*Linking them* (risks) *to the activities that the organisation does is probably very important piece to help improve quality*". Participants recommend that RI should be findable regardless of its location. Therefore, they suggest using cross-referencing, highlighting RI, and using clear headings so that RI can be easily found throughout the AR. I5 highlights "*There is a lot of information in what companies report which is about risk but not labelled as risk*".

Furthermore, participants emphasise that companies should provide a clear narrative story of its RE through linking RI with other financial and non-financial performance information to give investors a full picture of company performance and future prospects. They do not support reporting risks in a separate section but rather recommend integrating and linking RI throughout the AR. Participants also suggest giving managers some discretion over where they can disclose their risks in the AR. I28 highlights "*Linkages and cross-referencing allow people if things are not in the same page they know where related information is*". I7 indicates "*It needs to have a heading…it should be where it makes the most sense to management to tell the story…as long as it is findable that is the key*". I26 also comments "*Clear linkage between the risks…and the performance, and the prospect of the business in the future. So, it should not be standalone, but it should help you understand the business model and management governance structure*".

In addition, participants demonstrate that external auditors can provide an opinion on the whole AR including CRD and make a statement as to whether it is fair, balanced and understandable as discussed above. They also refer to the role of non-executive directors in enhancing

understandability of RI. I19 demonstrates "*Non-executive directors have a huge role with understandability…reading them and reflecting on does this communicate to your average reader whatever that means*". Participants also recommend that companies consider investors' feedback as discussed in Chapter 6 and tailor their risk disclosures to meet their needs to improve understandability.

7.10. CRD quality framework

The below CRD quality framework has been developed based on the data analysis and the operationalisation of the FASB qualitative characteristics considering users' information needs and how they can be best met by companies. This framework is intended to fill the previously highlighted gap and could be used to compare and evaluate CRD quality of companies. It could be used by companies to improve their CRD practices. Likewise, external auditors could use the framework to review CRD and provide assurance regarding its quality. Regulators could also use this framework to provide more guidance and/or introduce regulations or amend the existing ones to improve CRD quality.

7.1: Proposed CRD quality framework

Qualitative characteristics	CRD quality criteria
Relevance	1. Defining risk 2. disclosing the company's overall risk appetite 3. Reporting the company's appetite for each key risk 4. Disclosing company-specific risk information 5. Disclosing forward-looking risk disclosures including long-term risks 6. Reporting current and ongoing risks 7. Quantitative risk disclosures (sensitivity analysis) 8. Clear qualitative risk disclosures (scenario-based disclosure) 9. Disclosing risk mitigation/management plans and actions
Faithful representation	1. Disclosing key risks and uncertainties 2. Disclosing risks that are no longer considered material 3. Disclosing downside and upside risks 4. External auditors statement on CRD – Big 4 5. Disclosing audit/risk committee composition and responsibilities regarding risk oversight 6. Ranking risks in terms of significance 7. External independent body providing assurance on RM system

	8. Disclosing the company's risk culture 9. Professional recognition of CRD practices
Comparability	1. disclosing the development/changes of risk over time 2. Consistency of risk measurement and presentation (format and location) 3. Disclosing systematic risks in an industry/market context 4. Reporting and discussing variances between expected and actual risk outcomes 5. Disclosure of changes in risk assessment methods
Verifiability	1. Reporting risk assessment principles/methods and management strategies 2. The amount of quantitative risk disclosures vs qualitative CRD 3. Providing Sufficient information on each key risk in terms of impact, likelihood of occurrence and management 4. Disclosing gross risk and residual risk
Timeliness	1. Using different disclosure channels to report on risks in a timely manner 2. Cross-referencing to other disclosure channels in the AR 3. Disclosing changes in risks over time (up-to-date RI) 4. Disclosing the time-horizon of future risks
Understandability	1. Using tables, graphs, diagrams and heat risk maps 2. Findable and well-structured CRD (clear headings) 3. Cross-referencing to RI within AR 4. Highlighting important information using different colours or fonts 5. Using appendices for more information and explanation of technical terms 6. Relative length of the risk section to the entire AR 7. Sentence length (readability) 8. Linking RR to the company's business model, strategy and overall performance 9. Categorising risks

7.11. Conclusion

This chapter explores the last two research questions. The chapter investigates the concept of quality in the context of CRD and examines how the FASB qualitative characteristics can be applied to CRD. CRD quality is defined in terms of the decision-usefulness of RI. The chapter also highlights a number of characteristics that could be used to further improve and assess CRD quality. Accordingly, the initial framework developed in chapter 3 has been further amended and improved.

Chapter 8: Discussion of Findings

8.1. Introduction

This chapter discusses the findings outlined in the previous three chapters by comparing and contrasting them with the results of previous CRD and corporate disclosure studies. This should help interpret the results of this study, highlight its contribution and areas that need further investigation, and situate the study in terms of previous work.

This chapter is structured into a number of sections based on the themes that emerged from data analysis. Section 8.2 discusses the concept of risk. Section 8.3 addresses relevance of CRD and Section 8.4 discusses current CRD practices. CRD incentives and disincentives are discussed in section 8.4. Section 8.5 addresses CRD quality and section 8.6 discusses CRD quality characteristics. Section 8.7 concludes.

8.2. Definition of risk

This study highlights the lack of a clear and common definition of risk in practice and within the prior CRD literature. Reaching an agreed-upon definition is an essential first step towards understanding CRD practices and explaining the information gap between investors and managers. Such a definition is needed to avoid potential unfavourable reactions by stakeholders due to misinterpretation of CRD. In line with the findings, Leitner-Hanetseder (2012) suggests that companies define risk in their risk disclosures and highlights the absence of a clear definition of risk in regulations and CRD literature.

Risk can be perceived differently by different people and in different contexts. Risk as the term implies can be understood in terms of its negative impact potentially resulting in harm or loss. Previous CRD studies have overlooked the definition of risk with too little attention paid to defining risk before examining CRD practices. Miihkinen (2012) also emphasises that CRD regulations do not provide an explicit explanation of the concept and nature of risks that companies should disclose. The results show that this holds in practice.

Defining risk proves challenging and is a contentious area. A resolution of this contention is of critical importance for developing a CRD quality framework. The findings reveal mixed views regarding the concept of risk. There is generally a lack of common understanding of risk among the different stakeholder groups. Risk is generally perceived as uncertainty or volatility of future outcomes that may have a significant impact on company performance, but there is a disagreement concerning its outcome: positive or negative. Risk and uncertainty are perceived as synonyms.

Some participants indicate that risk is inherent to business and should be handled effectively so that the company can survive and continue to create value. Therefore, they tend not classify risk into upside and downside, but rather as an essential aspect of running a business.

Other participants perceive risk in terms of expected negative consequences arguing that risk may have a detrimental impact on company performance preventing it from achieving its strategic objectives. They make a distinction between downside risks and upside risks. Prima facie, companies and investors are more concerned about downside risks and what could go wrong. Nevertheless, they should consider potential opportunities arising from managing risks and running a business. Gough (1988) also states that "risk can also be associated with gain, particularly in financial management concerns" (p. 7).

Understandably, investors are concerned about potential loss, whereas professional and regulatory bodies are concerned about business failure and interested in promoting transparency and protecting investors. Individual and institutional investors may perceive risk differently depending on the nature and amount of their investments and their risk appetite and preference.

Conversely, the majority of the participants in this research perceive risk in a broader sense as both upside and downside. They define risk as the volatility/uncertainty of future outcomes that could lead to either favourable or unfavourable outcomes. This approach is consistent with the ISO's 31000:2009 definition of risk as the "effect of uncertainty on business objectives" (P. 1), which implicitly refers to potential positive and negative effects. This view also conforms to Linsley and Shrives' (2006) definition that is widely adopted in the previous CRD studies. Hence, risk can be defined in terms of both its likelihood of occurrence, and materiality as to its impact on company performance and future prospects.

The participants who perceive risk as both upside and downside provided a number of reasons to justify their argument. First, the complex and rapidly changing business environment in which companies operate imposes both threats and opportunities that companies have to manage effectively in order to survive and thrive. Second, every business organisation should have its own risk appetite to achieve profits and growth. Companies intentionally take and accept risk to maximise their values and achieve their strategies. Third, the type of risk and its impact should be considered. So, there are risks that managers are familiar with and can manage effectively, and other risks that could have detrimental impact on the business. Fourth, the impact of risk might vary depending on risk management (RM). Thus, management could reduce the impact of a downside risk or even turn it into an opportunity, and capitalise on upside risks through effective RM.

Linsley and Shrives (2006) used a broad definition of risk that encompasses both upside and downside risks and equates risk with uncertainty. The majority of prior studies have adopted

Linsley and Shrives' definition without attempting to investigate the concept of risk (Marzouk, 2016; Mokhtar and Mellet, 2013; Mousa and Elamir, 2013, 2014).

Oxford Dictionaries (n.d.) define risk as "a situation involving exposure to danger" and "the possibility that something unpleasant or unwelcome will happen" focusing on downside risk. However, Oxford Dictionaries provide another definition that acknowledges upside risk stating "a person or thing regarded as likely to turn out well or badly in a particular context or respect". The latter definition refers to particular conditions and uncertainty that may lead to either negative or positive outcomes.

Likewise, Solomon et al. (2000) define risk in its broadest sense as "uncertainty associated with both a potential gain or loss" (p. 449). Ryan (2012) defines risk as the variation in company performance arguing that risk is a "two-sided phenomenon" (p. 296). Beretta and Bozzolan (2004a) also define risk as the impact of uncertainty and volatility on expected outcomes without clearly indicating whether that impact could be positive or negative. However, Linsley (2013) recognises only the downside element of risk stating "once a risk has been defined and analysed, it would appear a relatively straightforward task to make a decision based on this and choose a course of action that minimises the loss of value" (p. 162).

The ICAEW (1999, 2002, 2014) acknowledges the necessity of taking risk for the achievement of strategic objectives and defines risk as uncertainty that could be either downside or upside. However, the ICAEW (2011) primarily focuses on downside risk arguing that "most risk reporting in practice is about risk in the negative sense, and it is this usage that we generally use in this report" (p. 3).

Davies, Moxey and Welch (2010) confirm the findings and indicate that risk is inherent in business and can have upside potential. They also caution against attempting to eliminate risk completely that can hinder company performance and the achievement of its objectives. There is a balance that needs to be maintained between taking and accepting risks and manging them effectively.

Disclosure regulations do not seem to have provided a clear and unified definition of risk. For example, the UK regulations do not explain the meaning of risk and generally require companies to disclose their principal risks and uncertainties. The UK CG Code (FRC, 2016a) addresses 'principal risks' and 'material uncertainties' separately. The Code requires the disclosure of principal risks and uncertainties that may prevent the company from achieving its strategic objectives and affect its going concern status, and explain how they are being managed. This view of risk focuses on downside risk. However, the Code recognises the necessity of risk taking and maintaining a robust risk management system so that companies can achieve their strategies. The Code indicates that the board of directors is "responsible for determining the nature and extent of the principal risks it is willing to take in achieving its

strategic objectives" (p. 17). Moreover, the UK Companies Act 2006 briefly requires companies to disclose their 'principal risks and uncertainties' in their strategic report. The Act uses both terms together and does not make a distinction between them or provide an explanation of each concept.

In Germany, GAS 20 requires companies to provide a description of their 'material opportunities and risks' in management report stating that "opportunities must be treated in the same way as risks" in terms of how they should be reported and presented in the annual report (ASCG, 2012). Accordingly, it can be argued that GAS 20 differentiates between downside risks and upside risks. However, these regulations are broad in terms of defining risk and risk reporting (RR) in general, thereby leaving a great deal of discretion to companies in interpreting and implementing disclosure requirements.

The absence of a common definition of risk is expected to widen the information gap between managers and investors, and between informed and uninformed investors. It is also expected that this absence can affect CRD quality. A common definition is also needed so that any regulations or guidelines for improving CRD quality can be more effective.

Risk is a complex concept to define in the context of CRD. There is not a unanimous definition of risk, which represents a major concern in terms of RM and RR. This could be attributed to the nature of risk that varies across different contexts. Doff (2008) highlights the absence of a common definition of business risk because it is used in different contexts.

Understanding and analysing risk is complex and context-dependent (Delogu, 2016; Spekman and Davis, 2004). The perception of risk depends on the context it is being addressed in and the type of risk. For example, health care organisations are mainly concerned with downside risks. Likewise, health and safety risk is a key risk facing oil and gas and pharmaceutical companies that is understood only in terms of its downside impact and hence managed to eliminate or reduce its potential impact. In such cases, there is no room for upside opportunities. Analysing risk also depends on managers' maturity and the sophistication of the business they are running, its business model and strategy and RM capabilities.

The definition of risk has evolved over time. Risk has been traditionally defined as the probability of unfavourable outcome and associated with potential loss or harm. Doff (2004) defines business risk as "the risk of financial loss due to changes in the competitive environment or the extent to which the organization could timely adapt to these changes" (as cited in Doff, 2008, p. 320).

Knight (1921) made a distinction between risk and uncertainty calling the former 'measurable uncertainty' where probabilities can be assigned to potential outcomes, and the latter 'unmeasurable uncertainty' where probabilities cannot be assigned to potential outcomes. Knight highlighted another difference between risk and uncertainty regarding their expected

outcome arguing that risk refers to an unfavourable uncertainty, while uncertainty refers to a potential favourable outcome, which is also consistent with Spekman and Davis' (2004) argument.

However, other definitions equate risk and uncertainty where both terms are used as synonyms interchangeably that is consistent with the view of the majority of participants. Therefore, risk is viewed as the possibility of future outcomes that may be positive or negative. HM Treasury (2004) defines risk as "uncertainty of outcome, whether positive opportunity or negative threat" (P. 9).

Furthermore, ISO 31000:2009 defines risk as uncertainty of outcomes that is associated with "a deviation from the expected - positive and/or negative". Ward and Chapman (2003) suggest substituting the concept of risk, which is always associated with threat, with uncertainty as a broader concept encompassing opportunities as well arguing that it could enhance RM. They call for adopting an 'uncertainty management' approach instead that comprises positive and negative outcomes. Delogu (2016) recognises the upside element of risk; however, states that "although risks are often associated with potential benefits or opportunities, the negative connotation prevails in the common language" (p. 7).

Another key aspect that is overlooked in the prior CRD literature is risk appetite which represents the amount of risk a company is willing to take, accept and/or tolerate to achieve its strategy. The findings highlight that risk appetite-related disclosures are generally missing or unclear. Bekefi, Epstein and Yuthas (2008) underline the importance of having risk appetite stating "risk taking, the engine driving business, is vital to companies seeking market success" (p. 3). Moreover, they confirm the findings of this study as they adopt a broad definition of risk highlighting that risk "can present significant opportunities and possibilities for organizational innovation and new competitive advantage leading to short- and long-term profitability" (p. 3). Setting a company's risk appetite is associated with improving its RM and performance and achieving its objectives (KPMG, 2008; Rittenberg and Martens, 2012).

