

---

**Intergovernmental Working Group of Experts on  
International  
Standards of Accounting and Reporting  
(ISAR)**

**34th SESSION**

1 - 3 November 2017

Room XVII, Palais des Nations, Geneva

Thursday, 2 November 2017

Afternoon Session

**Agenda item 4. The role of disclosure in risk assessment and  
enhancing the usefulness of corporate reporting in decision-  
making**

Presented by

Giuseppe Ballocchi  
Council Member, Future of Finance Content  
CFA Institute

*This material has been reproduced in the language and form as it was provided.  
The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.*

---

# USER PERSPECTIVE ON RISK COMMUNICATION

GIUSEPPE BALLOCCHI, CFA



CFA Institute



# MAIN POINTS

- **Relevance of risk reporting for investors**
- **Challenges and shortcomings of risk reporting**
- **Helpful way forward**

## CFAI 2017 SURVEY- IMPORTANCE OF RISK INFORMATION

	#	Rarely or never use	Often or always use	Average	Rank
Operational metrics	250	5%	84%	4.28	1
Description of business model, business plans and strategy	249	5%	81%	4.27	2
Supplemental financial performance	249	3%	79%	4.19	3
Capital commitments (near and long term)	249	7%	78%	4.08	4
<b>Principal risks and uncertainties</b>	<b>249</b>	<b>8%</b>	<b>70%</b>	<b>3.94</b>	<b>5</b>
Going concern and business viability related information	250	15%	65%	3.82	6
Off balance sheet arrangements	250	10%	65%	3.82	7
Customer related metrics	250	12%	58%	3.68	8
Corporate governance information	249	17%	49%	3.58	9
Intellectual capital information	248	28%	35%	3.11	10
Sustainability information (environment, social and reputational risk)	249	32%	25%	2.82	11

# CFAI 2017 SURVEY- USE OF RISK INFORMATION

Other KPIs Outside Financial Statements-Confidential Draft - Word

Table Tools

Vincent Papa

File Home Insert Design Layout References Mailings Review View Grammarly Design Layout Tell me what you want to do

Share

## REPORTING OF INFORMATION OUTSIDE FINANCIAL STATEMENTS

Table 2: Reasons for Applying Information within Corporate Reports

Sections within Corporate Reports	#	Assess Mgmt Qual	Valuation	S/t risk	L/t risk	F/stat ctxt
Operational metrics	238	48%	73%	40%	54%	52%
Description of business model, business plans and strategy	237	56%	52%	32%	60%	41%
Supplemental financial performance, revenue, asset quality, funding and liquidity information	242	29%	72%	46%	55%	56%
Capital commitments (near and long term)	230	21%	65%	48%	61%	32%
<b>Principal risks and uncertainties</b>	<b>229</b>	<b>25%</b>	<b>36%</b>	<b>58%</b>	<b>77%</b>	<b>23%</b>
Going concern and business viability related information	214	31%	30%	46%	61%	17%
Off balance sheet arrangements	221	19%	48%	46%	63%	35%
Customer-related metrics	225	34%	51%	38%	44%	38%
Corporate governance information	207	65%	8%	24%	45%	14%
Intellectual capital information	177	26%	27%	15%	33%	24%
Sustainability information (environmental, society and reputational risk)	145	32%	11%	16%	38%	10%

# is the number of respondents who sometimes (-3 rating), often (4 rating) and always (5 rating) use information within sections.

Mgmt Qual → Management quality; S/t → Short-term; L/t → Long-term; F/stat ctxt → Financial statements context.

