Master in Management

FINANCIAL AND ESG REPORTING
Class 1

Fall, 2026

ISEG
Lisbon School of Economics & Management
Universidade de Lisboa

Faculty Team

Dr Yi Wang (coordinator)

My contacts

Yi Wang

Invited Assistant Professor

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Office 303, Miguel Lupi, 3-4 pm (Wed.)

If you would like to attend office hours, please email me at least 48 hours in advance.

Learning outcomes:

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- 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 the latest financial and ESG reporting regulations and standards
- More interactive elements to enhance student engagement

Course timeline:

Week 1 (11 Sep)
Introduction to corporate reporting

Week 2 (18 Sep)
ESG reporting 1

Week 3 (25 Sep)
ESG reporting 2

Week 4 (2 Oct)
ESG reporting 3/Financial reporting 1

Week 5 (9 Oct)
Financial reporting 1

Week 6 (16 Oct)
Financial reporting 2

Week 7 (23 Oct)
Regular assessment

End of week 2 (19-20 Sep):
Finish team registration

End of week 6 (16 Oct):
Group work submission deadline

Reading materials:

- Slides, literature, and other materials uploaded to Fenix
- Recommended textbook: Rankin, M., Ferlauto, K., McGowan, S., & Stanton, P. (2022). Contemporary Issues in Accounting (3rd ed.). Wiley.
- Self-study resources for students without a background in accounting：https://openstax.org/details/books/principles-financial-accounting

Evaluation:

Regular Season (23 Oct):

Final grade includes (both are mandatory):

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

Attendance:

- Not mandatory
- Pedagogical Board: “2 – Lectures can only be streamed via Teams in the following exceptional situations: 2.1. – In the case of ill health, which is duly proven and validated by the Coordinator of the UC in question. 2.2 – When carrying out duties in the context of international organisations of which Portugal is a member, provided that such duties are authorised within the terms of the law. 2.3. – For any students enrolled in a Master’s or PhD degree who are awaiting an entry visa to Portugal. In such a case, the implication is that the student attends the lecture but does not actively participate in it.”
- In-class discussions may be reflected in the final exam to reward students who attend and actively participate in class

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 are the effects 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

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?

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???)

Q: How will you invest?

Poor (A or B???)

Expected Return: 30%

Expected Return:6%

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

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 (e.g., Tesla proposes trillion-dollar compensation package for CEO Elon Musk)

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 effects 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)

Let's get into groups!

- 5-6 students per group
- Preferably to form a group with students from the same shift as shown on Fenix

- Fill in the group form:
- Student name
- Student ID

- Register on Fenix by 20 September.
- If any student has difficulty finding group members, please inform me before 17 September. Students who fail to complete the registration by this time will be required to complete the group assignment individually
- Work as a team. Try to avoid a free rider issue
- The guideline for group work is now available on Fenix
- A more detailed explanation about group work will be discussed in Week 3