There is a balance that companies should maintain when disclosing their risks considering potential upside and downside risks that could also give comfort to investors rather than focusing on downside risks. There are a number of aspects that should be considered in defining and analysing risk including the inherent uncertainty, level of seriousness, RM and company risk appetite. The way risk is perceived in an organisation should determine its RM approach and external RR. This is where a broader definition of risk that meets the information needs of different stakeholders may be more appropriate.

8.2.1. Importance of defining risk

The absence of a unified definition of risk could lead to unfavourable consequences leading to misinterpretation of CRD and information asymmetry problem. The differences among stakeholders in the perception of risk should be taken into account.

Different people and organisations could perceive risk differently. Employees within the same organisation may hold different views of risk which could negatively affect RM practices. It is, therefore, important to develop and ensure a common understanding of risk among different stakeholders. Accordingly, a clear definition of risk that is adopted across the organisation and communicated to stakeholders could contribute to better RM and avoid any problems that might arise.

Reaching a shared definition of risk requires resolving the controversy between risk and uncertainty and whether it is appropriate to use both term interchangeably. It could be argued that risk refers to negative impact of 'known unknowns', where uncertainty refers to 'unknown unknowns' with the possibility of favourable or unfavourable outcomes depending on how events unfold and how they are being handled. Therefore, uncertainty could be seen as a broader concept that may also encompass risk. Uncertainty represents a risk/concern for businesses and investors regarding what the future holds irrespective of its impact. It could be argued that combing risk and uncertainty and using a unified definition could have significant implications for RM.

Hillson (2002) and Ward and Chapman (2003) support the above argument arguing that uncertainty is a broad concept that includes both downside and upside risks. Ward and Chapman (2003) further suggest using 'uncertainty management' instead of RM. Hillson (2004) also defines risk as "uncertainty that matters" associated with the achievement of objectives. Hence, risk is an event or uncertainty that may have a significant impact on expected outcomes. Hillson (2002) argues that there is a tendency towards an overarching definition of risk comprising threats and opportunities.

Hillson (2002) emphasises that both terms are similar in respect of the uncertainty associated with them. He recognises uncertainty as a broader concept, yet he calls for using risk in a broader sense that includes both favourable and unfavourable uncertainty. Hillson (2002) and Ward and Chapman (2003) further highlight that such approach/system that handles both risks and uncertainties can contribute to a more effective and efficient RM that mitigates risks whilst capitalising on opportunities. Moreover, this approach can enable the company to manage risks and uncertainties proactively and capture all potential outcomes. Delogu (2016) confirms this view stating "risk perception plays an important part in risk governance" (p. 7).

In addition, Linsley and Shrives (2006) emphasise the need for a definition of risk to overcome the challenge of conducting CRD research. Linsley, Shrives and Crumpton (2006) suggest that

companies should disclose the definition of risk they use to avoid information being interpreted incorrectly by information users. Doff (2008) draws attention to the need for a definition of business risk so that risk can be measured properly and managed effectively. Combes-Thue´lin, Henneron and Touron, (2006) also call for an agreement on the definition of risk to evaluate managers' performance and assess the company's level of compliance with regulations. Likewise, Linsley (2013) argues that risk can be managed quite easily if it is properly defined and analysed. Delogu (2016) also argues that "Understanding and properly addressing risk require clarity about its component concepts and rigour in the use of the corresponding terminology" (p. 8).

Furthermore, Eccles et al. (2001) address risk in a broader sense acknowledging its necessity for ensuring business survivability and achieving its strategy. They underline the danger of separating downside risks and upside opportunities calling the latter "the focal points of strategic planning and business development" (p. 32). They also indicate that chief risk officers further emphasise this distinction and focus more on reducing the impact and uncertainty associated with downside risks. Eccles et al. (2001) further argue that such distinction affects companies' decisions regarding their risk disclosures. Gough (1988) demonstrates that "reducing uncertainty does not mean that the risk will be reduced, reducing risk in one area may in fact introduce further risk" (p. 6). This argument is consistent with the findings that caution against attempting to reduce or eliminate every possible risk.

Accordingly, this study advocates a broad definition of risk that comprises downside risks (threats) and upside risks (opportunities) inherent in a company's business model and strategy to meet the information needs of different stakeholders. A technical definition of risk and the distinction between risk and uncertainty may be more appropriate for RM to identify potential outcomes and their likelihood of occurrence and RM actions needed.

8.3. Relevance of CRD

The findings underline the particular importance of CRD for understanding a company's risk position, overall financial health and performance, and future prospects. They indicate that CRD should be considered by investors in addition to financial information when making decisions. However, the results show that investors may disregard risk information (RI) particularly if the company is doing well financially or due to the lack of its quality and understandability. Therefore, it worth highlighting that a company's financial performance in terms of its market value, profitability, share price, and cash flows is closely related to its risk exposure (RE). The Accounting Standards Board (1999) considers a company's risk profile and RM approach a key indicator of its financial position and ability to survive changes.

The results suggest a number of benefits of CRD for investors and companies confirming previous studies and professional reports. Epstein and Buhovac (2006) argue that better CRD

enables both managers and information users make risk-informed decisions. The findings show that CRD helps investors make better informed decisions by assessing the company's performance and ability to achieve its strategic objectives, and attaching a fair value to its stock which is consistent with Epstein and Buhovac's (2006) argument. Previous studies also indicate that CRD enhances investors' decision-making in terms of assessing the business performance and future prospects considering its RE (Cabedo and Tirado, 2004; Campbell et al., 2014; Deumes, 2008; Linsley and Shrives, 2000; Solomon et al., 2000).

CRD provides investors with assurance about the company's RM system and how well it is managed. Hence, investors can assess management's stewardship and accountability regarding CRD and RM practices confirming ICAEW's (1997) claim. The FRC (2014b) emphasises that disclosure should help stockholders make informed decisions, evaluate stewardship and hold managers to account. This is also beneficial to companies to maintain investors' confidence and avoid any unfavourable reactions. Better CRD can reduce investor's uncertainty (Uddin and Hassan, 2011).

Furthermore, some studies argue that CRD can help investors predict stock returns, changes in stock prices and company's future cash flows (Beretta and Bozzolan, 2004a; Deumes, 2008; ICAEW, 1997; Linsley and Shrives, 2005b). CRD can also protect investors through reducing information asymmetry (Campbell et al., 2014; ICAEW, 1997; Linsley and Shrives, 2000; Rajab and Handley-Schachler, 2009).

The findings reveal that institutional investors may be less concerned with external CRD considering that they have other information sources particularly private meetings with management where they can gain a better understanding of a company's risk profile. However, external CRD provides them with assurance regarding their own assessment of a company's RE. Abraham, Marston and Darby (2012) confirm this result arguing that private meetings are a key source of information for investment analysts whereas external CRD serves as a source of assurance.

In addition, the findings demonstrate that companies could successfully attain particular benefits of financial and non-financial nature including reducing information asymmetry, cost of capital and stock price volatility, and hence reflecting the real value of the firm. Previous studies also emphasise that better CRD can lower the cost of capital (ICAEW, 1997; Keqa and Lannoy, 2016; Linsley and Shrives, 2000; Solomon et al., 2000). However, these studies have not quantitatively examined the relationship between CRD and cost of capital. Their argument basically revolves around the idea that investors will require higher risk premium for the uncertainty associated with their investments that can be reduced through better CRD. Accordingly, there is a need for more evidence to support the financial benefits associated with CRD. Nahar, Azim and Jubb (2016) find a negative relationship between CRD and cost of capital and argue that CRD enhances investors' confidence in the business and risk management

in particular. Likewise, Kim and Yasuda (2017) find that more CRD leads to lower cost of capital.

Rajab and Handley-Schachler (2009) argue that CRD can reduce agency costs through overcoming the information asymmetry problem and avoiding unfavourable reaction by investors. Likewise, Al-Hadi, Hasan and Habib (2016) find that the level of market risk disclosure improves firm-level investment behaviour by reducing information asymmetry and improving the investment efficiency of financial firms.

The results show that better CRD assist companies in fulfilling their stewardship towards investors as the capital providers by meeting their information needs and enhancing their confidence, and therefore improving company credibility. Hence, companies can take advantage of their CRD in reassuring investors by signalling the effectiveness of their RM. This benefit is consistent with the signalling theory (Linsley and Shrives, 2000). Furthermore, the findings indicate that companies can consequently gain a competitive advantage which conforms to Keqa and Lannoy's (2016) observation.

The findings indicate that better CRD is a reflection of effective RM practices. This claim is supported by Linsley and Shrives (2000; 2005a) who suggest that CRD can draw investors' attention to the effectiveness of RM. Dobler (2008) also argues that managers could use RR as a tool for RM through influencing stakeholders' decisions, behaviours and reactions. However, the ICAEW (1997) argues that improved CRD can contribute to better RM leading to higher cash flows, greater value for shareholders and better corporate image. The ICAEW's view is supported by Airmic (2013). Therefore, there is a need for further investigation as to whether better CRD is an outcome of or a contributor to effective RM.

The findings also suggest that CRD can protect the company particularly in the long-term through increasing its resilience and improving its recovery from crises as it is being favoured by investors over its competitors. Similarly, Epstein and Buhovac (2006) demonstrate that improved CRD can lead to more favourable stakeholder reactions.

Better CRD and enhanced transparency in general should lead to positive impact on the capital market and the economy as a whole. Some studies highlight that improved CRD should ultimately enhance capital market efficiency and contribute to the improvement and stability of investment environment and capital accumulation (Abraham, Marston and Darby, 2012; Epstein and Buhovac, 2006; Rajab and Handley-Schachler, 2009).

CRD is also relevant to other stakeholders depending on their interest in the company such as regulators who are interested in ensuring companies' compliance with regulations to protect investors and satisfy their obligation towards stakeholders.

8.4. Existing CRD practices

It is worth mentioning the difficulty of assessing CRD quality due to its challenging nature and the absence of a benchmark for evaluating CRD quality. The findings highlight the differences between the participants regarding current CRD practices. Similarly, Abraham, Marston and Darby (2012) provide mixed evidence where the annual report preparers group that participated in their study highlighted that CRD has not improved, the investment analysts group indicated that CRD quantity has increased due to regulations.

The findings reveal that CRD has improved in terms of quantity and informativeness, which is consistent with the findings of some previous studies that reveal an increasing trend in CRD quantity in particular (Hill and Short, 2009; Konishi and Ali, 2007; Miihkinen, 2012; Neri, 2010; Rajab and Handley-Schachler, 2009; Woods and Reber, 2003). However, the findings underline that there is still significant room for further improvement.

A few participants contest the above view emphasising that CRD lacks quality. Other participants oppose generalisation and demonstrate that CRD varies across companies where companies such as financial companies, oil and gas, utilities and supermarkets provide higher CRD quality.

The results highlight some limitations in current CRD practices that they suggest as areas for future improvement particularly reporting principal risks and company-specific risk information (RI) and ensuring linkage between risk disclosures and company business model and strategy. Some participants though recognise that there is some improvement regarding disclosing key risks and integration of RI throughout the annual report.

The findings emphasise that companies should tailor their risk disclosures to their own circumstances to ensure their specificity and usefulness rather than providing boilerplate RI. Campbell and Slack (2008) support this view as their investigation of the views of investment analysts specialising in the banking industry of narrative reporting reveals that CRD is boilerplate and lacks usefulness. Slack and Campbell (2016) also confirm the absence of specific risk disclosures. Previous CRD studies also indicate that CRD is vague, boilerplate and uninformative (Abraham and Shrives, 2014; Jia, Munro and Buckby, 2016; Linsley and Lawrence, 2007).

Some interviewees argue that companies focus on disclosing information on RM that is generic in nature rather than addressing risks and their impact confirming the findings of Miihkinen (2012). The results also suggest integrating risk disclosures throughout the annual report and ensuring linkage between risk disclosures and other relevant disclosures. This aspect has not been addressed in the prior CRD literature.

Some participants also call for disclosing long-term risks. The FRC (2016b) emphasises that companies should discuss in their viability statement the impact of principal risks on their long-term viability. Moreover, the FRC recommends that companies should disclose particular risks including cyber security and long-term risks such as climate change and Brexit.

The results of previous studies show mixed evidence on current CRD practices. Some of these results are consistent with the findings of this study. Some studies reveal that there is generally limited CRD (Linsley & Shrives, 2000; 2006). Some studies highlight the lack of quantitative and forward-looking RI in particular (Beretta and Bozzolan, 2004a; Konishi and Ali, 2007; Lajili and Zeghal, 2005; Linsley & Shrives, 2006; Ali, 2005).

However, other studies find an increasing trend of CRD quantity associated with the introduction of disclosure regulations (Deumes, 2008; Hill and Short, 2009; Konishi and Ali, 2007; Miihkinen, 2012; Neri, 2010; Rajab and Handley-Schachler, 2009; Woods and Reber, 2003), or following the 2007-8 financial crisis (Ntim, Lindop and Thomas 2013). Likewise, Linsley and Shrives (2006) argue that companies are willing to provide more forward-looking RI. Participants confirm this view arguing that regulations have played a part in improving CRD practices.

The findings are generally consistent with previous CRD studies underlining the poor quality of risk disclosures provided by companies and calling for more attention to CRD quality instead of quantity (Beretta and Bozzolan, 2004a, 2004b; Dobler, 2008; Lajili and Zéghal, 2005).

8.5. Incentives and disincentives for CRD

Prior CRD literature has focused on examining the relationship between CRD quantity and company-specific characteristics and other studies have examined the impact of CG mechanisms on CRD practices as discussed in chapter 2. However, these factors may not necessarily reflect CRD practices and behaviours considering the subjectivity in measuring CRD quantity.

It could be argued that organisational and managerial incentives and disincentives play a key role in determining the level and quality of CRD. This study analyses factors that may be difficult to investigate quantitatively related to managers' CRD decisions. Understanding the factors influencing CRD behaviours could help explain existing CRD practices and suggest a way forward for improving CRD quality. CRD incentives and disincentives depend largely on managers' perception of risk and RM approach.

The findings reveal a number of factors that could lead managers to reveal or conceal particular RI that have not been addressed in the prior CRD literature. CRD incentives and disincentives are related to the perceived benefits and consequences of CRD. Hence, managers will always consider the costs and benefits; organisational and personal, associated with CRD. Interestingly,

some of these factors can both be an incentive and disincentive at the same time including investor reaction. Investors could react unfavourably and/or irrationally to the disclosure of downside or upside risks. Generally, the role of incentives and disincentives depends on the type of risk and its impact, availability of information in the public domain, and whether other companies have disclosed the same risk. Abraham, Marston and Darby (2012) address directors' concerns about personal liability for the disclosure of downside risks in particular.

Considering the nature of CRD managers may exercise their discretion over the amount, type and timing of RI to report publicly. CRD is a contentious area where the disclosure and nondisclosure could have unfavourable consequences. The participants recognise the potential costs of CRD; however, they support more transparency and emphasise that companies can achieve more benefits and/or reduce potential costs through enhancing their credibility and increasing investor's confidence.

