

### AFAANZ 2018-2019 Final Grant Report

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| <p><b>(1) Name, Position, Contact Details for each applicant</b></p>   | <p>Principal researcher:<br/>Dr Jing Jia, Lecturer, jing.jia@utas.edu.au</p> <p>Other researcher:<br/>Zhongtian Li, n9332570@qut.edu.au</p> <p>Mentor:<br/>Professor Michael Bradbury, M.E.Bradbury@massey.ac.nz</p>   |
| <p><b>(2) Project Title</b></p>  | <p>Readability of Risk Management Disclosures: Evidence from Australia</p>   |
| <p><b>(3) Updated Project Summary (500 words) including any variations between the project undertaken and the original application</b></p> | <p>How to form a good risk governance has received significant attention after the Global Financial Crisis. However, good risk governance will not be fully realised to shareholders unless there is an effective risk communication in place. Annual report disclosure provides an important channel through which firms can disclose risk information. New literature is emerging on the textual analysis of risk management disclosure and testing whether it is informative to the market. Studies have consistently found that investors value the content of risk management disclosures and incorporate risk information when making investment decisions. Since risk management written documents are economically important and provide new information to investors, it is important for us to understand the determinants and consequences of the readability of risk management disclosure.</p> <p>Corporate risk management procedures include establishing a board of directors' risk management committee. This project examines the impact of the presence and human capital characteristics of risk management committees on the readability of risk management disclosures, and the relation between the readability of risk management disclosure and firms' future cash flows from operations. Our focus on the association between risk management disclosure readability and future cash flows is motivated by two considerations. There is a silo of literature emphasizing that financial reporting is expected to provide information useful to investors in evaluating/ predicting future cash flows (Atwood et al., 2010; Farshadfar and Monem, 2013; 2019). From practical perspective, AASB107 (Statement of Cash Flows) and surveys on financial analysts highlight that future cash flow is a primitive construct for share valuation (Francis and Schipper, 1999).</p> <p>Being provided with proper training and supervision, two research assistants were employed to manually collect data relating to risk management committees and risk management disclosures. We measure the readability of risk management disclosures using six different readability indices, namely Bog index, Flesch Reading Ease score, Coleman-</p> |

|   |   |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |
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|   | <p>Liau index, Flesch-Kincaid Grade level, simple measure of gobbledygook, and Automated Reading index. Overall, we find that (1) the existence and characteristics of human capital of risk management committees are associated with higher readability of risk management disclosures; and (2) better readability of risk management disclosure is associated with higher future cash flows.</p> <p>As far as we could ascertain, there is no variation between the project undertaken and the original application.</p>   |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |
| <b>(4) Funds Granted</b>  | \$5,000   |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |
| <b>(5) Detailed Report on Expenditure of Funds against Budget Items, with variations explained</b>                        | <p>We use all of the funds (\$5,000) on research assistance and editing service. UTAS kindly supported an additional \$3325.15 for this project. Detailed expenses are shown below:</p> <table data-bbox="613 635 1339 954"> <tr> <td colspan="2"><u>Expense</u></td> </tr> <tr> <td>Research assistant – salaries and on-costs</td> <td>\$8,165.15</td> </tr> <tr> <td>Editing service</td> <td>\$160</td> </tr> <tr> <td>Total expense</td> <td>\$8325.15</td> </tr> <tr> <td colspan="2"><u>Funding</u></td> </tr> <tr> <td>AFAANZ grant</td> <td>\$5,000</td> </tr> <tr> <td>UTAS grant</td> <td>\$3,325.15</td> </tr> <tr> <td>Total</td> <td>\$8325.15</td> </tr> </table>  | <u>Expense</u> |  | Research assistant – salaries and on-costs | \$8,165.15 | Editing service | \$160 | Total expense | \$8325.15 | <u>Funding</u> |  | AFAANZ grant | \$5,000 | UTAS grant | \$3,325.15 | Total | \$8325.15 |
| <u>Expense</u>  |   |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |
| Research assistant – salaries and on-costs  | \$8,165.15  |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |
| Editing service   | \$160   |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |
| Total expense   | \$8325.15   |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |
| <u>Funding</u>  |   |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |
| AFAANZ grant  | \$5,000   |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |
| UTAS grant  | \$3,325.15  |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |
| Total   | \$8325.15   |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |
| <b>(6) Outcomes, for example, working papers, presentations and publications (give full details, including abstracts)</b> | <p>We currently have one working paper out of this project.</p> <p>The abstract of this paper is shown below:</p> <p>“This paper examines the impact of the presence and human capital of risk management committees on the readability of risk management disclosures, and the relationship between risk management disclosure readability and firms’ future cash flows from operations. We measure the readability of risk management disclosures using six different readability indices, namely Bog index, Flesch Reading Ease score, Coleman-Liau index, Flesch-Kincaid Grade level, simple measure of gobbledygook, and Automated Reading index. We found that (1) the existence and human capital of risk management committees are associated with higher readability of risk management disclosures; and (2) better readability of risk management disclosure is associated with higher future cash flows. Our findings support resource dependence theory and should be of interest to regulators and investors.”</p> |                |  |  |            |                 |       |               |           |                |  |              |         |            |            |       |           |