The results in Tables 1 and 2 show the following:

## KEY CHALLENGES INVESTORS FACE WITH RISK REPORTING

- Proliferation and emergence of risk types (Cybersecurity, climate - physical and liability risk etc ) makes it challenging to have traditional trend analysis
- Boiler plate, generic disclosures
- Need for prioritization of principal risks
- Inadequate articulation of risks (i.e. probability and severity of risks)
- Lack of common language and comparable measures (e.g. risk appetite)
- Fragmentary and heavily siloed reporting of different risk types- **Often very hard to see forest from trees**
- Limited transparency by companies on risk mitigation measures
- Poor transparency of impacts across different time horizons
- Limited linkage to business model and strategy
- Limited delineation of financial impacts (e.g. quantified exposure) and cross reference to financial statements

# PWC- REVIEW OF RISK REPORTING-2015 FTSE 350

## INVESTORS CONSIDER PRINCIPAL RISKS& UNCERTAINTIES TO BE AN AREA OF MOST REQUIRED IMPROVEMENT

51\_corporate\_reporting\_survey\_2015.pdf - Adobe Acrobat Reader DC

File Edit View Window Help

Tools

good-practices-in-c...

22061\_corporate\_r... x

Sign In



14 / 23

## *reporting*

### How specific and detailed have FTSE 350 companies been in their risk reporting?

In response to regulatory change, commercial imperatives or competitor pressures your company may have been working hard behind the scenes to review, challenge and improve the quality of its risk management and internal controls. But we think there is more to be done to really give an insight into key risks. The latest regulatory change comes in the form of the 2014 UK Corporate Governance Code – in particular the new statement on a robust assessment of principal risks and the viability statement, which requires a focus on risks to liquidity and solvency. These statements mean that interest in risk reporting will only intensify.

The 2014 Code will have companies looking again at their risk management processes and how they identify, manage and mitigate their principal risks. We hope this will mean companies go beyond the bland and often boilerplate disclosures that are currently made. In particular there is scope for the principal risk disclosures to be more company-specific. We'd like to see more information on changes in the risks, the company's appetite for them and in the management or mitigation that is applied to them.

#### *The challenge*

Many companies have greatly increased their focus on enterprise risk management since the financial crisis. They're thinking more deeply about how they set their risk appetite and how they identify, assess and manage new risks or changes in existing risks.

Findings from our previous reviews of corporate reporting show how as a result, the quality of risk reporting has improved. Our 2007 review<sup>3</sup> of narrative reporting practices among the FTSE 350 found that, back in 2006, only 22% of companies were clearly disclosing their principal risk and uncertainties. Now, reflecting changes to the Companies Act, this is the norm among FTSE 350 companies. Similarly, in 2007, only 57% of companies that disclosed risk information indicated how those risks were managed or mitigated. In last year's survey, this had risen to 94%.

But risk reporting is still a work in progress – and it's important to keep moving forward. Having surveyed its chartered financial analyst members, the CFA Society of the UK concluded:

*“The area of the annual report that shows greatest need for improvement is – by a considerable margin according to our respondents – the disclosure of principal risks and uncertainties.”*

*Given that over 90% think this is a useful disclosure this is clearly an area which deserves more attention from companies, and perhaps also from regulators.”*

The spotlight on the quality of risk reporting is therefore inevitable and likely to intensify. The 2014 UK Corporate Governance Code – effective for reporting periods on or after 1 October 2014 – is the latest regulatory spur for improved risk management and reporting. Regulators and others will be interested to see its impact.

11.69 x 8.27 in



## 2I- 2017 REVIEW 125 COMPANIES- LIMITED COMMUNICATION ON LONG-TERM IMPACT

PowerPoint Presentation - Adobe Acrobat Reader DC

File Edit View Window Help

Home Tools good-practices-in-c... 22061\_corporate\_r... PowerPoint Present... x ? Sign In

5 / 76

- 1 *Corporate disclosure of **investment plans** are limited to **1-2 years**, even though companies usually establish plans for the next 5-10 years*
- 2 *Corporate disclosure of **financial forecasts** is limited to a **1 year timeframe** compared with estimates from financial analysts that usually cover the next 5 years.*
- 3 *Only about **5-10%** of companies analyzed **specifically discuss long-term risks** and only **25%** report on the sensitivity of their impairment test to adverse scenarios.*
- 4 *Long-term risk disclosure is discouraged by a '**perfect storm**' formed by the combination of vague regulatory requirements, race to the bottom among peers, limited role of auditors, fear of litigation and limited demand from financial analysts.*
- 5 *This disclosure gap inhibits the exploration and management of long-term risks by*