8.5.1. CRD disincentives

The findings demonstrate a number of disincentives and concerns about disclosing RI. These disincentives may explain the motives behind withholding risks and/or providing information of lower quality, but without suggesting concealing this information. The ICAEW (2011) refers to the risk of RR highlighting that "risk reporting creates its own risks and so needs to be undertaken by preparers, and interpreted by users, as an exercise in risk management" (P. iv).

First, risks are inherently uncertain and their assessment may be fundamentally difficult and subjective. Moreover, managers may not be aware of some risks or unable to predict their impact. Dobler (2005) confirms this result arguing that managers may not possess information about risk. However, this may raise concerns about the company's RM system. Dobler (2008) claims that managers may be more willing to disclose verifiable RI. Berger & Gleibner (2006) also indicate that managers may not have sufficient information about a particular risk to disclose. Abraham, Marston and Darby (2012) demonstrate that the inherent uncertainty of risk may discourage companies from disclosing future RI due to potential unfavourable consequences. Likewise, Eccles et al. (2001) underline the extreme difficulty and subjectivity of risk assessment and disclosures. Similarly, the ICAEW (2011) emphasises the unreliability of CRD due to the uncertainty and subjectivity of risk assessment that reduces users' reliance on RI.

Second, managers may be reluctant to disclose information related to ongoing internal investigations or legal disputes to avoid affecting the outcome of such events. They will seek legal advice regarding the amount and timing of disclosure considering potential litigation risk as well. Third, managers' own incentives and personal interests could influence their decisions and neutrality in terms of CRD, which is consistent with Abraham, Marston and Darby's (2012) findings. The findings are also in line with Kothari, Shu and Wysocki (2009) who state that

"managers' career concerns can affect their decisions to withhold their private information" (p. 247).

Managers' CRD decisions may also depend on the level of managers' position within the organisation. While lower- and middle-level managers could be interested in retaining their jobs, senior managers could be seeking to maximise their stock price-based wealth. Accordingly, they might be inclined to conceal or manipulate bad news in particular or present it in a favourable manner. These practices are also related to CG and risk culture within the company. The ICAEW (2011) acknowledges the costs of CRD for managers and organisations which could affect CRD quality particularly if expected costs surpass potential benefits, and Greco (2012) argues that managers are also concerned about potential litigation costs.

Fourth, lack of regulations or enforcement could affect CRD quantity and quality. Therefore, the findings suggest that CRD should be compulsory in general to guarantee that companies provide the minimum amount of disclosure; otherwise companies may choose not to disclose. The findings do not support more prescriptive regulations that could lead to boilerplate CRD. Some studies find a positive relationship between introducing disclosure requirements and CRD quantity (Deumes, 2008; Hill and Short, 2009; Konishi and Ali, 2007; Miihkinen, 2012; Neri, 2010; Woods and Reber, 2003). Other studies indicate that regulations can increase the amount of CRD (Linsley and Shrives, 2005a), but may have little impact on its quality (Greco, 2012; Rajab and Handley-Schachler, 2009).

Other studies confirm the findings and support a rules-based approach that gives companies discretion to tailor their CRD to their business model, strategy and circumstances (Elshandidy and Neri, 2014; Solomon et al., 2000). Berger & Gleibner (2006) find that CRD quality has slightly improved over time; however, they state that "under a mandatory reporting regime…there may well be an information asymmetry when it comes to risk information due to e.g. agency problems" (p. 15).

Some studies refer to the shortcomings of CRD regulations. Miihkinen (2012) indicates that CRD regulations do not explain the concept and nature of risks that companies should disclose and calls for detailed regulations to assist companies in disclosing risks. Beretta and Bozzolan (2004a) emphasise the absence of methods for measuring the impact of risk in the accounting literature and disclosure regulations. However, Linsley and Shrives (2005a) argue that regulations in the UK have contributed to improving CRD.

The UK Companies Act 2006 and CG Code generally require companies to disclose their principal risks and uncertainties. Disclosure regulations in other countries including the USA and Germany are more prescriptive and require companies to provide forward-looking and quantitative RI. For example, GAS 20 is more explicit and provides further guidance on CRD.

Likewise, IFRS 7 requires companies to disclose quantitative and qualitative information on market risks and explain financial risk assessment methods (IASB, 2005). Nevertheless, Dobler (2008) asserts the role of CRD incentives stating "regulation cannot overcome incentives in risk reporting" (p. 186). Moreover, Linsley and Shrives (2005a) justify the lack of CRD by managers' unwillingness to disclose commercially sensitive information. This lends support to the notion that regulations alone cannot guarantee higher CRD quality. Therefore, more attention needs to be paid to the incentives and benefits associated with CRD to encourage companies to disclose more RI.

Fifth, companies may refrain from reporting RI because of fear of misinterpretation of CRD by information users and investors in particular who might take adverse actions. Therefore, companies are encouraged to tailor their CRD carefully and ensure its clarity. The findings suggest that companies maintain the balance between disclosing too much information that might increase their RE or confuse investors, and disclosing sufficient, concise and clear information to accommodate stakeholders' needs. This finding is consistent with Linsley, Shrives and Crumpton (2006) who argue that companies can eliminate the problem of misinterpretation by defining the technical terms they use in their CRD.

Berger & Gleibner (2006) indicate that companies may be unwilling to disclose quantitative RI due to potential unfavourable consequences including investors' mis-reaction stating that investors might "call for a distribution of capital as the risk adjusted capital needed could be much lower than the actual company's equity capital" (p.15). This could be called the risk of risk reporting. Eccles et al. (2001) also highlight that CRD could lead to unfavourable reactions by competitors and investors due to the sensitivity of information. Uddin and Hassan (2011) find that greater CRD could increase investor's uncertainty. However, they call for more CRD to help investors diversify their portfolios and minimise their RE. The findings are also consistent with Kothari, Shu and Wysocki (2009) who indicate that managers may not promptly disclose bad news. Kothari, Shu and Wysocki (2009) further argue that the disclosure of bad news could lead to significant market reaction because it may be perceived by stakeholders as more credible than good news.

Sixth, the major disincentive is the sensitivity of RI that could affect company performance and competitive position. This is also consistent with previous studies that argue that managers are more likely to conceal commercially and competitively sensitive information (Abraham, Marston and Darby, 2012; Armitage and Marston, 2008; Linsley and Shrives, 2000; 2006). The finding is, according to Linsley and Shrives (2000), consistent with proprietary cost theory as companies will refrain from disclosing information that can be utilised by competitors.

However, the prior CRD literature does not provide further explanation for this disincentive. It can be argued that withholding sensitive information on upside or downside risks could be mutually beneficial for companies and investors especially if it might affect the going concern

status of the company, its financial position and future prospects. The ICAEW (2011) states that "there are some risks that firms will never report and others that they are always liable to understate" (p. iv). Wysocki (1998) argues that "investors seem to react more quickly to negative information" (p.19). Meek, Roberts and Gray (1995) indicate that disclosing sensitive information may result in more intense competition and/or more regulations. For this reason, companies end up disclosing generic RI (ACCA, 2014). Bill Knight; chairman of the Financial Reporting Review Panel (FRRP), cautions companies against boilerplate CRD stating "boards who retreat behind boilerplate give the impression that they have not themselves understood the risks they face" (FRC, 2011b).

The findings highlight a number of aspects that companies will consider before disclosing sensitive information including its potential impact on share price and whether or not it is known to the market. Companies may be more inclined to withhold downside risks, but they could also conceal upside risks that may encourage other companies to enter the market or capitalise on business opportunities. Likewise, if information is available in the public domain companies will have to report it to avoid any unfavourable consequences. Dobler (2008) confirms this view demonstrating that companies will disclose particular information if it is already known to stakeholders, which could affect CRD quantity and quality. Moreover, Gulko, Hyde and Seppala (2017) argue that a crisis event forces companies to disclose more and higher CRD quality.

Berger & Gleibner (2006) indicate that the sensitivity of particular risks such as strategic risks may discourage managers from reporting them publicly. The findings are consistent with some studies that highlight companies' fear of losing a competitive advantage due to disclosing commercially sensitive information that can be used by current and potential competitors (Abraham, Marston and Darby, 2012; Dobler, 2005; Dobler, Lajili and Zeghal, 2011; Linsley and Shrives, 2006). Walter Kielholz, CEO of Swiss Re, also states that "risk disclosures can be negative unless you can also disclose how you are managing this risk" (Eccles et al., 2001, p.30). Eccles et al. (2001) underline the relationship between effective RM and better CRD. Thus, companies can mitigate potential unfavourable consequences of market and investors' reaction to sensitive information through effective CRD and RM.

Moreover, companies may share positive and proprietary information with their institutional investors in particular in private meetings to reassure them and overcome their potential negative reaction, and/or intentionally disclose adverse information to discourage potential competitors from entering the industry which is consistent with Dobler (2005). The findings reveal that institutional investors can obtain more and useful RI in private meetings with management. Therefore, some participants support withholding competitively sensitive risk details that may expose the company or lead to losing a competitive edge. Solomon et al (2000) indicate that companies provide material RI to institutional investors and analysts in private

meetings, where public disclosure may become irrelevant and less timely. However, this may worsen the information asymmetry problem. The results of this study do not suggest concealing such information and caution against unfavourable consequences as discussed below.

The ICAEW (1999) opposes the argument regarding the commercial sensitivity of CRD stating that “companies have no informational or commercial barriers to enhanced risk disclosure, but simply do not provide as much useful information as they could” (p. 21). Davies, Moxey and Welch (2010) emphasise that companies may suffer reputational costs due to lack of disclosure.

8.5.2. CRD incentives

Although it may be difficult to articulate incentives for companies to disclose more RI voluntarily, the findings reveal a number of factors that could encourage companies to improve their CRD considering the benefits they can achieve through maintaining transparency about their RE, and the costs of nondisclosure or lack of disclosure. These incentives comprise internal and external factors.

Some prior studies have also placed particular emphasis on the role of incentives in influencing managers’ CRD behaviours and decisions and argue that management incentives affect CRD practices (Dobler, 2005; Dobler, 2008; Dobler, Lajili and Zeghal, 2011). Dobler (2005) demonstrates that companies tailor their RR to influence investors and competitors’ decisions and achieve benefits. Dobler (2008) also claims that companies will report RI if no disclosure costs are expected to be incurred.

8.5.2.1. Internal incentives

First, managers have a key responsibility to act in the best interest of investors whilst ensuring transparency about company financial performance and RE as part of their stewardship role. Hence, they should meet the information needs of capital providers to maintain their confidence. The findings suggest that better CRD can lead to lower cost of capital; the ultimate financial incentive for CRD, which is consistent with previous studies (Nahar, Azim and Jubb, 2016; Epstein and Buhovac, 2006; Heinle and Smith, 2017; Keqa and Lannoy, 2016; Kim and Yasuda, 2017). Dobler (2005) argues that managers may disclose more RI if it will reduce the cost of capital. This claimed benefit of CRD has been highlighted, yet not examined, by some studies and the ICAEW (ICAEW, 1997; Linsley and Shrives, 2000; Solomon et al., 2000).

However, Semper and Beltrán (2014) find an insignificant relationship between non-financial risk disclosure and cost of capital, and a positive and significant association between financial risk disclosure and the cost of capital. The ICAEW (2011) contradicts its previous position emphasising the lack of evidence for the relationship between better CRD and lower cost of capital. The ICAEW further underlines the difficulty of assessing and attributing the impact of disclosing particular information on the cost of capital.

In the context of corporate disclosure, Armitage and Marston's (20008) investigation of senior executives' view on the relationship between disclosure and cost of capital reveals that greater disclosure is associated with lower cost of capital. Likewise, Lambert, Leuz, and Verrecchia (2007) find that more disclosure reduces the cost of capital. Similarly, Botosan (2006) who conducted a review of prior research examining this relationship reached the same conclusion. Boujelbene and Affes (2013) show a negative and significant relationship between intellectual capital disclosure and cost of capital. Dhaliwal et al. (2011) indicate that companies that provide more corporate social responsibility disclosure on a voluntary basis enjoy lower cost of capital. Moreover, Francis, Nanda and Olsson (2008) find a negative association between the level of voluntary disclosure and the cost of capital.

Botosan and Plumlee (2002) find a positive association between greater disclosure especially timely disclosure and the cost of capital contradicting the above argument. Richardson and Welker (2001) demonstrate that social disclosure and the cost of capital are significantly positively related. Accordingly, the impact of disclosure on the cost of capital is an area which requires further investigation particularly in the context of CRD considering the mixed evidence on this relationship.

Second, CRD could enhance organisational resilience and flexibility to a changing and volatile business environment. Maintaining transparent communication with investors about their RE could help companies recover more quickly during crises, which is consistent with Airmic's (2013) argument. The findings indicate that companies could attain some benefits by withholding particular RI but they may also suffer significant consequences in the long-term when this information becomes available to the market resulting in a loss of investors' confidence.

The findings are supported by some studies. For example, Bravo (2016) finds a positive association between voluntary RR and firm's value suggesting that enhanced CRD improves corporate image and reputation as the company is perceived more favourably. Likewise, Louhichi and Zreik (2015) find that CRD is positively associated with corporate reputation. Biddle, Hilary and Verdi (2009) find that disclosure quality enhances firm's resilience to external events and market conditions and hence it is more likely to achieve its investment target. This should ultimately enhance company's credibility and investors' confidence making the company more capable to manage risks and adapt to a changing business environment.

Third, a company that has a robust RM system may disclose more RI to highlight the effectiveness of its RM practices. Therefore, the company can send a positive signal to the market to take advantage of its RR by reflecting the existence of sound RM systems and internal controls. ACCA (2014) states that "greater disclosure of risks is not a threat; it is a chance to demonstrate the strength of the company's controls and management" (p. 14). The findings are also consistent with the signalling theory which argues that the disclosure of more information

can reduce information asymmetry and investor's uncertainty (Campbell et al., 2014; Morris, 1987; Spence, 1973). Likewise, the results are in line with Linsley and Shrives (2000) and Abraham, Solomon and Stevenson (2007) who argue that companies may voluntarily disclose more RI to highlight that they are more effective in managing risks than their competitors, and hence make their stock more attractive to investors. Nahar, Azim and Jubb (2016) find that poor performing banks provide more RI to reduce the cost of capital.

Fourth, building a proper risk culture within the company that promotes transparency in addressing risk could enhance RM and external CRD. This is also related to maintaining sound CG practices. CG mechanisms include the existence of an audit and/or risk committee and independent non-executive directors with relevant financial and industry experience on such a committee and board of directors who can question, challenge and monitor RM and CRD practices, which could ensure transparency about the company's RE. Davies, Moxey and Welch (2010) also emphasise the importance of creating and ensuring a culture of transparency within the company.

