



Master in Management

FINANCIAL AND ESG REPORTING

Class 1

Fall, 2025



**Lisbon School
of Economics
& Management**
Universidade de Lisboa

Faculty Team

Dr Yi Wang (coordinator)

My contacts



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Invited Assistant Professor



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Learning outcomes:

- Understand the theories and roles of information disclosure;
- Comprehend the importance of financial and ESG reporting;
- Deepen knowledge on financial reporting framework and standards;
- Grasp and apply key concepts in financial statement analysis;
- Examine the concepts and evolution of ESG reporting and policies in the EU and other countries;
- Learn and apply appropriate procedures for preparing ESG disclosures;
- Understand key sustainability-related issues, including sustainability assurance, ESG investments, and ESG ratings;
- Evaluate the quality of corporate reporting;
- Understand and discuss some literature references, case studies and scenarios on reporting, sustainability, accountability and ethics.

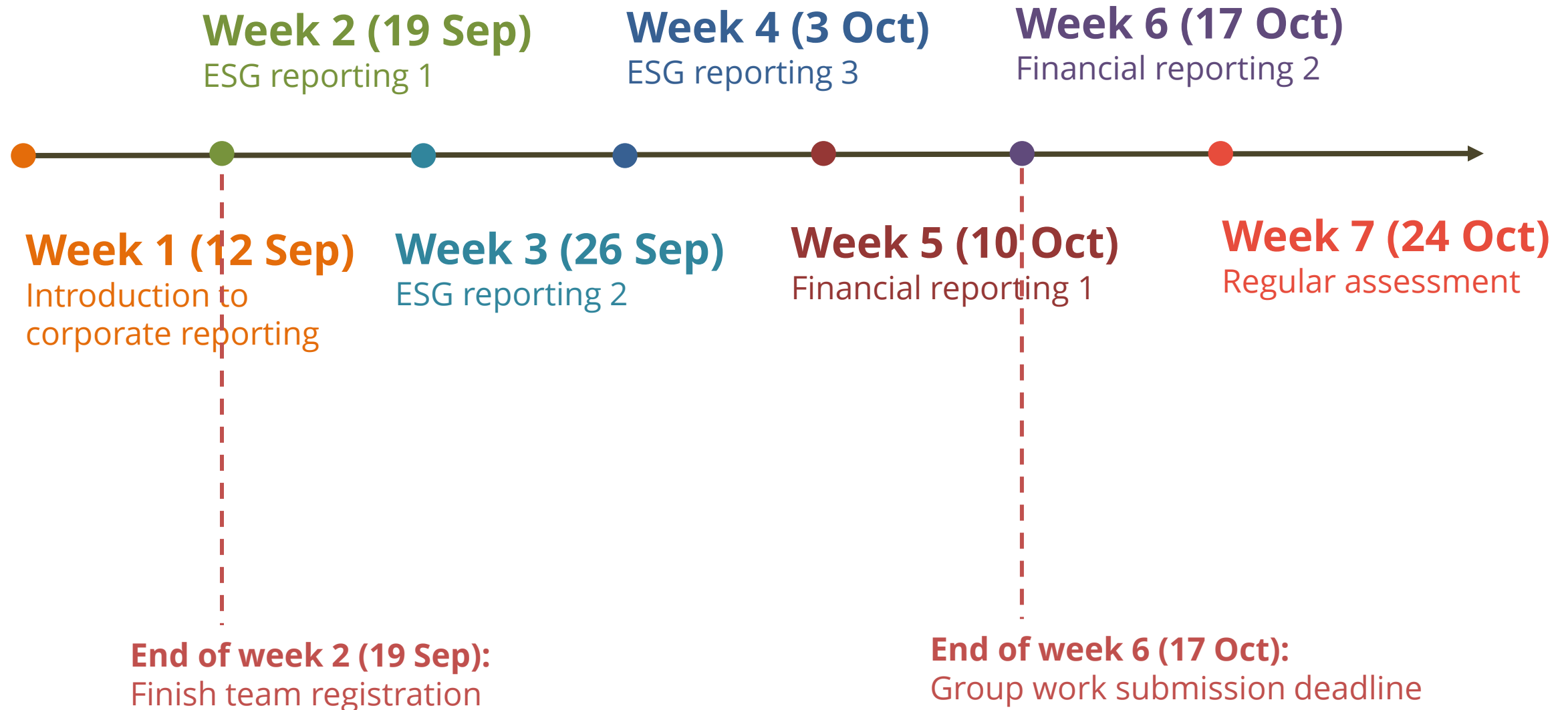
Program:

1. Introduction to Corporate Reporting
2. ESG Reporting (Part 1): Foundations
3. ESG Reporting (Part 2): The ESG Reporting Process
4. ESG Reporting (Part 3): Sustainability Assurance and Emerging Issues
5. Financial Reporting (Part 1): Fundamentals
6. Financial Reporting (Part 2): Financial Analysis and Interpretation

Main change of the course

- Restructured content for better logic and flexibility
- Added real-world, engaging, and debate-worthy topics
- Updated reporting regulations to reflect the latest standards
- More interactive elements to enhance student engagement

Course timeline:



Reading materials:

- Rankin, M., Ferlauto, K., McGowan, S., & Stanton, P. (2022). Contemporary Issues in Accounting (3rd ed.). Wiley.
- Literature and other materials uploaded to Fenix

Evaluation:

Regular Season (24 Oct):

Final grade includes:

- Individual written test with a minimum grade of 8 points (60%);
- Group work on Sustainability Reporting (40%).

Objective of this class:

1. The concepts of information asymmetry and the market for lemons
2. The role of corporate reporting and accounting disclosures
3. Different managerial reporting incentives
4. What is the effect of corporate reporting

Reading of this class:

Supplementary reading:

Healy, P. M., and K. G. Palepu. 2001. Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of Accounting and Economics* 31: 405-440.

Mini Survey: The Role of Company Reports



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Join at menti.com | use code 5418 3527

Mentimeter

Why do we need company reports?



leader bold transpiration
creative
fast
inspiration focus



Information asymmetry and the market for lemons

What is information asymmetry?

Information asymmetry occurs when one party (e.g., managers) has an advantage over the other parties (e.g., investors and other interested parties) as the former one possesses **more information** about the current and future prospects of the company, and can decide when and how to disseminate such **information**.

Why does information asymmetry occur?

Financial and ESG Reporting



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George Akerlof (1970) — Adverse Selection: The Market for Lemons

Car A: £10,000



Car B: £5,000



Do these two used cars look alike?
If you are a buyer, which one will you choose?

Watch this Youtube video

<https://www.youtube.com/watch?v=sXPXpJ5vMnU>

The market for lemons — An example from the view of an investor (1)

Assume:

1. You would like to invest in companies producing “lemons”.
2. There are two companies in the market.
3. Their products look alike.

Company A
Good



Expected Return: 20%

Company B
Poor



Expected Return: 10%



The market for lemons — An example from the view of an investor (2)

**Will you invest in Company A (Good) or
Company B (Poor)?**

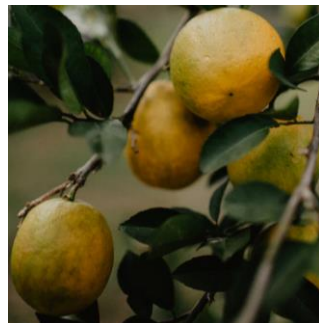
Why?

The market for lemons — An example from the view of an investor (3)

However, if we assume that:

1. You **only** know that there are companies producing “lemons” in the market.
2. You **can not tell** which one is good and which one is bad.

Good
(A or B???)



Expected Return: 30%

Poor
(A or B???)



Expected Return: 6%

**Q: How will you
invest?**

The market for lemons — An example from the view of an investor (4)



Outside investors: face uncertainty about the quality of the products produced by Companies A and B

50% of investment opportunities are “good” ($r_G=30\%$)

50% of investment opportunities are “poor” ($r_P=6\%$)

Average return expectations:

$$0.5 * 30\% + 0.5 * 6\% = 18\%$$

=> Investors will use the expected return of 18% as a benchmark to determine the target share price of their potential investment.

The market for lemons — An example from the view of an investor (5)

Managers — Good knowledge about the quality of their products

Q: If you are the manager, are you happy that the expected return of 18% is used to be the basis to determine the value of your company's share price?

If you are the manager of the “Good” company, you may choose to leave the capital market. You may find a private channel to finance your company (private finance).

=>

The average return expectation will go further down in the market.

$$0.33 * 30\% + 0.66 * 6\% = 14\%$$

The market for lemons — An example from the view of an investor (6)

Q: What is the major problem arising from the example?

Ans:

What is the potential solution to reduce “information asymmetry”?

Ans:



Accounting information can enhance “**Information flow**” between firm and the external capital market.

The role of corporate reporting and accounting disclosures

What is the impact of improper accounting behaviors?

An example:

Toshiba's Accounting Scandal in 2015

TOSHIBA

Q: What did they do?