# PWC-REVIEW OF RISK REPORTING-2015 FTSE 350

## LIMITED LONG-TERM ORIENTED INFORMATION



When giving strategic and sustainability information, the furthest most companies looked ahead was five years to 2020. In contrast, when giving data on their markets, some companies are willing to look ahead 25 years.

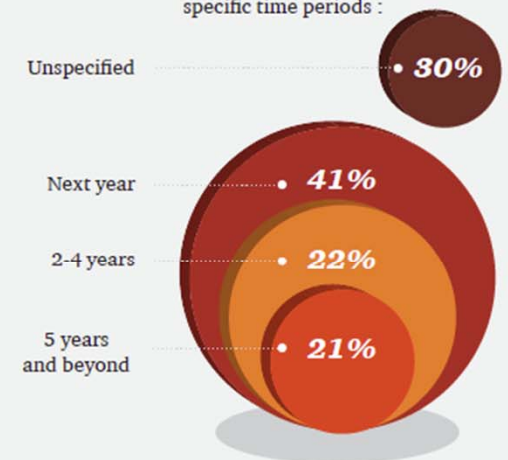
When companies do provide forward-looking information in their strategic reports, they do so over a variety of different periods. The period used when talking about their strategy may differ from that considered in their discussion of their market, or that used in any forward-looking KPIs. This inconsistency is hard to understand as a reader. It will look particularly strange if, in future, you provide forward-looking information that doesn't correspond to the period covered by your viability statement. You'll need to give readers enough content to understand