The findings are consistent with the UK CG Code that highlights the role of the board of directors and audit and/or risk committees in reviewing and ensuring the effectiveness of internal control and RM systems and transparency of CRD (FRC, 2016a). The Code also underlines the board and committees' composition in terms of the skills, knowledge, experience and independence of their members, and requires disclosing the work undertaken by the audit committee in the AR including any major concerns raised by the committee.

There is a large body of disclosure literature that examines the impact of CG mechanisms on the level and quality of corporate disclosure (Torchia and Calabrò, 2016), or particular types of disclosure including corporate social responsibility reporting (Ahmad, Rashid and Gow, 2017), and sustainability reporting (Al-Shaer and Zaman, 206). These studies find that CG mechanisms including board diversity and board independence positively impact on the quality and/or quantity of disclosure. Salehi and Shirazi (2016) find a negative association between the number of audit committee meetings and disclosure quality, and a positive relationship between audit committee size and expertise and disclosure quality.

In the context of CRD, Barakat and Hussainey (2013) find that banks with good CG provide higher quality operational risk disclosures. Moumen, Othman and Hussainey (2016) show that board size and composition are positively associated with the informativeness of CRD, and find no relationship between CEO duality and CRD quality. Saggar and Singh (2017) find a significant positive association between board size and gender diversity, and CRD. Likewise, Elshandidy and Neri (2015) demonstrate that well-governed companies provide more and useful CRD on a voluntary basis than poorly-governed companies. Some studies also find a positive relationship between the number of independent non-executive directors and CRD quantity (Abraham and Cox, 2007; Lajili, 2009; Ntim, Lindop and Thomas, 2013).

While some participants oppose a separate risk committee because of fear of conflict between the audit committee and risk committee, the findings generally emphasise that forming a separate risk committee depends on company size and the nature of its activities. Al-Hadi, Hasan and Habib (2016) provide empirical evidence that the existence of a separate risk committee should enhance risk oversight and management and improve market risk disclosure. Their findings also show a positive relationship between risk committee size and qualifications of its members, and market risk disclosure. Habtoor and Ahmad (2017) find a positive association between an independent and small-size board with more royal family members and regular board meetings during the fiscal year and CRD.

Al-Maghzom, Hussainey, Aly (2016b) find a positive association between CRD and some CG mechanisms including audit committee meetings and gender diversity, and a negative association between board size and voluntary CRD. The also find an insignificant relationship between CRD and independent directors, non-executive directors, and audit committee independence and education contradicting the findings of this study. Whereas Zhang et al. (2013) reveal a positive association between CRD and audit committee independence, they find no relationship between CRD and the financial expertise of committee members which contradicts my findings. Likewise, Martikainen et al. (2015) demonstrate that the experience of board members is a significantly negatively related to the level and coverage of CRD. Vandemele, Vergauwen and Michiels (2009) find that none of CG mechanisms; audit quality, the existence of a risk committee, CEO duality and board composition, is related to CRD quantity.

As discussed above, previous studies show mixed results regarding the impact of CG on corporate disclosure and CRD. Whereas some studies demonstrate the positive impact of CG on disclosure level and quality, other studies reveal a negative and/or insignificant relationship between CRD and some CG mechanisms. This suggests the need for more research to further examine the impact of CG on CRD quality.

8.5.2.2. External incentives

The findings highlight that external factors too may play their part in encouraging and/or obliging companies to improve their RR. First, companies will respond to investors' queries and pressure regarding their RE by disclosing more information which is consistent with the agency theory (Jensen and Meckling, 1976; Linsley and Shrives, 2000). Achmad, Faisal and Oktarina (2017) argue that better CRD can alleviate investors' pressure and increase their confidence. Investors are encouraged to read CRD and provide feedback to companies, ask questions and require clarification. Consequently, companies should address investors' questions and respond to their queries by disclosing more and higher quality information.

Moreover, companies should seek feedback from their investors and tailor their disclosures to meet investors' needs to ensure their engagement and maintain their trust. Some studies suggest that stakeholders' pressure and engagement play a vital role in improving disclosure practices (ACCA, 2014; Slack and Campbell, 2016; Solomon et al., 2000). Abraham, Marston and Darby (2012) highlight the lack of feedback provided by investors about CRD practices confirming the findings of this study. The UK CG Code encourages investors to get engaged and respond to risk disclosures made by companies, and recommends companies to maintain communication with investors through meetings to encourage their engagement (FRC, 2016a).

Second, companies should disclose clear and transparent CRD that reflects their RE to avoid potential investor and market mis-reaction. Investors may react unfavourably to the lack and non-disclosure of RI that could affect stock price and cost of capital. Nahar, Azim and Jubb (2016) argue that the lack of CRD increases potential investors' uncertainty. Hope, Hu and Lu (2016) find a significant positive association between specific risk disclosures and market reaction. This suggests that companies should not only disclose RI but also ensure its quality and informativeness.

Skinner (1994) argues that managers may voluntarily disclose bad news to avoid litigation costs because of failure to disclose particular information, and unfavourable reaction by market participants to less timely disclosure and the company might consequently incur reputational costs. Lundholm and Winkle (2006) also argue that investors may take adverse actions in response to the lack or absence of disclosure.

Third, companies should consider the disclosures made by their competitors. Peer pressure could force the company to disclose particular risks following its competitors to avoid any unfavourable consequences and reactions by investors and regulators. Investors may raise concerns about nondisclosure of particular risks that competitors have reported. This result is consistent with Stanga's (1976) findings that companies may mimic the disclosure practices of leading companies. Stanga also highlights that such disclosure practices may lead to further disclosure requirements introduced by regulators. Likewise, Dobler (2008) refers to the 'herd behaviour' that may encourage the company to disclose more RI following other companies. However, companies should tailor CRD to their circumstances to accommodate users' needs.

Likewise, a company should disclose why it is not exposed to a particular risk or why a risk is immaterial to its business. A company may take the initiative to disclose a particular risk and how it is managing it, and thereby expose other companies and force them to provide more information. Market pressure also plays a role in case of significant market events or systematic risks where companies have to disclose information to assure investors about their impact and how they are being managed. Nevertheless, Kieholz (Eccles et al., 2001, p. 30) comments "if we disclose more about risk, but competitors do not follow our lead, will investors be able to make any relative judgements, and as a consequence will we derive any benefit?

Fourth, recognising companies that provide useful CRD could encourage other companies to improve their CRD practices. Professional and regulatory institutions such as audit firms could play a role in reviewing CRD and providing awards to companies that disclose high quality RI. Such awards could improve company's image and reputation in terms of its RM and RR practices. Accordingly, the company may be more appealing to investors and analysts. However, there is no evidence in the extant CRD literature that supports this view.

Fifth, companies consider whether or not particular information is available in the public domain and will provide more RI if a risk is already known to the market to avoid any negative consequences. Companies are encouraged not to remain silent and reassure investors who may react unfavourably to the lack of CRD. Companies should also consider that investors and investment analysts in particular are aware of the key risks they are facing. Eccles et al. (2001) demonstrate that "the market knows that managers know and wants to know as well" (p. 30).

Sixth, assurance provided by an independent third party such as external auditors could drive companies to improve their CRD quality and reassure information users. External auditors have access to proprietary information and internal company's document including risk register, and board and audit/risk committee minutes. Therefore, they can ensure that external CRD is consistent with risks discussed internally and with their knowledge about the company's overall performance. They can also ask managers to provide more RI. However, the impact of external assurance depends on the type and level of assurance.

Some previous CRD studies find a positive relationship between audit quality proxied by big audit firms and CRD quantity and quality arguing that audit firms are concerned about their corporate image and reputation and, therefore, encourage companies to disclose more information (Kim and Fukukawa, 2013; Lopes, P. and Rodrigues; 2007; Mokhtar and Mellett, 2013; Oliveira, Rodrigues and Craig, 2011). Other disclosure studies also reveal a positive relationship between audit quality and disclosure quantity and quality (Nosheen and Chonglerttham, 2013). However, Elshandidy and Neri (2015) find that companies audited by non-big audit firms disclose more compulsory RI; otherwise they may incur costs due to non-compliance. Kim and Fukukawa (2013) find that companies that have been audited by the same auditor for a long period of time disclose less RI.

There are also some concerns about the extent to which external auditors can ensure CRD quality considering the inherent subjectivity of risk assessment and CRD. External auditors may not be able to review the RM system that produces this information. Likewise, audit and auditing standards need to evolve to keep pace with the change in business complexity and enable auditors to provide the necessary assurance to stakeholders about a company's RE.

The findings demonstrate that external auditors can communicate with independent directors to discuss any significant issues regarding RM and CRD. One of the responsibilities of the audit

committee set out by the UK CG Code is ensuring auditor independence and objectivity (FRC, 2016a). Accordingly, auditors can work with the board and audit/risk committees that have the appropriate skills and knowledge to review and provide assurance on RM and CRD, which is consistent with recommendations made by Cohen, Krishnamoorthy and Wright (2002) and Cohen et al. (2007).

In addition, regulations were also discussed as a negative incentive for CRD. The findings reveal a mixed view regarding the extent to which regulations can improve CRD quality. Whereas a few participants call for more and prescriptive regulations, the vast majority of the participants do not support introducing more regulations. The findings indicate that CRD should generally be compulsory to guarantee that companies provide the minimum level of disclosure confirming the argument presented by Abraham and Cox (2007), and Abraham, Marston and Darby (2012).

The findings recommend a principles-based approach where companies are obliged to disclose their risks, whilst exercising discretion in disclosing risks that are specific and material to their business. The results indicate that more regulations will detract from CRD quality as companies will comply with regulations without disclosing useful information. This is consistent with Kravet and Muslu’s (2013) argument emphasising the role of management incentives and highlighting that companies can technically comply with regulations by disclosing generic RI instead of company-specific RI. The findings also demonstrate that further requirements will eventually lead to boilerplate CRD.

Campbell et al. (2014) Kravet and Muslu (2013) and Mirakhur (2011) find that CRD quantity has improved following the introduction of mandatory disclosure requirements. However, in line with the findings, other studies demonstrate that regulations have no significant impact, if any, on CRD quality or quantity, but rather lead to more boilerplate CRD (Hernández-Madrigal, Blanco-Dopico and Aibar-Guzmán, 2012; Oliveira, Rodrigues and Craig, 2011).

Elshandidy and Neri (2015) support the UK principles-based approach which gives managers discretion to report on their company’s RE considering its unique circumstances rather than a ‘one size fits all’ approach. The ICAEW (2011) and ACCA (2014) share the same view highlighting that companies can comply with regulations without providing informative CRD. The findings suggest more guidelines or best-practice examples which is consistent with Abraham, Marston and Darby’s (2012) argument. However, Abraham and Shrives (2014) argue that general guidelines may be ineffective in enhancing RR quality. Likewise, whereas Abraham and Cox (2007) support flexible CRD regulations that consider the differences among companies, other studies call for tightening CRD regulations by introducing more detailed CRD requirements (Airmic, 201; Greco, 2012; Ryan, 2012), which provide guidance and examples of how companies can report on their risks to enhance CRD quality (Miihkinen, 2013).

UK companies are encouraged to take advantage of the safe harbour provision in the UK companies Act 2006 and disclose more forward-looking information. According to the Act, companies will face litigation only in case of omitted material or misleading information. However, the findings, in line with Abraham, Marston and Darby (2012), show that the impact of the safe harbour provision remains unclear because it has not yet been tested in the courts.

8.6. CRD quality

There has been little research on the concept of quality in the context of CRD. Previous studies have focused on measuring CRD quality using a number of proxies that may not necessarily capture its essence as discussed in chapter 2. There is no common definition or measure of CRD quality. This study explores CRD quality in terms of its definition and characteristics through the eyes of stakeholders considering users' information needs and management concerns about CRD.

The findings show the lack of unanimous definition of quality among the different stakeholder groups. One definition of CRD quality raised by participants is in terms of disclosing information that is capable of influencing investors' decisions and useful for assessing a company's RE, RM systems and the impact of its risk profile on its overall performance and future prospects. Accordingly, information is deemed to be of high quality if it is useful to information users. The results are consistent with Jonas and Blanchet (2000) and Botosan (2004) who define disclosure quality in terms of the decision-usefulness of information.

A key question, however, is useful to whom? The results underline the differences among information users regarding their knowledge, experience and risk appetite and preference that should be considered when reporting risks. CRD quality is also related to stakeholders' perception of risk as discussed above. Different information users have different interests in a company and, hence, may have different information needs. Companies should strive to meet information users' needs and expectations, yet it may be challenging.

The findings highlight a number of synonyms for quality including informativeness, succinctness, usefulness, honesty, granularity, transparency, bespoke and frankness. However, some of these terms focus on particular aspects of quality rather than its overarching concept.

Similarly, previous studies have used different terms to refer to CRD practices including quality (Abraham and Shrives, 2014; Miihkinen, 2012; Mousa and Elamir, 2014; Ryan, 2012), relevance (Abraham and Shrives, 2014; Campbell and Slack, 2008), usefulness (Elshandidy and Shrives, 2016; Maffei et al., 2014; Miihkinen, 2013), and informativeness (Dobler, 2005). Likewise, professional and regulatory bodies have used quality and usefulness. Whereas ICAS utilises the term usefulness (Abraham, Marston and Darby; 2012), Airmic (2014) uses quality. The ICAEW (2011, 2014), and the ACCA (Campbell and Slack, 2008; Slack and Campbell, 2016) use both quality and usefulness interchangeably. Likewise, the FASB uses decision-

usefulness while the FRC utilises quality. Nevertheless, these studies and reports do not attempt to define quality or usefulness of CRD in an in-depth and comprehensive manner.

Beest, Braam and Boelens (2009) highlight that measuring and defining disclosure quality has been a challenge to researchers. It could be argued that usefulness is more appropriate for describing CRD quality, yet it may not reflect the whole essence of quality. The results demonstrate that usefulness raises as many issues as does quality as discussed previously.

8.7. FASB qualitative characteristics

This study adapts the FASB qualitative characteristics to fit the context of CRD and suggest a way forward for assessing and enhancing CRD quality. Jonas and Blanchet (2000) highlight the importance of the FASB framework as the basis for better quality disclosure. The FASB qualitative characteristics are general principles for financial reporting in particular that need to be operationalised in the relevant context.

There have been very few previous attempts to examine the qualitative characteristics of corporate disclosure and CRD in particular (Beest, Braam and Boelens, 2009; Nichita and Țurlea, 2015; Nobes and Stadler, 2014). Beest, Braam and Boelens (2009) operationalise the qualitative characteristics and suggest a weighted disclosure index for assessing financial reporting quality based on the 2008 IASB's Exposure Draft. Although they argue that the proposed index represents a valid measure of quality, the index operationalises only four characteristics and seems to focus on the presence of certain information rather than its quality. Nichita and Țurlea (2015) operationalise four out of six IASB qualitative characteristics and propose an index accordingly based on conducting 10 interviews with accountants. However, the study falls short of explaining clearly and precisely its method of data collection and analysis, and the development of the proposed index.