Ans: Overstated \$1.2 billion operating profit in 2015

What is the impact of the accounting scandal?



Market value fell by 30% in 5 months

Why is financial reporting and accounting important?



Information flow

- ❑ Decision usefulness
 - Useful for making prediction about what may happen in the future
 - Provide feedback on previous decisions
- ❑ Stewardship (or accountability) role
 - Managers prepare **a report** to **the providers of the resources** and explain how well they have managed them.
 - Shareholders — Separation of managers and owners
 - Other stakeholders (e.g., lenders, costumers, suppliers and governments)
- ⇒ Discipline managers
 - Monitor managerial performance
 - Set managerial incentive scheme

Types of corporate reporting and accounting disclosures



- ❑ Corporate reporting/disclosures could be **mandatory** or **voluntary**
 - Financial statements (Statement of financial position, Statement of comprehensive income & Statement of cash flow)
 - Corporate governance (board of directors, executive compensation & shareholdings, and block ownership)
 - Risk disclosures
 - Future business strategy
 - Corporate social responsibility reporting

Different managerial reporting incentives

Why do (don't) managers have incentive to disclose information? (1)



There are some theoretical rationalities: (See, **Healy and Palepu, 2001**)

- ❑ Capital Market Transaction Hypothesis
- ❑ Corporate Control Contest Hypothesis
- ❑ Stock Compensation Hypothesis:
 - ❖ Insider Trading;
 - ❖ Stock Liquidity;
 - ❖ Contracting Costs (undervaluation)
- ❑ Litigation Cost Hypothesis
- ❑ Management Talent Signalling Hypothesis
- ❑ Proprietary Cost Hypothesis

Why do (don't) managers have incentive to disclose information? (2)

❑ Capital Market Transaction Hypothesis

- Managers have incentive to provide more internal information in order to obtain cheaper external finance (Beyer et al., 2010).

❑ Corporate Control Contest Hypothesis

- Managers are more likely to be replaced when their firms' share perform poorly in the market. They therefore have incentive to make an accounting choice in a manner that can help avoid the firm is undervalued by its shareholders (Christie and Zimmerman, 1994).

What is the effect of corporate reporting and accounting disclosures? (3)

- ❑ Stock Compensation Hypothesis:
 - Managers' reporting behaviours may be subject to their share-based compensation packages. (Beyer et al., 2010)
 - ❖ Provide more disclosures in order to avoid restrictions or concerns of insider trading.
 - ❖ Provide more disclosures in order to increase the liquidity of shares and avoid undervaluation of the shares.
 - ❖ Provide more disclosures to decrease the contracting costs with new employees who have share-based compensation.

Why do (don't) managers have incentive to disclose information? (4)



❑ Litigation Cost Hypothesis

- Managers have incentives to or not to disclose information in order to reduce the cost of litigation.
- Litigation against **in appropriate level of disclosures** (especially bad news)
- Litigation risk due to unexpected errors (such as earnings forecast errors).

❑ Management Talent Signalling Hypothesis

- Managers have incentives to provide quality disclosures to signal their ability to anticipate and respond to future changes.

Why do (don't) managers have incentive to disclose information? (5)



❑ Proprietary Cost Hypothesis

- Managers have incentive not to disclosure information if such information may threat to the firm's competitive advantage in the product market.

The effect of corporate reporting

What is the effect of corporate reporting and disclosures?

- ❑ Dependent on the **quality** and **reliability** of the reports and disclosures.

Managerial reporting decisions, behaviours or strategies. E.g.,

- Earnings management
- Accounting conservatism
- Voluntary disclosures



Perception or behaviours of information users and organisation (e.g., shareholders, debtholders)

- Share price (e.g., Lang & Lundholm, 2000)
- Cost of equity (e.g., Francis et al., 2008)
- Cost of debt (Dhaliwal et al., 2011; Zhang, 2008)
- Other organisational outcome — e.g., Investment efficiency (Lara et al., 2016)

Tesco Scandal 2014

Fraud triangle

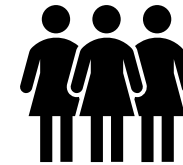


Managerial behaviour

- Agency conflicts (Jensen and Meckling 1976)
 - Directors (agents) operate companies on behalf of shareholders (principals)