### What information do you need to give a longer term perspective?

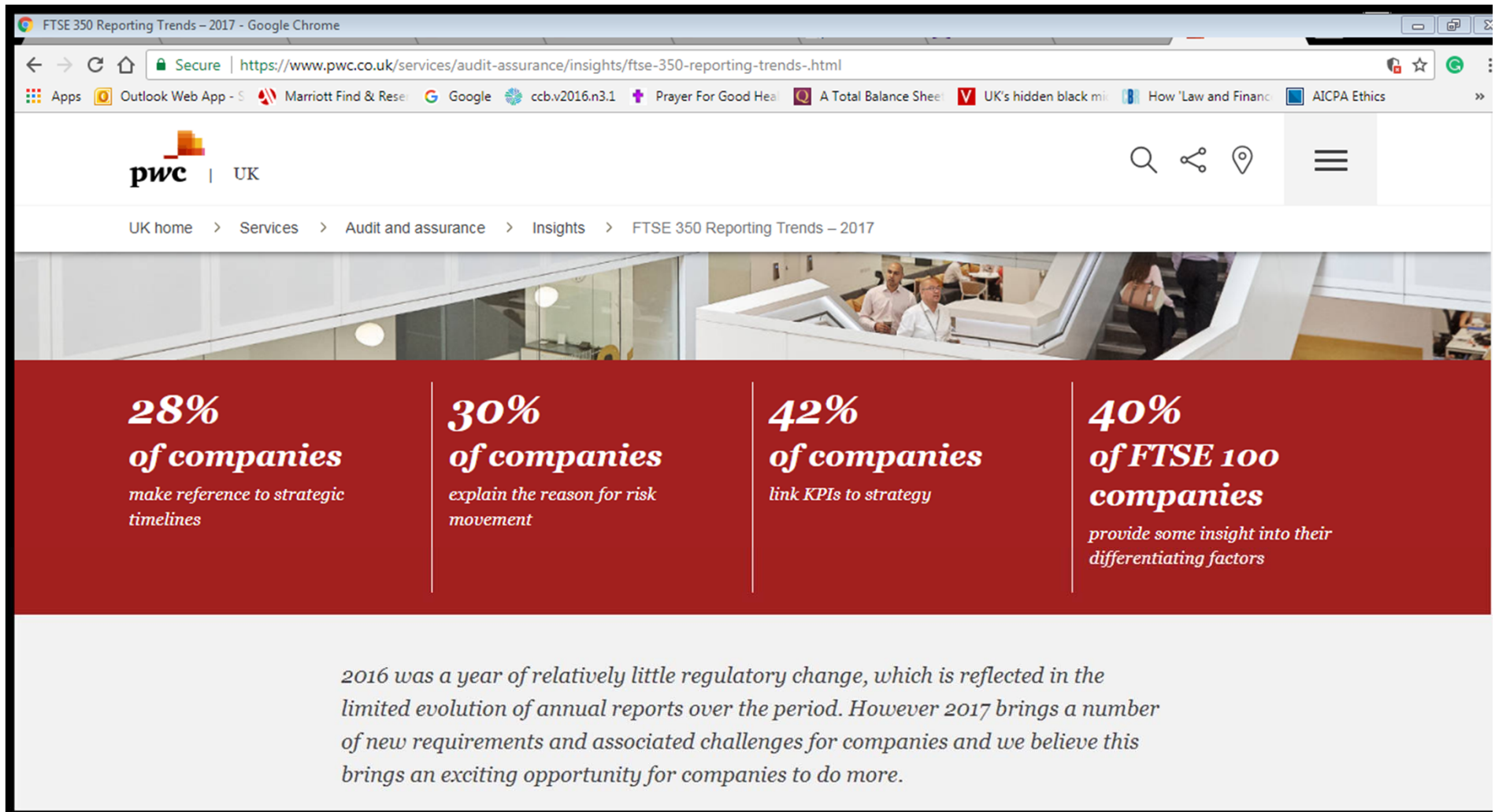
Percentage of FTSE 350 companies with forward looking data in key areas:



Percentage of FTSE 350 companies providing forward looking data in specific time periods :



# PWC- REVIEW OF RISK REPORTING-2017 FTSE 350- LIMITED TRANSPARENCY ON RISK DRIVERS



# PWC- REVIEW OF RISK REPORTING-2017 FTSE 350- VARIED QUALITY OF REPORTING ACROSS COMPANIES

ftse-350-reporting-opportunities.pdf - Google Chrome

Secure | <https://www.pwc.co.uk/audit-assurance/assets/pdf/ftse-350-reporting-opportunities.pdf>

Apps Outlook Web App - S Marriott Find & Rese Google ccb.v2016.n3:1 Prayer For Good Heal A Total Balance Sheet UK's hidden black mi How 'Law and Financ AICPA Ethics

Risk dynamics also need to be put in context. Some companies, such as Pearson [Example 4], have introduced risk case studies to bring more depth to certain key risks.

Whilst 61% of companies indicated risk movement, only 30% of the FTSE 350 gave any commentary as to why the movement had occurred. Fresnillo [Example 5] provided a clear explanation of the reasoning for changes in their heatmap.



*Our survey showed that companies and directors have a sense of improvement in risk reporting: 72% of them agreed or strongly agreed that annual reports provide useful insights into companies' principal risks and how they are managed. Investors were far less convinced – only 36% agreed or strongly agreed.*

## Example 4: Pearson AR 2016

### Risk in action case study – Pearson Test of English (PTE) *How risk management adds value to strategic and day-to-day business decision making*

Following recent rapid growth of PTE, one of our successful global products, further work was needed to prevent any risks associated with future delivery, in order to ensure that quality was maintained and to avoid reputational risk.

#### Risk governance

A cross-company programme was set up in 2016, with workstreams based around identified risks and recommending actions in time for strategy decision-making in September. Each workstream owner was tasked with setting up their own working group to identify risks relating to their area, presenting these back for debate by the wider group, along with proposed recommendations for resolving them.