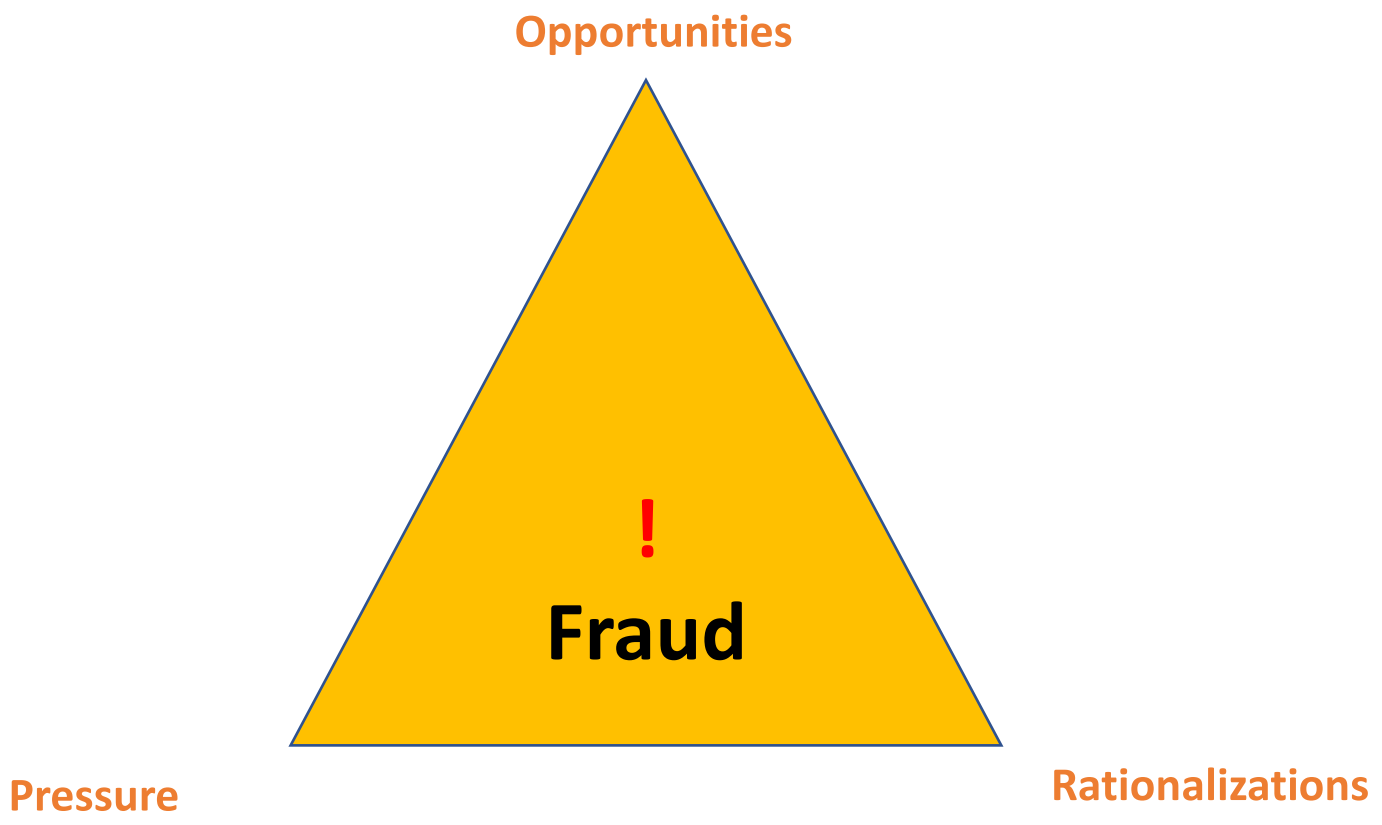
The next step:

Please select <u>a suitable SME</u> for your group work

- No restrictions regarding the industry or country
- No published ESG report in 2025
- Aim to complete this by the third class

Tesco Scandal 2014

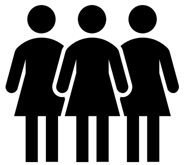
Fraud triangle



Managerial behaviour

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

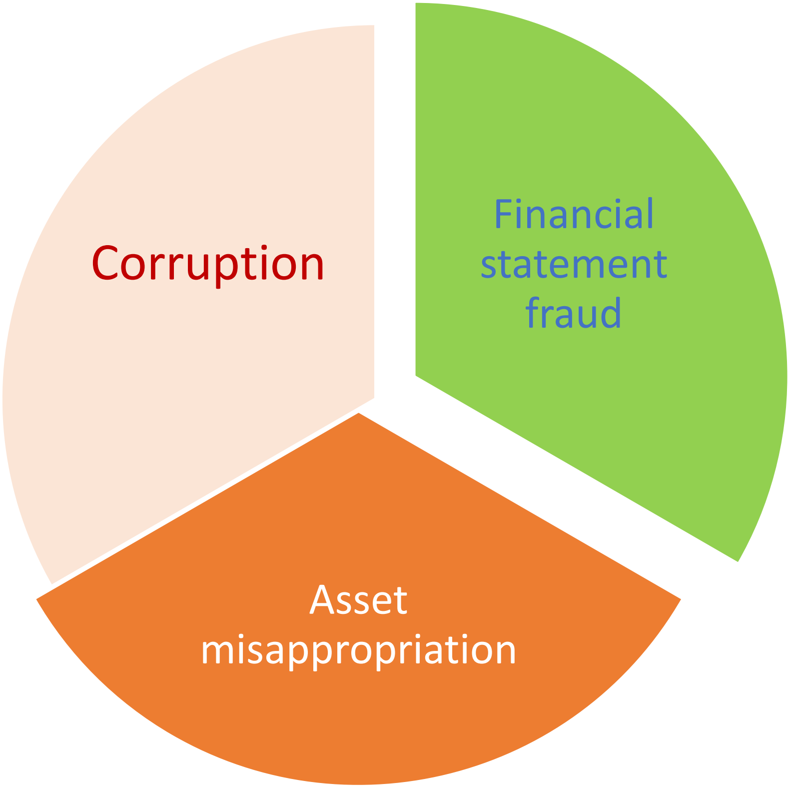
Director/Manager



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)