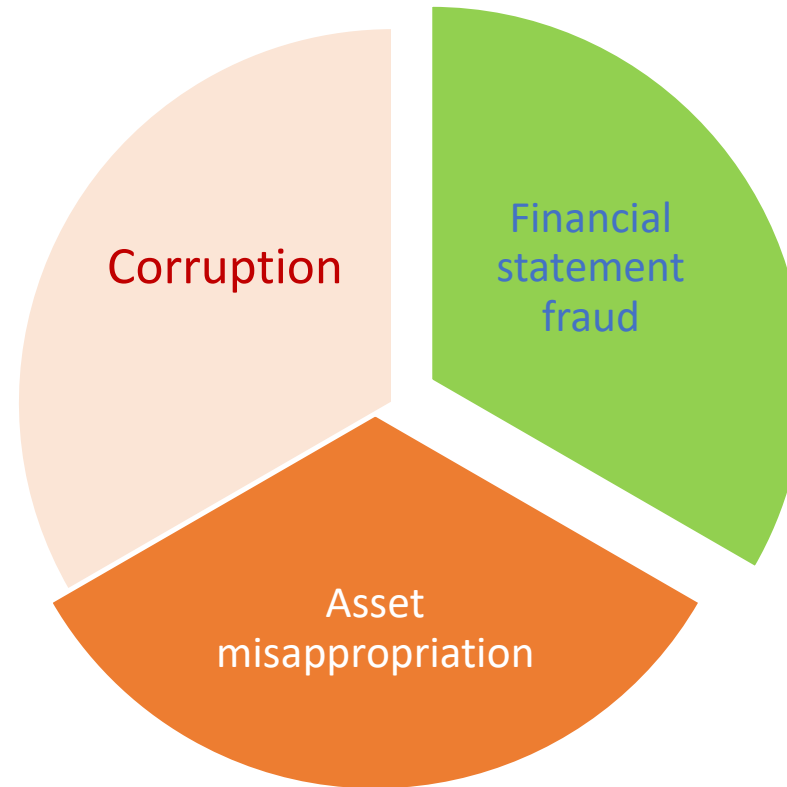
Director/Manager



Shareholders

- Information asymmetry (Akerlof 1970)

Types of fraud



Association of Certified Fraud Examiners (2020)

Polling Question 1

- **What type of fraud is the most common one?**
 - A. corruption
 - B. asset misappropriation
 - C. financial statement fraud

Polling Question 2

- **What type of fraud is the most costly one?**
 - A. corruption
 - B. asset misappropriation
 - C. financial statement fraud

There were a lot of financial scandals



2003 Parmalat

2004 American International Group

2008 Lehman Brothers

2011 Autonomy

2014 Tesco

2015 Toshiba

2018 Patisserie Valerie

Tesco scandal (2014)

Fact sheet

- 517, 000 colleagues
- 7817 shops around the world
- Over 80 million shopping trips per week