In line with the FASB, the findings emphasise that some characteristics are more important and applicable than others. The results indicate the challenge of meeting some characteristics due to the uncertainty of risk and the forward-looking and qualitative nature of CRD. They also demonstrate the inherent subjectivity in meeting these characteristics. However, companies have to make judgements about their future RE and its potential impact. Parfet (2000) argues that "the use of judgment and subjectivity in accounting is important and desirable" (p. 482).

It is worth noting that these qualitative characteristics are not mutually exclusive, but rather interrelated. The results highlight the need for a common definition and measure of CRD quality considering the particular nature of risk and CRD.

8.7.1. Relevance

The findings emphasise key aspects of relevance including company-specific and forward-looking RI, and a quantitative and/or sufficient and clear qualitative description of risk which is

consistent with previous CRD studies that place particular emphasis on these sub-characteristics (Abraham and Shrives, 2014; Linsley and Shrives, 2006; Ryan, 2012). Hope, Hu and Lu (2016) highlight that specificity of CRD enables investment analysts to properly assess a company's RE. Likewise, the prior literature underlines a major shortcoming of current CRD practices regarding the disclosure of generic RI as discussed in chapter 2.

Regulatory and professional bodies also call for disclosing company-specific RI and linking it to information on the business model and strategy (FRC, 2011a, ICAEW, 2011). According to GAS 20, "group management must also address specific risks to which the group is exposed from the use of financial instruments" (ASCG, 2012). The UK CG Code and Companies Act 2006 require companies to address risks that could have material impact on company's performance. This is also a call for providing specific RI.

The seventh principle proposed by the Enhanced Disclosure Task Force (EDTF) (FSB, 2012) calls for reporting risks that are related to the bank's business model suggesting the disclosure of "key risks that arise from the bank's business models and activities, the bank's risk appetite in the context of its business models and how the bank manages such risks". EDTF indicates that such disclosure should help information users understand the impact of risk on bank performance and the achievement of its objectives. The FRC (2013) emphasises the disclosure of company-specific information and indicates that the board should "provide succinct, meaningful information tailored to the specific circumstances of the company" (p. 12). The findings confirm the results of ACCA (2014) as well.

The findings suggest that companies disclose their risk appetite to enhance the specificity criterion. Disclosing a company's risk appetite should give information users an insight into its risk profile and preference. The ICAEW (2014) highlights that "risk reporting is a product of company's risk appetite". Hence, CRD should include relevant information about the company's risk appetite in the pursuit of its strategic objectives, which should be company-specific.

The results are also consistent with Rittenberg and Martens' (2012) argument that companies should regularly report on their risk appetite in the context of their business models and strategies, and suggest different approaches for disclosing risk appetite including an overall risk appetite for the company, an appetite for each business objective or an appetite for each key risk. They, however, acknowledge the difficulty of disclosing a company's risk appetite. Likewise, Keqa and Lannoy (2016) underline that companies should report on the risk appetite associated with their business strategy and objectives. Keqa and Lannoy (2016) and Rittenberg and Martens (2012) suggest revisiting and reassessing the company's risk appetite considering that it might change which is also in line with the findings.

The findings demonstrate that reporting a company's risk appetite is related to the company's overall perception of risk. EDTF (FSB, 2012) suggests that banks define their risk terminology. Nichita and Țurlea (2015) propose that companies disclose their perception of risk to enhance understandability of their risk disclosures.

The results also emphasise the particular importance of reporting future and long-term risks that could affect company performance and survivability. They also suggest disclosing current and ongoing risks confirming the ICAEW's (2011) argument. The findings highlight that retail investors may be more short-term oriented, whereas institutional investors concentrate on long-term investments and therefore are concerned about company sustainability and long-term risks.

The findings highlight the absence of information on long-term risks and suggest using scenario-based approach where risks can be disclosed in terms of their potential outcomes (possible scenarios) and RM strategies. This should serve as a source of reassurance on how well a company is prepared for the future. Although disclosure regulations do not explicitly require companies to disclose their long-term risks and determine a one-year time-scale for forward-looking RI as discussed below, they do not discourage companies from reporting their long-term risks. The UK CG Code requires companies to disclose in their viability statement "risks which affect longer term viability" (FRC, 2016a, P. 2).

In line with the findings, one of the principles set out by EDTF (FSB, 2012) suggests the disclosure of new and arising risks and addressing the development of the company's RE over time. The ACCA's (2014) results confirm the findings and highlight that information users call for reporting emerging and new risks.

Likewise, Abraham and Shrives (2014) demonstrate that providing up-to-date information on emerging risks and risks that are no longer considered material is a key aspect of CRD quality. Abraham, Marston and Darby (2012) also emphasise that CRD should address the change in a company's RE over time in terms of the emergence of new risks and removal of others. Dobler (2008) also indicates that CRD should serve as an 'early-warning' indicator of a company's RE.

The ICAEW (2011) recommends companies to discuss their risk experience over the reporting period by disclosing the difference between estimated and actual impact of risk. GAS 20 requires disclosing RE over the next year as the minimum time scale and any other issues after this period (ASCG, 2012). Similarly, the UK CG Code indicates that future CRD should cover at least a one-year period (FRC, 2016a). Furthermore, the Code requires companies to justify the period that forward-looking disclosure covers and the underlying assumptions used in risk assessment.

The results also indicate that historical CRD can be helpful in understanding a company's future RE, the development of risks over time and the effectiveness of RM strategies. Therefore, historical CRD can provide reassurance to investors, which is consistent with the ICAEW's

(2014) argument. The findings suggest that companies should firstly discuss the impact of past risks and how they have evolved followed by future risks and their potential impact.

The results show mixed views about quantitative/qualitative CRD. Some participants call for disclosing more quantitative RI so that information users can gain a better understanding of the impact of risk arguing that it is more company-specific. They encourage companies to disclose their best estimate of future risks, which is consistent with the FRC's (2016b) argument that recommends companies to disclose quantitative information using sensitivity analysis and explain the judgements made to enhance information users' understanding of estimates and their impact.

The findings suggest using qualitative CRD or combining both quantitative and qualitative disclosures where appropriate considering the inherent nature of risk. Companies can provide useful qualitative RI particularly when it is difficult to assess risks to effectively communicate with investors using terms such as high, low, medium, very high, very low, likely, unlikely, highly likely and highly unlikely to describe the impact and probability of risk occurrence. Therefore, the findings indicate that a clear and sufficient qualitative description of risk could be more appropriate and realistic. They also highlight the danger of imprecise quantitative CRD in terms of potential litigation costs and competitive disadvantages.

Previous studies have focused on quantitative CRD as a key aspect of CRD quality contradicting the findings (for example, Marzouk, 2016; Linsley and Shrives, 2006). Eccles et al. (2001) emphasise the necessity of quantitative CRD and information on risk assessment methods and RM plans. Likewise, one of the ICAEW's (2011) seven principles for improving CRD quality recommends companies to "focus on quantitative information" that it claims to be more useful. However, the ICAEW (2011) confirms the findings and implicitly suggests using both types of information arguing that "this is not a call for quantification of risks…Nor is it a call for qualitative information to be neglected" (P. IV).

In addition, GAS 20 emphasises quantitative CRD stating "risks presented must be quantified if this is also done for internal management purposes and the quantitative disclosures are material for a knowledgeable user" (ASCG, 2012). EDTF (FSB, 2012) recommends quantitative CRD if possible.

The ICAEW (2011) contradicts its above position recognising the inherent subjectivity of risk assessment and the imprecision of quantitative and qualitative CRD asserting that "it is impossible to know even after the event whether most qualitative, and some quantitative, risk reporting is accurate or inaccurate" (P. IV). Delogu (2016) demonstrates that risks can be presented effectively in qualitative terms considering their inherent uncertainty confirming the findings. He further states that "risk…cannot be reduced to a single figure" (p. 7). Lee (2012) also argues that investors appreciate qualitative information. The results also advocate the

FASB's (2010) position regarding combing words and number to faithfully represent a transaction.

The findings indicate that qualitative CRD is necessary for understanding and interpreting figures related to the impact of risk. Souabni (2011) also provides an argument that is consistent with the findings calling for using quantitative and qualitative RI to enhance users' understanding of a company's risk position and improve understandability of quantitative CRD and its linkage to corporate business model and strategy.

8.7.2. Faithful representation

The findings suggest that companies should focus only on reporting material risks that could have a significant impact on their performance and future prospects. Companies should also provide a complete description of each key risk in terms of its impact, probability of occurrence and how it is being managed. The findings are consistent with disclosure regulations across different jurisdictions including UK Companies Act 2006 and GAS 20 that require disclosing principal risks that could prevent the company from achieving its strategy and may influence investors' decisions.

The UK CG Code requires companies to disclose their principal risks and uncertainties "that would threaten its business model, future performance, solvency or liquidity" and how they are being managed (FRC, 2016a). The FRC (2011b, 2016a) also suggests that managers provide sufficient information on each principal risk and uncertainty to help investors understand its impact on company performance. Likewise, the ICAEW (2011) suggests companies "keep lists of principal risks short". The ACCA (2014) also recommends explaining why some risks are considered the key risks and how they are being managed. The results underline that reporting all or immaterial risks could detract from CRD quality and distract information users from focusing on key risks.

Some participants suggest disclosing a specific number of the most significant risks facing the company, which is consistent with Lee (2012) who calls for ranking risks and reporting the top five risks. However, disclosure regulations do not prescribe a number of key risks that companies should disclose.

Furthermore, the results emphasise the importance of disclosing information that if omitted or misreported could be misleading to information users. However, there is inherent subjectivity in identifying and assessing key risks considering the forward-looking nature of risk. Information users have to recognise that CRD is, to a certain extent, a judgement based on management's view of a company's RE.

Neutrality and freedom from are also related to the company's perception of risk and its incentives and disincentives to report RE that may affect CRD tone. The results suggest that

companies disclose both upside and downside risks without overstating or understating their respective impacts which is consistent with Beest, Braam and Boelens' (2009) view.

The findings reveal that external assurance can play a role in enhancing faithful representation of CRD as discussed earlier. Beest, Braam and Boelens (2009) consider that an unqualified auditor's report should reflect faithful representation of financial information. Moreover, the ICAEW (2014) suggests that external auditors provide assurance on CRD highlighting that such assurance enhances information credibility and increases users' confidence.

The results are also consistent with the ICAEW's (2011) argument that external auditors do read narrative disclosure including CRD to ensure that is consistent with their overall knowledge about the company's financial performance. The ICAEW further indicates that auditors can then challenge management and report to non-executives regarding the difference between risks discussed internally and external CRD, and RM strategies if it is related to their area of expertise.

The ICAEW (2014) recommends that external auditors provide an opinion on the company's CRD process rather than RI arguing that it should give information users a better understanding of the company's RM system including external CRD. The central question is whether the auditor is capable of reviewing and providing assurance on RM as previously discussed. Eccles et al. (2001, p. 155) emphasise that "some of these disclosures are audited, most are not" due to the qualitative nature of CRD.

In addition, the findings emphasise the absence of an accounting and/or auditing standard for CRD that can assist external auditors in reviewing CRD. Similarly, the ICAEW (2014) highlights the need for a reference in the form of disclosure requirements or an accounting standard that companies can adopt to disclose risks and auditors can use as a basis for their audit. The ICAEW (2014) suggests three forms of assurance including an assurance opinion based on a framework introduced by regulators, an opinion based on an internal framework developed by the company or an auditor's opinion regarding CRD quality.

In line with the findings that suggest disclosing more information on the RM system and plans in place, beest, braam and boelens (2009) indicate that more information should be reported on the assumptions and estimates, the underlying accounting principles and the use of these principles, and CG practices to enhance this characteristic. The results show that CG characteristics can play their part in ensuring this characteristic and CRD quality in general as discussed previously.

8.7.3. Comparability

The findings place more emphasis horizontal comparability in terms of providing specific RI that enhances investor's ability to assess and compare the company's RE over time and the

difference between risk estimate and its actual impact. The findings suggest that companies disclose the change in its risk appetite, current risks, emerging risks and risks that are no longer considered material. Conversely, the findings do not place similar importance on vertical comparability due to its difficulty and indicate that attempting to meet vertical comparability may lead to generic CRD. Moreover, the results indicate that the company should tailor the disclosure of systematic risks to its circumstances and highlight their impact on its performance.

The discussion above also indicates that companies should revisit and update their risk appetite as it changes over time. Likewise, disclosure of forward-looking and historical RI can also improve horizontal comparability and explain the evolution in risk over time. The results highlight some aspects discussed below under understandability including using tables and graphs that can enhance CRD comparability. Beattie, Dhanani and Jones (2008) emphasise that graphs are an effective way of communicating information stating "graphs are particularly useful for highlighting trends" (p. 186). The FRC (2014a) highlights that an example of good disclosure practices is presenting actual and expected outcomes in the same table to improve comparability.

The ICAEW (2011) confirms the findings and encourages companies to disclose their 'risk experience' where they can discuss and compare their estimate of risk with its actual impact. The ICAEW (2011) states that "firms can report on their risk experience over the past year, discuss how far it matches their previous risk reporting" (p. 44). Abraham and Shrives (2014) also use the same principle to explore how CRD has evolved over time to reflect the company's actual risk profile.

Beest, Braam and Boelens (2009) suggest that disclosure should highlight any changes in the disclosure policies applied and the effect of such changes. They also argue that disclosure should address the difference between past and current performance, which is consistent with the findings. Nichita and Țurlea (2015) recommend that companies use risk assessment methods consistently over time and explain any change in using these methods. Mousa and Elamir (2014) also argue that disclosing risks in annual reports could enhance vertical comparability.

8.7.4. Verifiability

The results demonstrate that verifiability is either difficult to achieve due to the nature of risk and CRD or unimportant. They indicate that historical RI can be verified, whilst forward-looking RI is difficult to verify until after risk has materialised. However, verifiability depends on satisfying the other characteristics and providing sufficient, clear and understandable RI. They findings suggest disclosing more information on the overall RM process including the assumption and methods used to assess future risks, which is consistent with Eccles et al. (2001). However, such information might be a subjective and generic description of a process

rather than risks themselves. Cabedo and Tirado (2004) and Nichita and Țurlea (2015) advocate reporting more quantitative information to improve CRD verifiability.

The FASB's definition of this characteristic assumes that different users have the same qualifications and access to the same information to be able to reach the same conclusion, however, this is unlikely to hold in practice. Different information users have different expertise, knowledge, and risk appetite and perception, and therefore may interpret the same information differently. Information users also have access to different types and levels of information. Verifiability of CRD may also continue to be problematic until the debate and disagreement on the definition of risk is resolved to ensure that different users perceive risk similarly as discussed above.

8.7.5. Timeliness

The results emphasise that lack of timeliness may lead to information asymmetry problem and unfavourable consequences. The findings reveal that institutional investors and investment analysts obtain more and higher quality CRD in private meetings with management confirming Solomon et al.'s (2000) argument.