#### Risk treatment

Identified risks were rated in terms of their impact on the business in order to support their prioritisation and recommended courses of action were divided into two categories: 'Compliance' risks – potential areas that needed to be tackled in order to ensure ongoing secure delivery. These are risks for which we typically have a low risk appetite and were the highest priority to resolve.

'Opportunity' risks – these recommendations (sometimes requiring further investment) were identified as areas we needed to tackle to accelerate future growth of the product. We typically have a higher risk appetite for 'opportunity' risks.

A high-level summary of the risks and mitigation plans formed part of a strategic paper for the Pearson executive to make better informed decisions on the future strategic direction of (and related investment in) PTE.

#### Risk monitoring

Tracking the full set of recommendations will be part of business-as-usual in 2017, monitored by a cross-functional governance board who will also continue to identify opportunities for continuous improvement.

## Example 5: Fresnillo AR 2016

### Change in heat map:



### Description of risk change

During 2016 all macroeconomic variables favoured our financial results, however volatility and uncertainty were constants in the same period (and are expected to remain as such in 2017); therefore we still consider the impact of global macroeconomic developments our principal risk driver; in addition, most industry and financial analysts who follow metal prices continue to foresee volatility in silver and gold prices for 2017, with a notable spread among forecasts, meaning continued volatility.

### Key risk indicators

- Gross profit sensitivity to % change in metals price and to MXP/US\$ exchange rate.
- EBITDA sensitivity to % change in metals price and to MXP/US\$ exchange rate.

*"Risks tend to be boilerplate and not really those that keep company executives awake at night and/or relevant to key stakeholders."*

Investor comment in our survey

**61%**

of companies indicate risk movement

**30%**

of companies explain the reason for risk movement

**19%**

of companies provide a risk heat map



# PWC-REVIEW OF RISK REPORTING- ICAP- CASE

## HELPFUL BUT OFTEN QUALITATIVE & HARD TO COMPARE ACROSS COMPANIES

good-practices-in-corporate-reporting.pdf - Adobe Acrobat Reader DC


File Edit View Window Help

Home Tools good-practices-in-c... 22061\_corporate\_r... PowerPoint Present... ? Sign In

8 / 15



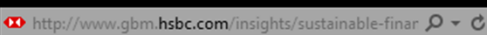

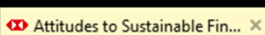



mitigation. This is intended as an indicative summary of the Group's risk profile only.

Risk	Rating	Appetite	Description of change
Strategic	High	Proactive	Changing market landscape in addition to regulatory reforms potentially impacting the business model.
Operational	High	Cautious	Greater reliance on technology. More intrusive and enforcement lead regulation. Improved processes and employee training to reduce inherent risk.
Liquidity	High	Cautious	Significant mitigation has been implemented but has been partially offset by increased liquidity requirements from clearing houses.
Credit	Medium	Minimal	Enhanced monitoring system infrastructure globally is partially offset by deterioration in counterparty quality given macroeconomic conditions.
Legal and compliance	Medium	Averse	New regulations have been introduced in addition to increased regulatory scrutiny of markets where ICAP has regulated entities.
Financial	Low	Minimal	Profile remains stable with no major changes in operations or appetite.
Reputational	Medium	Averse	Increased due to the continued uncertainty in the regulatory environment.
Market	Low	Minimal	Remains stable as a second order impact risk.











# HSBC RESEARCH-12<sup>th</sup> September 2017-


## INVESTORS FIND CLIMATE-RELATED RISK DISCLOSURES ARE HIGHLY INADEQUATE

File Edit View Favorites Tools Help


 Suggested Sites  Web Slice Gallery  ERNIE  Office 365  Concur  Workday  Google

Global Banking and Markets 

 [Insights](#) | [Solutions](#) | [About Global Banking and Markets](#) [Log on](#)

The Corporate Issuers View - the trends driving ESG strategy and disclosure

**The institutional investor view – the evolution of ESG as an investment concept**



**79% of investors that think there are barriers to increasing climate related investment.**



In addition, poor availability of research and analysis and a lack of standardised sector definitions are also barriers.