2014 Annual report (52 weeks ended 22 Feb 2014)

- Group Revenue £ 63.5 bn
- Group operating profit £ 2.6 bn

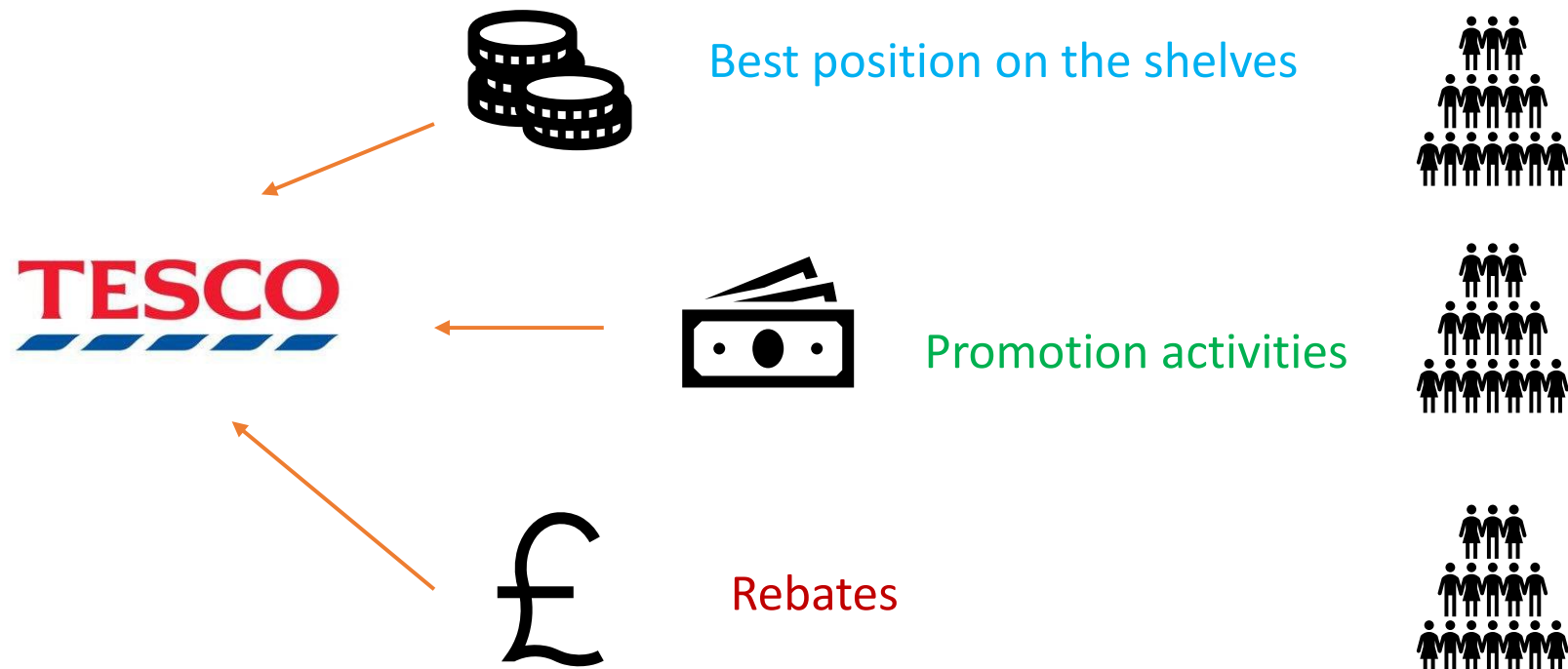
Tesco's pressure



Source of pictures: [bbc.co.uk](https://www.bbc.co.uk)

Commercial income

Economic relationship with supplier



Cooked the book

- **Overstatement of profits by more than £250 million**
 - Accelerate revenue recognition
 - Delay accruals of costs
- **PwC served Tesco since 1983 (32 years)**

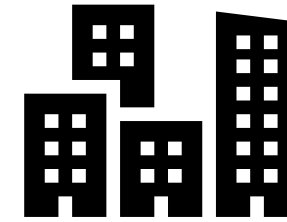
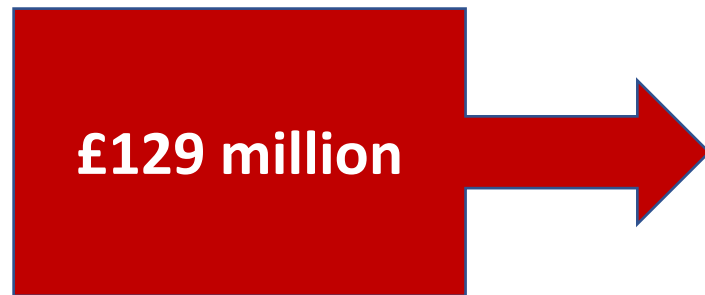
Aftermath

- UK finance director: **Carl Rogberg**
- UK managing director: **Chris Bush**
- UK food commercial director: **John Scouler**

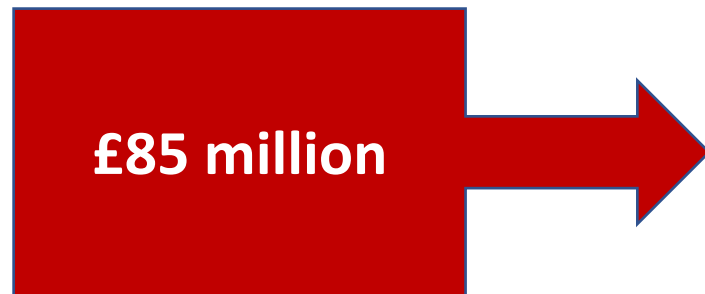


Arrested and charged

Financial costs due to the scandal



Serious Fraud Office



Investors

Guilty?



- 2018

Former Tesco directors have been **acquitted of charges** of fraud and false accounting due to lack of evidence



Questions

- Q1: What are the problems inherent in the accounting practices/policies in the Tesco's scandal?
- Q2: In what respect might the Tesco's managers hope to benefit from using such accounting practices/policies?
- Q3: Did Tesco benefit from such accounting practices/policies?
- Q4: Does disclosing the accounting treatment for **commercial income** help to mitigate the concern arising from the scandal? Any other mechanism could be put in place to mitigate the concern over accounting misbehaviours?

Conclusion:

1. The concepts of information asymmetry and the market for lemons
2. The role of corporate reporting and accounting disclosures
3. Different managerial reporting incentives
4. What is the effect of corporate reporting

Next class:

ESG reporting 1