The results underline the importance of reporting risks on a timely basis considering the dynamic business environment and the changing and uncertainty nature of risk. The results also suggest that CRD should reflect the change in a company's risk profile and appetite. Accordingly, companies should continually scan their business environment to identify strategic threats and opportunities and update their CRD accordingly to keep investors informed about significant changes in their risk position. This directly leads to the question: Which disclosure vehicle is capable of meeting this characteristic considering the other qualitative characteristics?

The findings reveal that there is no single most appropriate disclosure vehicle because each vehicle serves a different purpose, and they all complement each other. Therefore, the results suggest reporting risks via different channels including annual reports, interim reports, corporate websites and press releases to satisfy timeliness and meet the information needs of different users. For example, institutional investors may be more willing to read and analyse the information disclosed in annual reports, whereas individual investors may prefer more concise and understandable information. The findings highlight that the other characteristics should be considered to ensure overall CRD quality. The findings also underline the forward-looking nature of risk and management concerns about disclosing future RI.

The findings demonstrate that the AR is more appropriate for CRD considering that it provides the full picture of company performance and RE and is reviewed by external auditors which gives it more credibility. The results support the argument which highlights that the AR is a formal document providing information on the different facets of company performance including its RE (Amran, Bin and Hassan, 2009; Gray, Kouhy and Lavers, 1995). Hence, the

findings suggest that risks can be disclosed in the AR and updated in the interim reports. Meanwhile, any significant emerging risks or change in the company's risk position should be disclosed promptly via other channels such as press releases, corporate websites, and conference calls, and then discussed in the AR in the context of company's business model and strategy and financial performance.

The prior literature presents mixed evidence. beest, braam and boelens (2009) use the length of time it takes for the auditors to sign their report after year end as a measure of timeliness. However, this may raise concerns about timeliness of financial reporting that may then become irrelevant. Linsley and Shrives (2005a) suggest using corporate websites to provide timely CRD. Gajewski and Li (2015) find that internet disclosure reduces information asymmetry. Similarly, the ICAEW (2011) emphasises the need for timely CRD considering the changing nature of risks and recommends disclosing risks on corporate websites. Yet, it claims that many risks do not change frequently, and generally encourages companies to "think beyond the annual reporting cycle" when disclosing risks.

The findings are consistent with Abraham, Marston and Darby (2012) who report that the AR is considered the key CRD vehicle by AR preparers and individual investors. They also recognise other disclosure channels such as announcements, conference calls, private meetings, and corporate websites in particular to reduce information overload in the AR. They indicate that the AR represents a reference document for information users confirming the findings of this study.

Likewise, the UK CG Code also requires companies to use the AR cycle; annual and semi-annual reports, to disclose material risks and any change to these risks that may affect company performance (FRC, 2016a). The Code indicates that the AR is appropriate for reporting future risks recommending companies to use these platforms to disclose risks and uncertainties that may occur over a minimum period of one year, which is consistent with the findings.

In addition, the AR has always been perceived as the key channel for corporate disclosure (Botosan, 1997). Previous CRD studies have also focused on examining CRD practices in annual reports as well (Abraham and cox, 2007; Beretta and Bozzolan, 2004a; Lajili and Zéghal, 2005; Linsley and Shrives, 2006; Linsley, Shrives and Crumpton, 2006; Mousa and Elamir, 2013; Deumes, 2008).

8.7.6. Understandability

The results highlight the importance of providing understandable CRD to avoid unfavourable consequences resulting from investors' misinterpretation and mis-reaction. In line with the findings, Linsley, Shrives and Crumpton (2006) state "to avoid the problem of stakeholders misinterpreting the risk disclosures within the annual report banks can, and do, provide definitions of technical terminology that they have used" (p. 274).

The FRC (2016b) highlights investors' concerns and needs stating "investors call for annual reports to be more user-friendly and information to be communicated more clearly". Bill Knight, Chairman of FRRP, also emphasises "any board should be able to describe…simply and clearly, the principal risks and uncertainties facing the company" (FRC, 2011b). The findings demonstrate a number of factors that can improve CRD understandability.

First, companies should use simple and plain English and avoid Jargon and technical terms, if possible, which may be difficult to understand. The findings suggest that companies include an appendix to explain technical terms. The results also suggest maintaining conciseness and paying attention to the length of CRD. This confirms the views of the participants who took part in the ACCA's (2014) investigation calling for reporting key risks in plain English.

While disclosing too much information could lead to information overload and detract from CRD quality, the FRC has emphasised two criteria; clarity and conciseness, calling for disclosing sufficient, yet clear disclosures. The FRC (2014a) underlines clarity and conciseness in terms of the length of disclosure stating "reduction in page count was identified as one measure indicative of conciseness" (p. 4).

The findings suggest using appendices and cross-referencing to ensure conciseness and reduce information overload in the AR, which is consistent with the FRC (2014a) and Beest, Braam and Boelens' (2009) argument. Abraham, Marston and Darby (2012) report that investment analysts prefer conciseness in CRD through focusing on company-specific risks instead of generic and immaterial risks. This view is also shared by the ICAEW (2011) that encourages companies to "keep lists of principal risks short" (p. 42). Similarly, the FRC (2016a) suggests that companies should carefully consider the materiality of information to ensure clarity and conciseness.

Likewise, GAS 20 requires ranking risks in terms of their materiality to enhance CRD clarity (ASCG, 2012). This should also give information users a better understanding of the company's principal risks. Bloomfield (2008) draws attention to the possibility that companies may provide long and complex disclosures to conceal their poor performance.

Second, the findings suggest using tables, graphs, and heat maps to display risks in a more concise, yet clear, understandable and comparable manner. Such presentation methods can give information users a better insight into keys risks, how they have developed and how they are being managed. This finding is consistent with Abraham, Marston and Darby's (2012) suggestion for using tables with "columns headed risk, impact and mitigation" (p. 10). Likewise, Ryan (2012) suggests that companies use a tabular format for presenting RI to improve its usefulness.

Furthermore, using tables and graphs is an item of understandability as operationalised by Beest, Braam and Boelens (2009), and Nichita and Țurlea (2015). Beest, Braam and Boelens

(2009) argue that the AR should be well organised in order to be more understandable. Beattie, Dhanani and Jones (2008) also state that "Graphs, especially colour graphs, are more likely to attract attention and stimulate interest" (p.186). The FRC (2015) underlines that information presented in diagrams, tables, graphics and pictures can be easily found and understood.

Third, the location of CRD in the AR is another aspect to consider. The results show that risk disclosures are scattered through the AR, which ultimately affects their understandability. However, it may be necessary for companies to address risks at different sections throughout the AR. Therefore, the findings demonstrate that RI should be highlighted so that it is findable. The findings further suggest linking risk disclosures throughout the AR using cross-referencing to avoid repetition and ensure conciseness. The results reveal that location of risk disclosures does not matter if they are connected and findable.

Moreover, the results highlight that risks should be discussed in the context of the company's business model and strategy so that their impact can be better understood, which is consistent with previous studies that emphasise the lack of linkage between CRD and other relevant information (Linsley and Shrives, 2006; Nichita and Țurlea, 2015). The findings also confirm the argument presented by professional and regulatory bodies underlining the importance of linkage between risk disclosures, and between risk disclosures and other relevant disclosures. Slack and Campbell (2016) highlight the lack of linkage between different types of narrative disclosures arguing that "areas of narrative disclosure, in particular, are often viewed in silos with limited relevance to decision making" (p. 40).

Abraham, Marston and Darby (2012) call for ensuring connectivity between RI disclosed via different disclosure channels. In line with the findings, the FRC (2014b) recommends using cross-referencing to ensure linkage and remove unnecessary repetition and guide information users to additional information. The ICAEW also calls for integrating RI with other relevant financial and non-financial information to improve CRD quality.

Conversely, Cabedo and Tirado (2004) recommend preparing a separate statement for CRD. Likewise, EDTF (FSB, 2012) suggests that companies "present all related risk information together in any particular report". However, EDTF continues to argue that "where this is not practicable, provide an index or an aid to navigation to help users locate risk disclosures within the bank's reports", which is consistent with the findings. EDTF also highlights the need for making RI more findable. The findings of this study do not suggest a standalone statement for CRD.

8.8. Conclusion

This chapter presents the key findings and compare and contrast them with the results of the existing CRD and corporate disclosure literature in general and professional reports. Some findings confirm the results of previous studies whereas other findings have not been addressed

or examined in the prior literature and need further investigation. These findings represent contribution to the area of CRD. The next chapter concludes with a summary of research results, discussion of research contribution and limitations, and recommendations for future research.

Chapter 9: Conclusion

9.1. Introduction

This chapter draws conclusions about the research results obtained and discussed in the previous four chapters. These conclusions are related to the research questions and objectives presented in chapter 1. The chapter also presents the theoretical and practical implications of this study in terms of its contribution to the existing CRD literature and towards informing policy (disclosure regulations and guidelines) and improving practice leading to higher CRD quality. The research limitations are discussed and suggestions are provided for future research.

The main aim of this study was to examine CRD quality from the perspectives of stakeholders and achieve a number of objectives. First, the study conceptualises and contextualises the concept of risk in terms of CRD. Second, the study investigates the perception of stakeholders of the extent and quality/usefulness of CRD to identify the needs of information users. Third, the study explores the relevance of CRD to different stakeholders.

Fourth, this study develops an understanding of the constraints on managers to disclose or withhold risk-related information. Hence, the study highlights a number of incentives and disincentives that can explain firms' disclosure behaviours and managers' CRD decisions. Understanding discretionary CRD strategies and constraints on managers can help regulators and other relevant stakeholders develop ways to mitigate managements' concerns and encourage them to disclose useful risk information (RI).

Fifth, the major objective of the study following the achievement of the above objectives is to recognise and analyse the characteristics of high CRD quality to enhance investors' ability to make better decisions. Therefore, the study adopts the FASB qualitative characteristics that have been operationalised into a CRD framework through eliciting the interviewees' view about how each characteristic can be satisfied and enhanced by companies to meet users' information needs. These characteristics can also be used to assess CRD quality.

The remainder of this chapter is structured as follows. The next section summarises the research findings set out in chapters five, six, and seven. Then, section 9.3 highlights the research contribution with regard to theoretical and practical implications, followed by the limitations of this study in section 9.4. Finally, suggestions for future research are provided in Section 9.5.

9.2. Summary of results

This study tackles the complexities of CRD recognising both the difficulties and subjectivity associated with CRD through considering the nature of risk and RI. However, it is an area that

should be examined and the difficulties should not deter researchers from investigating CRD quality and suggesting a way forward for its improvement.

The current study takes account of the views of relevant stakeholder groups that have an interest in CRD through conducting a number of semi-structured interviews and has developed a framework for CRD quality considering and reconciling the different perspectives of multiple stakeholders.

CRD quality is an under-researched area particularly in terms of stakeholders' perspectives and in there is a lack of qualitative and interview-based research. Therefore, this study fills this gap in the literature by answering the research questions initially set out in chapter 1 and summarised below.

1- How do different CRD-related stakeholders comprehend the concept of risk?

Generally, the findings reveal a lack of an agreed-upon definition of risk among the interviewees. The interviewees acknowledge that defining risk in the context of business and corporate reporting is problematic. Some participants have a neutral view of risk as *a fact of life* regardless of its impact arguing that risk is inherent in running a business, and hence companies have to handle it effectively to succeed and grow. Whereas risk is perceived largely by the participants as a synonym for uncertainty, there is a disagreement among them on the impact of such uncertainty on company performance. Some participants perceive risk as uncertainty leading to downside impacts and the potential of not achieving business objectives. These participants representing members of professional and regulatory bodies and retail investors comprehend risk as the deviation from the expected outcomes, but only in the negative direction and what can go wrong. Retail and institutional investors indicate that risk is predominantly associated with potential loss, but meanwhile they recognise the opportunities that a risk may entail.

On the other hand, the majority of the participants argue that risk means volatility of future outcomes which encompasses both downside and upside risks. Accordingly, risk is perceived as the deviation from the predicted outcomes that could be positive or negative, where the former refers to meeting or exceeding expectations and the latter refers to failing to achieve the desired objectives. Nevertheless, some participants provided a contradicting view later during the interview and focused on the downside aspect of risk while addressing CRD incentives and disincentives.

There are a number of reasons for supporting a broad definition of risk. First, companies are exposed to risk and should have robust risk management (RM) systems to ensure their success and survivability. Second, companies intentionally take and accept risk in the pursuit of their business strategies and objectives to achieve growth and create value for their shareholders. Furthermore, each company has to have its own risk appetite (RA) to achieve its strategic

objectives. Third, the inherent uncertainty of risk could lead to positive or negative outcomes depending on how effective RM plans are in minimising downside risks and taking advantage of potential opportunities.

Overall, it is worth highlighting that there is no consensus on the definition of risk among the different stakeholders. This lack of agreement may arguably contribute to creating an information gap between the different stakeholders. For example, companies' perception of risk will affect their risk disclosures, whereas investors' understanding of risk will reflect their expectations in terms of CRD. Therefore, there is a need for reaching a unanimous consensus on the concept of risk with regard to CRD to eliminate any unfavourable consequences such as information asymmetry. The adoption of a broad definition of risk could be more appropriate to meet the information needs of different stakeholders.

2- What are the perceptions of information users, and other stakeholders, of the relevance of risk reporting (RR) and of current CRD practices?

Unlike the mainstream literature that examines CRD practices using content analysis of corporate reports this study evaluates extant CRD practices from the perspectives of information users and relevant stakeholders. The aim was to indirectly identify the limitations of current CRD and users' information needs to be considered in building the proposed framework. Another purpose was to investigate the perceived benefits and relevance of CRD to information users and companies.

A few participants argue that current CRD is irrelevant to investors because of its poor quality particularly in terms of its generic and qualitative nature. Some participants highlight the difficulty of assessing CRD quality/usefulness in the absence of a unified concept of quality and a framework to assess CRD quality. The results also show an emphasis on providing information on RM plans instead of risks and their impact.

However, the majority of the participants emphasise that CRD has improved arguing that CRD practices vary widely across companies. Hence, some companies make better risk disclosures than others depending on the nature of their activities, the market they operate in, and the regulatory framework they are subject to. However, participants indicate that CRD lacks quality particularly in terms of specificity and quantification, which is consistent with the evidence presented in the prior CRD literature.

The findings highlight aspects where CRD has improved, yet there is a room for further improvement in these areas. First, companies should focus on disclosing their key risks. Second, companies should provide more specific RI by tailoring their RR to their circumstances. Some participants call for reporting more quantitative RI that is more company-specific. Other participants recognise the challenging nature of risk and difficulty of providing quantitative information, and therefore, support disclosing sufficient, clear and understandable RI that can

help investors gain an understanding of company risk exposure (RE). Third, there is a lack of linkage between risk disclosures, and absence of integration between risk disclosures and other relevant disclosures in the annual report (AR). Fourth, institutional investors in particular require more information on long-term risks.

