Role of Disclosure in Corporate Governance

“Disclosure, again disclosure and still more disclosure”
Richard B. Smith
US SEC Commission
Index

- Definition
- From Transparency to Disclosure
- Why disclosure is important (in terms of concrete advantages for the Market)
- Why disclosure is important (in terms of concrete advantages for the Company)
- What information shall be disclosed (by law)
- What information should be disclosed (according to the Company strategy)
- How to disclose information
- Role of disclosure preventing financial crimes
Disclosure

Transparency is letting the truth be available for others. This view implies a passive position on the part of the company under consideration. Today transparency is taking on a whole new meaning: active disclosure. In other words, the new concept of transparency includes action or motion, putting new responsibilities on the company. New concept of transparency requires not only letting the truth be available but imposes to disclose it to every stakeholders.
"Sunlight is said to be the best of disinfectants; electric light is the most efficient policeman".

It is an old quote from Louis Brandeis, Supreme court of justice in the context of Great depression 1933.

It demonstrates how financial transparency was the remedy for fraud and market manipulations in the 1920s as it is now.
The corporate governance framework should ensure timely and accurate disclosure on all material matters, including financial situation, performance, ownership and governance of the company.

- At minimum annually, or even semi-annually or quarterly; or more frequently for material developments.
- Material info is that information whose omission or misstatement could influence economic decisions taken by users of information.
- Should be simultaneous to all shareholders.
- Requirements should not create unreasonable administrative or cost burdens.
Why disclosure is important (in terms of concrete advantages for the Market)

- Strong transparent disclosure regime is pivotal for market-based monitoring of companies and central to shareholder ability to exercise ownership rights.
- Can be powerful tool for influencing companies and protecting investors.
- Can help to attract capital and maintain confidence in the markets.
- Weak disclosure can contribute to unethical behaviour and loss of market integrity, costing not only company but economy as a whole.
- Insufficient or unclear information may hamper ability of markets to function, increase cost of capital and result in poor resource allocation.
Why disclosure is important (in terms of concrete advantages for the Company)

• Reliable and timely information increases confidence among decision-makers within the company and enables them to make good business decisions directly affecting growth and profitability.

• Information also affects decision makers outside the entity-shareholders, investors and lenders, who must decide where and with what risk to place their money.

• The information provided, show the decision-makers and outside interests whether and to what extent corporations meet legal requirements.

• Disclosure helps public understanding of a Company's activities, policies and performance with regard to environmental and ethical standards, as well as its relationship with the communities where the Company operates (relations with Stakeholders).

• Disclosure and transparency, as well as proper auditing, serves as a deterrent to fraud and corruption, allowing firms to compete on the basis of their best offerings and to differentiate themselves from firms who do not practice good governance.
What information shall be disclosed

- Financial and operating results of the company.
- Company objectives.
- Major share ownership and voting rights.
- Remuneration policy for board members and key executives, and info about board member qualifications, selection process, other company directorships and whether they are independent.
- Related party transactions.
- Foreseeable risk factors.
- Issues regarding employees and other stakeholders.
- Corporate governance codes and policies, and how they are implemented.
What information should be disclosed:

The Annual Report should explain/disclose as follows:

- Adherence with applicable Accounting Standards
- Consistent use of appropriate accounting policies supported by reasonable and prudent judgment and estimates.
- Maintenance of adequate accounting records and an effective system of internal controls.
- The Directors’ responsibility to prepare financial statements that fairly present the state of affairs of the Company, as at the end of the financial year, and the Profit or Loss for that period.
- The Auditor’s responsibility for reporting on the financial statement.
- Detailed report on stock option activity, if any - outstanding, granted, exercised, exercisable and forfeited/expired.
- Report on all major outstanding litigation and their progress during the year.
- The system for evaluation of Board Members, the Chief Executive Officer and officers.
- Full details of the form and level of the total remuneration of the Management Board members.
What information should be disclosed: Accounting Records

The main criteria to assure appropriate disclosure are as follows:

– Accounting transparency is based on the use of true, accurate and complete information for construing entries in the books of accounts.
– Each employee shall cooperate in order to have events properly and timely registered in the books of accounts.
– For each transaction the proper supporting evidence has to be maintained in order to:
  • facilitate registration of the accounting;
  • identify the different degrees of responsibilities;
  • provide an accurate representation of the transaction so as to avoid any errors in interpretation of the facts.
– Each record shall reflect exactly what is shown by the supporting evidence.
– Each employee shall make sure, through accurate filing according to logical criteria, that the documentation can be easily traced.
– Every employee who becomes aware of any omissions, misrepresentations, negligence in the accounting or in the documents on which accounting is based, shall bring the facts to the attention of his or her superior.
What information should be disclosed: Other information

- The main criteria in order to decide whether information and data are to be communicated is relevance: all relevant information is subject to disclosure, except from “Company confidential” information, i.e. information that might jeopardize the Company competitive strategy if revealed.

- In order to evaluate the relevance, it is important to analyse each Stakeholder motives, i.e. what kind of stake the Stakeholder holds in the Company:
  - For instance, the full disclosure and comprehension of the Organizational Chart is of the highest relevance for employees, while for minority shareholders the same information can be just “nice-to-have”.

- Furthermore, it is important to fine-tune the degree of disclosure consistently with strategic priorities:
  - For example, if the Company wants to obtain the Quality Certification, it might be smart to disclose the Organizational Chart, including the Total Quality Managers role and responsibilities.
How to disclose information

• A Code of Disclosure must explain the procedures that allow information to better reach its recipient.
• Company shall make timely and accurate disclosure when matters of importance have been decided.
• Each Company shall have mechanisms to inform investors, in order to maintain effective communication channels with shareholders, stakeholders and potential investors.
• All Reports by each organism submitted to the Board shall be available to the shareholders, with exception of such information of a confidential nature as may affect the competitiveness of the Company.
• In addition, it is recommended that the Annual Report includes the names of the Members of each Company’s Body.
Role of disclosure preventing financial crimes

• When self-interested behavior veers into outright criminality true transparency would cast a light on these activities causing a change in behavior
• Increasing transparency will be key to the future success of corporate governance.
• Only with transparency will it be possible to deter frauds, embezzlement and financial scandals, and foster efficiency in the allocation of investments across companies and countries
Conclusions

Rules, regulations, laws, concepts, structures, processes, best practices, and the most progressive use of technology cannot ensure transparency and accountability. This can only come about when individuals of integrity are trying to ‘do the right thing,’ not just what is expedient or even necessarily what is permissible. What matters in the end are the actions of people, not simply their words.