This investor sentiment that there is a lack of credible investment opportunities is backed up by the point that 66% of the investor respondents do not hold any green bonds in their portfolios. Since the green bond market is relatively small, at USD232.2bn<sup>1</sup> issuance outstanding in July, it is unsurprising that many respondents don't hold any.

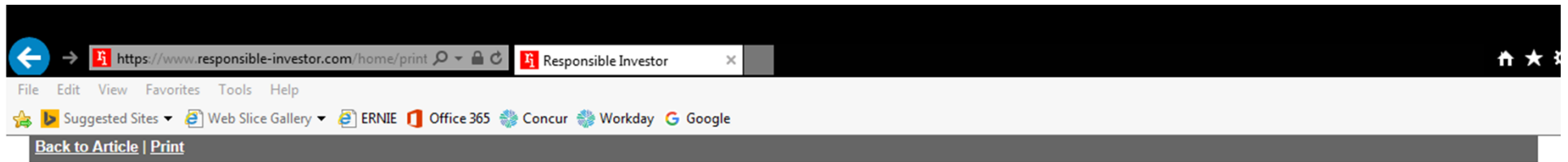
All respondents however, felt that investment institutions were 'quite' to 'very' important for driving low-carbon transition. Climate related-risk disclosure remains a problem for investors. When asked about the adequacy of risk disclosure 56% said that disclosure is 'highly inadequate'.

**56% of investors think climate-related risks disclosure is 'highly inadequate'**

The survey reveals even higher momentum for social impact investing than for climate related investment, with 73% of respondents citing that they will increase social impact related investments. This could be because investors are increasingly thinking about what the sustainable development goals mean for them and how they can address these challenges. Social impact

 Join the conversation? 

# INVESTORS SEEKING COLOR ON STRANDED ASSETS



## Investors trigger first major campaign to push 62 leading banks to back TCFD climate reporting recommendations

Letter signed by shareholders with \$2trn in assets aims to corral support for clear environmental disclosure.



by Paul Verney | September 14th, 2017

More than 100 of the world's biggest institutional investors representing nearly \$2tn in assets have launched one of the first major campaigns to push the world's largest banks to back the recent recommendations of the Taskforce on Climate Related Financial Disclosures (TCFD) launched by Mark Carney, Governor of the Bank of England and Chairman of the G20's Financial Stability Board (FSB), which also supported it. They have written to the 62 of the world's largest banks demanding more robust climate-related disclosure, citing research that up to 20% of banks' investment portfolios could be at risk because of market dislocation as a result of climate-related asset stranding.