The findings demonstrate the particular importance of CRD to investors in making informed decisions based on understanding a company's performance and RE. The results, however, show that CRD may be dismissed by information users due to lack of quality. CRD does not attract much attention from individual and institutional investors alike. Retail investors are more interested in the company's profitability and share price volatility. Institutional investors have access to other information sources including private meetings with company's management, yet external CRD provides them with some assurance regarding company risk profile and their assessment of risk. The results also show that CRD is relevant to other stakeholders depending on their interest in the company and the type of risk it is facing.

In addition, the findings highlight the benefits of CRD for companies. Initially, interviewees recognise the costs that companies may incur as a result of CRD; however, they do not call for withholding RI. Hence, most of the interviewees focused on downside risks as they addressed the potential consequences of CRD. A few participants indicate that RM is more significant for companies than external RR. Nevertheless, other participants respond to this claim arguing that external CRD is an opportunity for managers to signal to the market that they are aware of risks facing their company and managing them effectively.

The results suggest some benefits of CRD that may mitigate companies' concerns regarding CRD, and highlight the risks associated with lack of disclosure and non-disclosure. Therefore, companies should ensure transparency of their RR to avoid any unfavourable consequences. The findings highlight that stakeholders are aware of the risks facing the company and hence expect the company to disclose their impact and how they are being managed, whereas non-disclosure could raise investors' concerns about the company's RM system.

The results show that better CRD is perceived positively by investors as it enhances their confidence through providing reassurance about company risk profile and RM. CRD could also protect companies in the long-term and in times of crises by improving their flexibility and response to crises and helping them recover more quickly.

Furthermore, the findings show that companies can gain a competitive advantage and boost their image and reputation by providing higher quality RI. The results demonstrate that better CRD can lower the cost of capital. Although this argument is consistent with some previous studies, more evidence is needed to support this claim that may encourage companies to disclose more RI.

3- What are the management incentives and disincentives for risk reporting?

While the prior CRD literature has focused on examining the impact of some company-specific characteristics and CG on the level of CRD, this study finds other factors that may influence CRD and could be difficult to examine empirically. Understanding management incentives and disincentives could help explain current CRD practices and management's disclosure behaviour, and suggest a way forward for improving CRD. Managers will always consider the benefits and costs resulting from CRD. It is worth noting that some factors were discussed as potential incentives and disincentives at the same time.

The findings demonstrate a number of disincentives that may deter companies from reporting more RI. First, managers may prefer not to disclose risks that are difficult to assess including reputational and environmental risks. However, this could be perceived negatively by investors as an indicative of poor RM. Second, companies will be reluctant to disclose ongoing negotiations, legal issues and internal investigations so as not to affect the outcome of such issues. Managers will rather seek legal advice about the reasonable level and timing of CRD to disclose publicly in order to comply with regulations.

Third, managers' personal interests could affect the disclosure of information that may influence the value of their shares, their jobs and/or remunerations. Fourth, the legal implications and disclosure requirements could play a part in determining the level of CRD. Fifth, the financial cost of producing and providing quantitative CRD considering its sensitivity is another disincentive.

Sixth, the key issue that sums up the above disincentives is the sensitivity of CRD. However, companies will consider some factors before disclosing such information including the potential impact of disclosing commercially and competitively sensitive information, and the availability of information in the public domain. Companies will be reluctant to disclose both positive and negative information that might be utilised by competitors.

On the other hand, the results highlight a number of incentives that may encourage companies to improve their CRD quality, yet the extent to which these incentives can contribute to better CRD remains unknown. Moreover, further investigations are needed to support these incentives and suggested benefits. Incentives can be classified into positive and negative incentives where the latter refer to regulations.

The findings reveal internal and external factors that may affect managerial discretion regarding CRD. Internal incentives include the following factors: 1) the financial benefits in terms of lower cost of capital and share price volatility; 2) enhancing company resilience and flexibility especially during crises through improving investor's confidence; 3) highlighting company effective RM and hence reassuring investors; and 4) building a proper risk culture through better CG practices to enhance RM and CRD. The results emphasise the impact of a risk/audit

committee that takes responsibility for risk oversight and challenges management regarding their RM and RR. Likewise, independent non-executive directors and members on the board and audit/risk committee with relevant financial and industry expertise can play a key part in ensuring CRD quality.

External incentives include investors' engagement with and feedback on CRD, market and investors' reaction to non-disclosure and/or lack of CRD that could have unfavourable implications, peer pressure, recognition of good CRD practices, availability of information in the public domain and assurance from an independent third-party. For example, companies may provide more RI in order not to attract the attention of regulators and capital market authorities. Companies may respond to competitors' risk disclosures by providing more RI. Likewise, companies are more likely to disclose more information about risks that are known to stakeholders.

The results show a mixed view regarding the role of regulations in enhancing CRD quality. Regulations are generally viewed as a negative incentive. A few participants call for more regulations arguing that companies will not disclose RI unless they are obliged to do so. However, the majority of the interviewees support a principles-based approach highlighting that existing disclosure requirements are sufficient. They advocate more guidelines or best practice examples that can encourage companies to provide useful RI. They draw attention to the consequences of introducing more regulations claiming that they could detract from CRD quality and lead to boilerplate RI. Furthermore, they emphasise that CRD is a difficult area to regulate due to the inherent uncertainty of risk and subjectivity of risk assessment. Accordingly, the results suggest that a principles-based approach that gives managers discretion regarding the disclosure of RI specific to their business is more effective than a rules-based approach that is more prescriptive.

4- What is quality and what are the characteristics associated with good quality risk disclosure?

This study explores the concept of quality in the context of CRD. Previous CRD studies and reports raise concerns about CRD quality, yet there is not a unified definition or measure of CRD quality. Defining quality represents a key step in developing a framework for CRD quality.

The findings reveal some synonyms or characteristics to describe CRD quality including *informativeness*, *succinctness*, *usefulness*, *honesty*, *granularity*, *transparency*, *bespoke* and *frankness*. The discussion of CRD quality generally centred around the decision-usefulness of RI and its capability to enhance stakeholders' understanding of company RE and future prospects. Some participants view usefulness and quality as two partially synonymous terms.

However, the above argument raises an important question regarding for whom CRD is useful? The results indicate that the degree of information usefulness vary from one user to another depending on their knowledge, expertise, and risk perception and appetite. However, it seems that both terms have been used interchangeably in the prior literature and professional reports.

Whereas some participants suggest that companies should focus on disclosing downside risks that could hinder the achievement of its strategy, others recommend reporting both downside and upside risks. Generally, usefulness is arguably the most appropriate term to describe quality in terms of CRD. Therefore, information that is useful is typically of high quality.

5- How can the FASB qualitative characteristics be operationalised to create a CRD quality framework and how can CRD quality be further improved to correspond with the framework?

A key objective of this study was to develop a best practice framework for CRD quality. This study operationalises the FASB qualitative characteristics in the context of CRD considering the nature of risk and the above discussion regarding the perception of risk, users' information needs, and management incentives and disincentives. The study provides an insight into how each characteristic can be improved and assessed. Therefore, a number of sub-characteristics have been identified for each fundamental and enhancing characteristic.

First, the findings suggest the disclosure of company-specific, quantitative and/or qualitative, and forward-looking risk disclosures to enhance relevance of CRD. Companies should disclose key risks inherent in their business models and strategies, their potential impact and how they are managed. The results also show that disclosing company risk appetite can enhance the specificity CRD.

However, some participants place more importance on quantitative RI claiming that it is more specific than qualitative information. The majority of participants do not underestimate the value of qualitative CRD arguing that quantitative CRD may be more difficult to understand by investors, considering the uncertainty nature of risk that might make it difficult or misleading to quantify a risk. They also recognise the subjectivity and consequences of disclosing quantitative RI. Thus, the participants generally support using both quantitative and qualitative information where appropriate. Participants recommend providing clear and sufficient qualitative information particularly when it is difficult to assess a risk to give a better understanding of its impact.

The findings highlight the particular importance of reporting future risks, their impact and the plans in place to manage them. Stakeholders are interested in company future performance and ability to achieve its strategic objectives. Institutional investors are particularly interested in long-term risks. However, there are some concerns related to assessing and reporting future risks due their inherent uncertainty. Conversely, the results show that historical RI can also

serve as a basis for understanding company future RE and how risks have developed over time, reassuring investors about the effectiveness of RM plans.

Second, the results highlight the challenge of meeting faithful representation when reporting risks due to the nature of risk. The results indicate that companies should only report risks that are material to their business and could have detrimental impact on the achievement of their business strategies. Materiality is defined in terms of both the potential impact of a risk and the likelihood of its occurrence.

Neutrality and freedom from error were seen as extremely difficult to meet in the context of CRD. The findings demonstrate the judgement about company key risks, their impact and likelihood, and how they can be handled. This is clearly subject to management's view of and approach to risk. Therefore, assurance provided by an independent third party including the external auditor can enhance these two sub-characteristics considering that auditors have access to company internal documents, and hence can ensure that all principal risks discussed internally are disclosed externally. Nevertheless, external auditors may lack the skills and experience to evaluate the RM system that produces RI.

Third, comparability can be classified into horizontal and vertical comparability, where the former refers to comparing a company's RE over time, and the latter refers to comparing RE of different companies. Horizontal comparability is perceived to be more important than vertical comparability that is considered difficult to meet or unimportant. The results indicate that CRD should help information users evaluate the change in a company's risk profile and appetite over time. Therefore, companies should provide both historical and future risk disclosures regarding risk estimate and actual outcome to enhance horizontal comparability. The findings demonstrate that attempting to satisfy vertical comparability could yield generic risk disclosures. They underline the differences between companies which expose them to different risks or similar risks yet with different impacts.

Fourth, verifiability of CRD is also perceived to be challenging. The results show that historical CRD can be verified, yet forward-looking CRD is extremely difficult to verify. The findings suggest that disclosing risk assessment methods could improve verifiability of RI. Overall, satisfying the other characteristics could make CRD verifiable.

Fifth, the findings demonstrate that there is no single disclosure channel that can satisfy timeliness whilst meeting the other characteristics. Instead a combination of channels may be appropriate. A number of different disclosure vehicles were recommended including press releases, corporate websites, conference calls, RNS announcements, interim reports and annual reports.

The AR was generally perceived to be more appropriate for CRD for a number of reasons. First, the AR is approved by the board of directors and reviewed by the external auditor which gives it

more credibility. Second, the AR provides the full picture of company financial performance and RE. Third, the annual report is arguably the best platform to address company future risks. Fourth, risks can be disclosed through the annual reporting cycle where risks can be reported in the AR and updated in the interim reports. Fifth, the AR is a referential document that can be used to verify previous risk and how risks have evolved over time. However, other channels should also be used as necessary to provide timely RI.

Sixth, the results emphasise that companies should ensure the understandability of their risk disclosures to avoid any potential unfavourable consequences including RI being misinterpreted by information users. Likewise, the results show that understandability varies from one user to another depending on their knowledge and experience. The findings suggest a number of aspects to ensure understandability of CRD including the language, the structure and presentation and the location of CRD in the AR.

Companies should use simple, plain and jargon free language when describing their risks. Companies are recommended to avoid technical terms where possible, otherwise provide an appendix to explain any technical terms. The findings suggest that using charts, graphs, tables and heat maps can be effective in presenting RI in a clear, concise and understandable manner. Moreover, the findings indicate that it may be necessary to address risks in different sections in the annual report, yet companies should maintain linkage between risk disclosures and between risk disclosures and other relevant disclosures such as business model and strategy. Therefore, companies can use cross-referencing to ensure linkage and avoid unnecessary repetition, and highlight RI so that it is findable.

9.3. Areas of tensions

Despite the agreement among the participants on aspects of risk reporting as previously discussed a number of tensions emerged as well. This section discusses some of the tensions that arose between annual report preparers group on one hand and other stakeholder groups particularly the information user group (investors) on the other hand. It is worth stressing that these tensions and disagreement among stakeholders should be resolved in order to further improve CRD quality and reduce the information gap between managers and investors as well as between informed and uninformed investors.

The first aspect of disagreement concerns the participants' perception of risk. While the annual report preparers group perceive risk in its wider context encompassing both potential threats and opportunities, the members of professional and regulatory bodies define risk only in terms of the downside impact of risk. Moreover, investors are predominantly concerned with risks of unfavourable outcomes resulting in decline in share price. Another tension emerged regarding existing CRD practices. AR preparers claim that RR practices have improved which is consistent with previous studies. On the other hand, a few participants including retail investors

argue that there has been no noticeable improvement in CRD. This disagreement might be explained as investors will always ask for more information to be disclosed. Generally, the participants agree that CRD could be further enhanced by providing, for example, more company-specific risk information.

Furthermore, investors and other participants call for more and higher CRD quality arguing that enhanced CRD quality could be beneficial for companies as well. On the other hand, AR preparers seem to be more concerned about disclosing more risk information particularly commercially and competitively sensitive information leading to unfavourable outcomes including market and investor mis-reaction to such information, and understandably so, as previously discussed. Accordingly, companies should maintain transparency about their risk exposure and at the same time investors should appreciate this transparency, understand the implications of CRD and not punish companies for addressing their risks in a transparent manner.

However, the majority of the participants oppose the previous argument regarding sensitivity of risk information highlighting that the benefits companies can realise particularly in the long-term through ensuring transparency about their risk exposure and profile. They also dismiss the argument that the disclosure of more and particular risk information could be misinterpreted by investors leading to unfavourable reaction. According to the participants, companies providing higher quality risk information on their risk position and risk management strategies could enhance their credibility, increase investor confidence and hence can be perceived more favourably by investors.

In addition, there was a disagreement between Annual report preparers group and a number of participants including investors and academics on the role of regulations in enhancing CRD quality. Investors and academics call for prescriptive CRD regulations to oblige companies to improve their risk reporting practices. AR preparers are in favour of a principles-based approach rather than a rules-based approach which is consistent with the view of the majority of the participants who do not support introducing further regulations. They further argue that more regulations could rather lead to the disclosure of poor quality risk information that is of generic nature and not truly useful to investors. They also emphasise the role disclosure incentives play in determining the amount and quality of risk disclosure.

9.4. Research contribution

This study has significant implications for research and practice. The findings are of interest to relevant stakeholders including investors, auditors and academics who can use the proposed framework to properly review and examine CRD quality. The findings can inform policy making in terms of reforming existing disclosure regulations/guidelines and/or developing new regulations/guidelines. They can also inform and improve CRD practices of companies by

highlighting the needs of information users and how companies can meet these needs, and the benefits that companies can attain through providing high quality RR.

9.4.1. Theoretical implications

This study has addressed a gap in the CRD literature by directly exploring the issues of CRD quality. The study has theoretical implications and contributes to the existing CRD literature in a number of respects.