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| <p><b>(7) Future Intentions for this Project (give full details)</b></p> <p><b>a. Conference submissions</b></p> <p><b>b. Journal submissions</b></p> <p><b>c. Grant applications</b></p> <p><b>d. Projects</b></p> | <p>a. we plan to submit this working paper to the 2020 AFAANZ conference.</p> <p>b. we plan to submit this working paper (revised version) to Accounting and Finance.</p>   |
| <p><b>(8) Summary of Outcomes and Benefits</b></p>  | <p>We collected the data we needed, completed data analysis and wrote up a preliminary draft. We are now in the process of revising our draft and conducting additional analysis. The experience of using this AFAANZ funds to conduct this project has been very beneficial to us, this project enhanced our research experience and gained a deeper understanding of the readability of risk management disclosures in Australia. We would like to thank AFAANZ for funding this project.</p> <p>Knowledge generated from this project will have both practical implications and academic contributions.</p> <p><u>Practical Implications</u></p> <p>Our study provides four important practical implications. First, to directors and senior managers, benefits of risk management committees are worthy of attention. The complexity of risk management disclosure can be difficult to mitigate, we provide empirical evidence that the complexity caused by poor communication can be reduced by changes in corporate governance. Secondly, from a readability perspective, our results lend support to the ASX-CGC’s recommendation about risk management committees by highlighting the benefit of forming a risk management committee to risk management disclosure (ASX CGC, 2014). Thirdly, our results collaborate the ASX-CGC’s emphasis on composition of risk management committees. High-calibre committee members contribute more to concise and effective communication relating to risk management. Our results highlight the value of having risk committee members with sufficient skills and knowledge. Fourthly, our results should be interest to investors, as we found that the readability of risk management disclosures is related to higher future cash flows.</p> <p><u>Academic Contributions</u></p> <p>Our study contributes to the literature at least in three ways. First, our study extends the readability literature by linking corporate governance and the readability of risk management disclosure. In this study, we found that the readability of risk management disclosure can be enhanced by having a risk management committee and by appointing committee members with high human capital. Second, while many papers link disclosure readability with firm performance (e.g., Li, 2008; Lo et al., 2017; Bonsall and Miller, 2017), few of them examined the implications of disclosure readability on future cash flows. Our study extends the previous literature by illustrating that the readability of risk management disclosure is</p> |

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|  | <p>associated with higher future cash flows from operations. Third, following Bonsall, Leone, Miller, and Rennekamp (2017) and Guay, Samuels, and Taylor (2016), our study adopted a more robust approach to measure readability of financial information by utilising six different measures of risk disclosure readability (including the Bog index), which is expected to more accurately capture the readability of risk management disclosures.</p> |
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