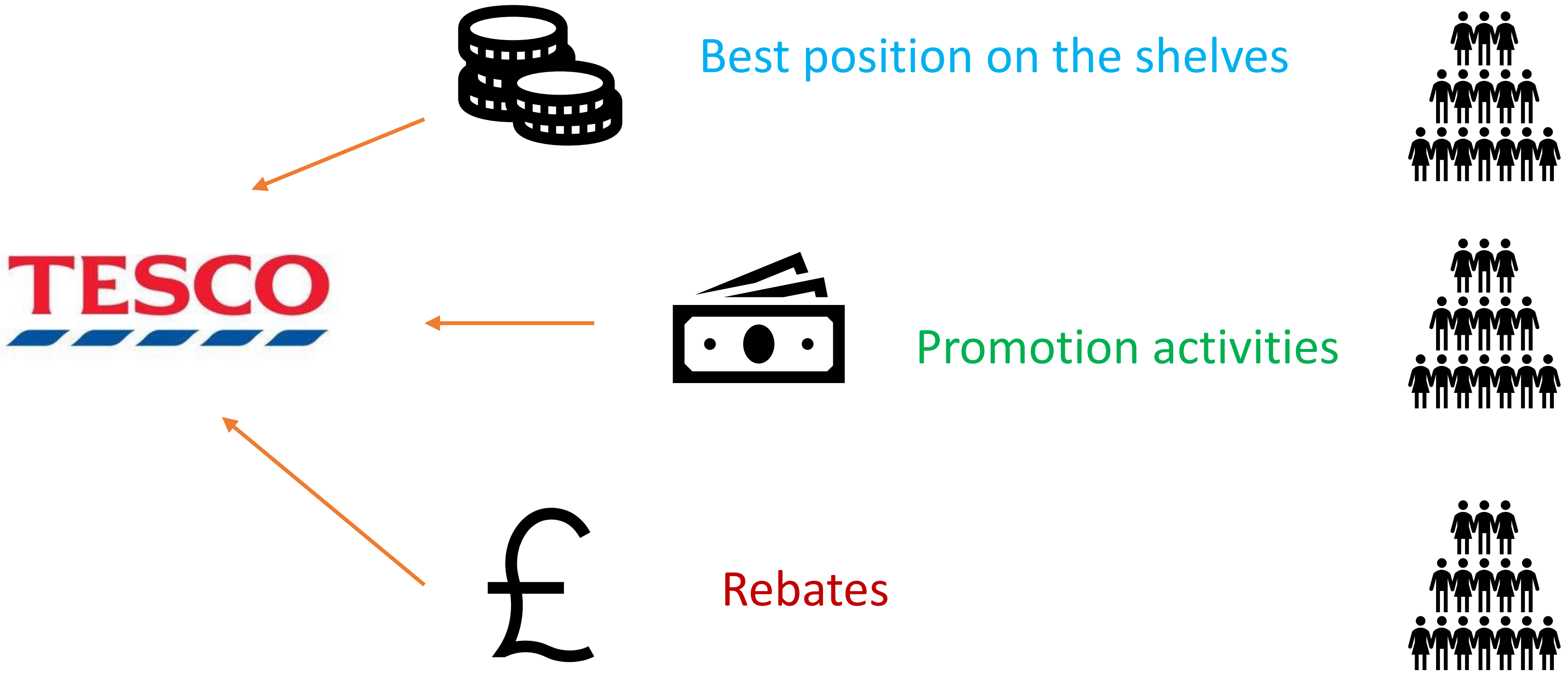
- Group Revenue £ 63.5 bn
- Group operating profit £ 2.6 bn

Tesco's pressure

Source of pictures: bbc.co.uk

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

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Financial costs due to the scandal

£129 million

Serious Fraud Office

£85 million

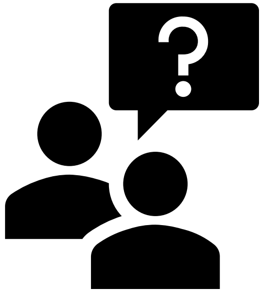
Investors

Guilty?

Tesco admitted fraud and agreed a £129m to the Serious Fraud Office !!!

- 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 are the effects of corporate reporting

Next class:

ESG reporting 1