This study is the first study to investigate the different facets of CRD from the perspective of all the relevant stakeholder groups. The current study addresses under-researched aspects of CRD that have been overlooked or taken for granted in previous studies such as the perception of risk. The study draws attention to the lack of a common definition of risk and its impact on CRD practices and the information gap between management and investors. This study also highlights the importance of reaching an agreed upon definition to avoid such unfavourable consequences and enhance RM and RR practices. There is generally a lack of research on CRD quality and usefulness focusing on stakeholder perspectives. Therefore, this study advances our understanding of CRD quality, specifically in respect of developing a CRD framework which can enhance CRD quality.

In terms of methodology, this study represents a methodological contribution to CRD research considering the noticeable lack of CRD qualitative and interview-based research. The lack of qualitative research and interview-based studies in this particular area of CRD is surprising given it is an area where, inherently, there is a great deal of subjectivity and judgement required as CRD is inevitably based upon management's view of risk, the key risks facing its organisation, and how these risks can be assessed and managed.

This study investigates current CRD practices and CRD quality from information users' and other stakeholders' perspective rather than drawing a conclusion based on subjective content analysis of annual reports. It seems appropriate to argue that users' information needs should be the basis for any recommendations made to improve CRD quality. The study also identifies incentives and/or consequences that may encourage and/or force companies to provide more RI.

A major contribution of this study is the development of CRD quality attributes through operationalising the FASB qualitative characteristics in the context of CRD considering the forward-looking and inherent uncertainty of risk and the qualitative nature of CRD. Accordingly, the proposed framework has been developed through defining relevant concepts including quality and the different qualitative characteristics and how each characteristic can be measured and enhanced.

9.4.2. Practical implications

The findings of this study have also implications for practice. The results can inform policy and improve risk practices in the area of CRD. There has been increasing interest shown by professional and regulatory bodies in RR and improving its relevance to information users' decisions. Regulators could use the research findings to inform policy making in terms of introducing new disclosure regulations and/or improving existing requirements. The findings could serve as a foundation for setting an accounting standard for CRD that defines concepts and principles, and presents measurement, presentation and disclosure methods. Such a standard might play a role in ensuring useful CRD is provided by companies in their AR and, hence, could enhance CRD practices.

Professional bodies could also utilise the research results in developing and suggesting some guidelines or a best practice framework that companies can voluntarily subscribe to. Likewise, acknowledging companies that adopt such framework could encourage more companies to engage in better CRD practices and implement the framework. Introducing an accounting standard or a best practice framework can ensure some degree of comparability among companies regarding their CRD and RE. Thus, the framework generally represents a common understanding among the different stakeholders of the concepts and different facets of CRD that could encourage better CRD and enhance comparability among companies.

In addition, the findings should be of interest to external auditors considering the important role they could play in ensuring CRD quality. External auditors could take advantage of the proposed framework when examining and reviewing a company's risk disclosure. They could also, based on the framework, request companies to provide particular RI that is useful for information users. External auditors could contribute to setting and developing an auditing standard to review CRD that explains the auditor's role and responsibilities in this area and enables them to form an opinion on company's RE and compliance with regulations.

The results could be also helpful to companies wishing to understand and meet users' needs with regard to CRD and the provision of decision-useful RI. Companies might also consider the benefits they can achieve from providing high quality RI.

9.5. Limitations of this study

All academic studies have limitations; in part this is because boundaries have to be placed around any piece of research. This study makes a contribution to the CRD literature, but it is important to note the methodological and contextual limitations. First, one limitation of qualitative research and interview-based research in particular is the difficulty of generalisation of the results to other settings. In this respect it should be noted that all the research participants were UK-based and care might be needed in generalising the results to other countries. However, considering that this study represents the first attempt to explore CRD in this way, the

purpose of gaining an in-depth understanding of CRD quality, and investigating and highlighting the differences among the different stakeholder groups with regard to the different facets of CRD does appear to have been achieved. Knowledge of these differences provides an understanding of limitations and issues of extant CRD practices. It also permits the author to suggest how CRD can be better improved. Further, all the participants were knowledgeable about corporate disclosure and CRD and disclosure regulations in different countries and some of them had the experience of working across a number of countries and were aware of the commonalties and differences between different companies, cultures and regulatory regimes

Second, another inherent challenge associated with conducting qualitative research is avoiding subjectivity in analysing and interpreting the data as well as ensuring and enhancing research validity and reliability. Care was taken to ensure, as far as possible, there were no preconceptions or bias that could have affected the analysis and interpretation of the research data by focusing on conveying the views of the interviewees of CRD.

Third, it proved to be difficult to gain access to more research participants and recruit the targeted number of research participants. It took a lot of time to identify and approach relevant participants, and conduct, transcribe and analyse the interviews considering that participants from the different stakeholder groups are represented in this study. However, 28 agreed to take part in this study and in interview-based research this would normally be considered more than sufficient for the research to be deemed valid. Furthermore, data saturation was reached between the participants as discussed in the analysis chapters, and the interviews were conducted until no new themes emerged.

9.6. Suggestions for further research

There are a number of suggestions for future research arising from this study. Firstly, a cross-country and cross-sectoral CRD quality-based research project is a possible avenue for future research whereby semi-structured interviews are conducted with stakeholders from different countries with different disclosure cultures, practices and/or regulatory frameworks. This could help develop an internationally accepted framework for CRD and inform an international accounting standard for CRD. Likewise, a cross-sectoral study that takes account of the differences in the nature of the risks among different industry sectors is worthy of investigation as it might ascertain where the CRD quality would be improved if the framework were made sector-specific.

Second, another theme which has emerged from the data and would provide a fruitful avenue for future studies is to investigate the internal risk communication process and how it can be connected to CRD quality. It would seem important to examine how RI is communicated throughout the company including how different employees at different levels perceive risk and how it influences RM and then flows through external CRD practices. Researchers could

potentially employ participant observation as the research method for data collection and this could be triangulated through examining the company's internal documents such as risk register and board and risk/audit committee minutes.

Third, in terms of methodology, an index for CRD quality could be developed based on the proposed framework. Such an index can be used by investors, academics, regulators, and auditors to assess CRD quality. The index can encompass a number of sub-characteristics under each main characteristic, and quality of RI can then be evaluated according to these criteria. CRD quality can be measured by the amount and characteristics of RI provided by companies in their annual reports. Based on the proposed index a CRD quality score can be calculated for each company/annual report.

Fourth, the development of the CRD quality index could be used to examine the determinants of CRD quality such as CG practices and mechanisms. This type of study could also examine the impact of internal or company-specific variables such the degree of development of RM systems on corporate CRD behaviour and quality.

Fifth, more research is needed to examine the impact of CRD on company's market value (share price) and cost of capital. Specifically, these studies need to investigate if higher quality CRD has a beneficial impact on these market value and cost of capital. If proven this may well encourage companies to provide better quality risk disclosures.

Appendices

Appendix 1 Interview Topic Guide

Major themes covered during the interviews

- **Definition of risk**
  - What is your definition of risk?
  - Upside risks vs downside risks

- **Relevance of CRD**
  - Is CRD important?
  - What are the benefits of CRD (if any) for companies and/or investors?

- **Current CRD practices**
  - What is your evaluation of current RR practices?
  - What are the shortcomings of current CRD practices? And how can they be overcome?

- **Incentives and disincentives for CRD**
  - What kind of risk information would companies not disclose?
  - Why would companies refrain from reporting particular risk information?
  - What incentives could encourage managements to report more and meaningful risk information?
  - What are the obstacles to better CRD?
  - Other incentives for and constraints on CRD
  - Managers' discretion and manipulation of CRD

- **The concept of CRD quality**
  - What does quality of CRD mean from your own perspective?
  - What are the characteristics of high CRD quality?

- **Operationalisation of FASB qualitative characteristics; relevance, faithful representation, comparability, verifiability, timeliness and understandability, in terms of how each characteristic can be enhanced and measured.**
  - Quantitative vs qualitative CRD.
  - Forward-looking vs past CRD.
  - Specificity of CRD (company-specific vs generic risk information).
  - All risks vs key risks.

- Disclosure of risk measurement principles and methods and risk management plans.
- Risk culture within the company and its relationship to external CRD?
- Timing of CRD: when should companies disclose a risk?
- What is the most appropriate disclosure vehicle for CRD and why?
- Where in the annual report should risks be disclosed?
- Do you prefer reporting risks in a separate statement?
- What information sources do investors use to assess a company's risk profile?
- Would you prefer reporting risks in private meetings with managers rather than in published corporate reports?
- How can comparability of risk disclosures be enhanced?
- How can CRD understandability be improved?
- CRD and the company's business model and strategy.

- **Further proposals for improving CRD quality**
  - How can CRD be further improved?
  - What is the relationship between corporate governance and CRD quality?
  - How can corporate governance mechanisms contribute to better CRD?
  - What is the external auditor's role in enhancing CRD quality?

Appendix 2 Interview Participant Information Sheet

A FRAMEWORK FOR THE QUALITY OF CORPORATE RISK DISCLOSURE

INTERVIEW PARTICIPANT INFORMATION SHEET

This study seeks to develop a best practice framework for the quality of risk disclosures provided by non-financial firms. The purpose is to investigate how companies can provide high quality risk information that is more meaningful to information users. Improving risk reporting presumably begins with identifying information users` needs as well as constraints on managers and annual report preparers considering management concerns about assessing and reporting risks (for example, sensitive and forward-looking risk information). Therefore, the framework is based on the notion of quality and the qualitative characteristics developed by the Financial Accounting Standards Board (FASB) taking account of the information needs of different users of corporate financial reporting, management incentives and disincentives for risk disclosure as well as feedback from auditors, members of regulatory and professional bodies (policymakers) and academics with relevant knowledge and expertise in this area. Consequently, if applied by non-financial firms, the framework would potentially enhance the quality of their risk disclosures. The framework could also be used to assess the quality of risk disclosures made by non-financial companies.

The study, therefore, will answer the following main questions:

1- How do different CRD-related stakeholders comprehend the concept of risk?
2- What are the perceptions of information users, and other stakeholders, of the relevance of risk reporting and of current CRD practices?
3- What are the management incentives and disincentives for risk reporting?
4- What is quality and what are the characteristics associated with good quality risk disclosure?
5- How can the FASB qualitative characteristics be operationalised to create a CRD quality framework and how can CRD quality be further improved to correspond with the framework?

This is a PhD research project being conducted by Mahmoud Marzouk who is a doctoral researcher in Accounting and Finance at the York Management School, University of York. The interviews will be conducted, transcribed and analysed by Mahmoud.

Your participation in this research study is voluntary. You have been invited to participate in an interview that will take approximately 60 minutes.

Your responses will be confidential, the interviews will be recorded initially and then transcribed, once transcribed the recordings will be deleted. Prior to transcription, the recordings will be stored in a password protected file. Electronic copies of the transcriptions will also be stored in a password protected file and any paper based will be stored in a locked room.

The results of this study will be used to write up my PhD thesis, but only the researcher named above will have access to the raw data. We will send you a copy of the transcribed interview for your approval prior to using any of the information in the thesis.

If you have any questions about the research study, please contact Mahmoud Marzouk, University of York, at mkmm500@york.ac.uk. You may also contact Mahmoud`s PhD supervisor who is Professor Philip Linsley (email: philip.linsley@york.ac.uk).

This research has been reviewed according to the University of York procedures for research involving human subjects. The Chair of the The Economics, Law, Management, Politics and Sociology Ethics Sub-Committee, is Professor Celia Kitzinger (e-mail: celia.kitzinger@york.ac.uk) and she can be contacted at the following address, The Department of Sociology, Wentworth College, University of York, York, YO10 5DD.

Appendix 3 Consent Form

The York Management School
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A Framework for the Quality of Corporate Risk Disclosure

Consent Form for Interview Participant

Researcher: Mahmoud Marzouk

Consent Form

This form is intended for you to provide your consent to participate in this research project. Please consider each of the questions and provide a response where appropriate in the check boxes below. If you have any further questions or concerns before completing this form, please speak to the researcher.

		YES	***NO***
1.	*Have you reviewed and understood the information sheet detailing the nature of the study and your role as a participant?*	☐	☐
2.	*Have you had the opportunity to ask questions about the research and/or your role in the research?*	☐	☐
3.	*Do you understand that you can withdraw from participating in the interview at any point and that any data collected until the point of withdrawal will be confidentially destroyed?*	☐	☐
4.	*Do you understand that the data collected in this interview will be used for a PhD thesis?*	☐	☐
5.	*Do you understand that any comments that you make will be anonymised and will not be attributable to you?*	☐	☐
6.	*Do you understand that all information you provide will be held securely and in confidence by the researcher and will be anonymised unless you have agreed otherwise?*	☐	☐
7.	*Do you understand that the data collected for this interview will be deleted or destroyed securely and confidentially following the completion of this research project?*	☐	☐
8.	*Do you agree to take part in this research?*	☐	☐

9.	*If you have agreed to take part in this research, do you consent to having the* *<u>entire</u>* *interview recorded? (If 'yes', you may move on to the signature section. If 'no', continue to question 10.)*	☐	☐
10.	*If you have agreed to take part in this research, do you consent to having* *<u>any portion</u>* *of the interview recorded? (If you answer 'yes', you will be asked to detail the information you wish not to be recorded prior to commencing the interview. However, if you prefer, you may clearly state during the interview when to begin and end the recording. Please note that handwritten notes will still be used.)*	☐	☐

Your name and title (in capital letters): DATE

Your signature:

Name and title of researcher (in capital letters):
MAHMOUD MARZOUK – DOCTORAL RESEARCHER IN ACCOUNTING & FINANCE
Signature of researcher:

You may also contact the Chair of the Economics, Law, Management, Politics and Sociology departmental ethics committee, Professor Celia Kitzinger (e-mail:celia.kitzinger@york.ac.uk , at The Department of Sociology, Wentworth College, University of York, York, YO10 5DD).

Abbreviations

ACCA	Association of Chartered Certified Accountants
Airmic	Association of Insurance and Risk Managers in Industry and Commerce
AR	Annual Report
ASCG	Accounting Standards Committee of Germany
CG	Corporate Governance
CRD	Corporate Risk Disclosure
EDTF	Enhanced Disclosure Task Force
EFRAG	European Financial Reporting Advisory Group
EU	European Union
FASB	Financial Accounting Standards Board
FRC	Financial Reporting Council
FRRP	Financial Reporting Review Panel
FSB	Financial Stability Board
GAS	German Accounting Standard
IASB	International Accounting Standards Board
ICAEW	Institute of Chartered Accountants in England and Wales
ICAS	Institute of Chartered Accountants in Scotland
ICGN	International Corporate Governance Network
ICSA	Institute of Chartered Secretaries and Administrators
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
ISO	International Standards Organisation
OECD	Organisation for Economic Co-operation and Development
RNS	Regulatory News Service
RA	Risk Appetite
RE	Risk Exposure
RI	Risk Information
RM	Risk Management
RP	Risk Profile
RR	Risk Reporting
SEC	Securities and Exchange Commission
UAE	United Arab Emirates
UK	United Kingdom
US	United States
USA	United States of America

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