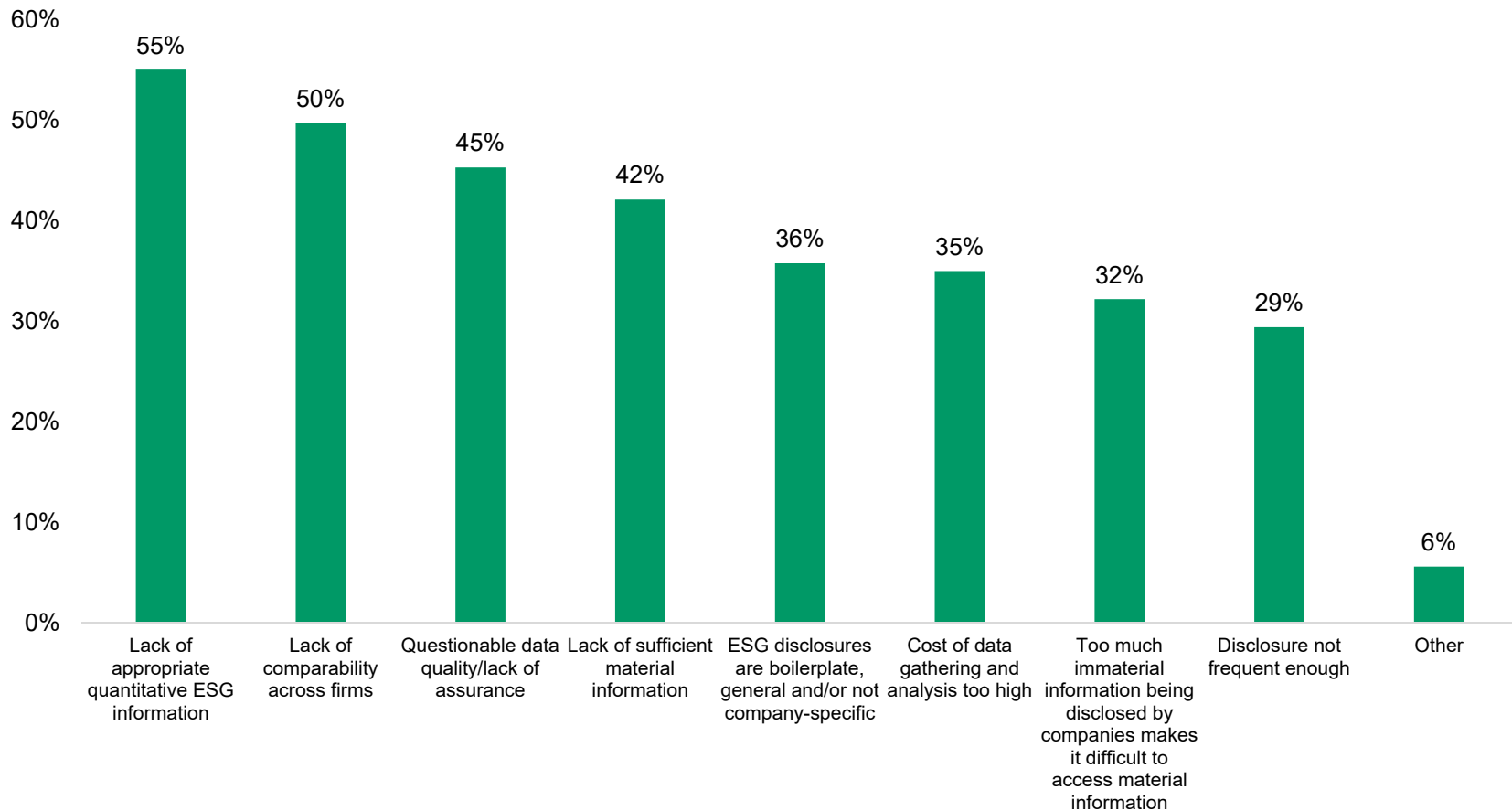
Banks targeted include Australia and New Zealand Banking Group, Bank of America, Deutsche Bank, HSBC Holdings, JP Morgan Chase, Mitsubishi UFJ Financial Group, Inc. and TD Bank.

The investor group, which is being co-ordinated by ShareAction, the UK non-profit, and Boston Common, the US asset manager, says the banks should align their public disclosures with the recommendations of the TCFD, including outlining their climate-relevant strategy and implementation, climate-related risk assessments and management, low-carbon banking products and services, and public policy engagements and collaboration with other actors on climate change.

The banks have also been invited to outline how they are managing climate risk subsequent to the 2015 Paris COP21 Agreement. The investor group says responses will not be made public but will inform a related report due to

# 2017 CFAI ESG SURVEY INSIGHTS: IMPEDIMENTS TO USE OF INFORMATION

## FACTORS LIMITING INVESTOR ABILITY TO USE NONFINANCIAL INFORMATION IN INVESTMENT DECISIONS





# WAY FORWARD

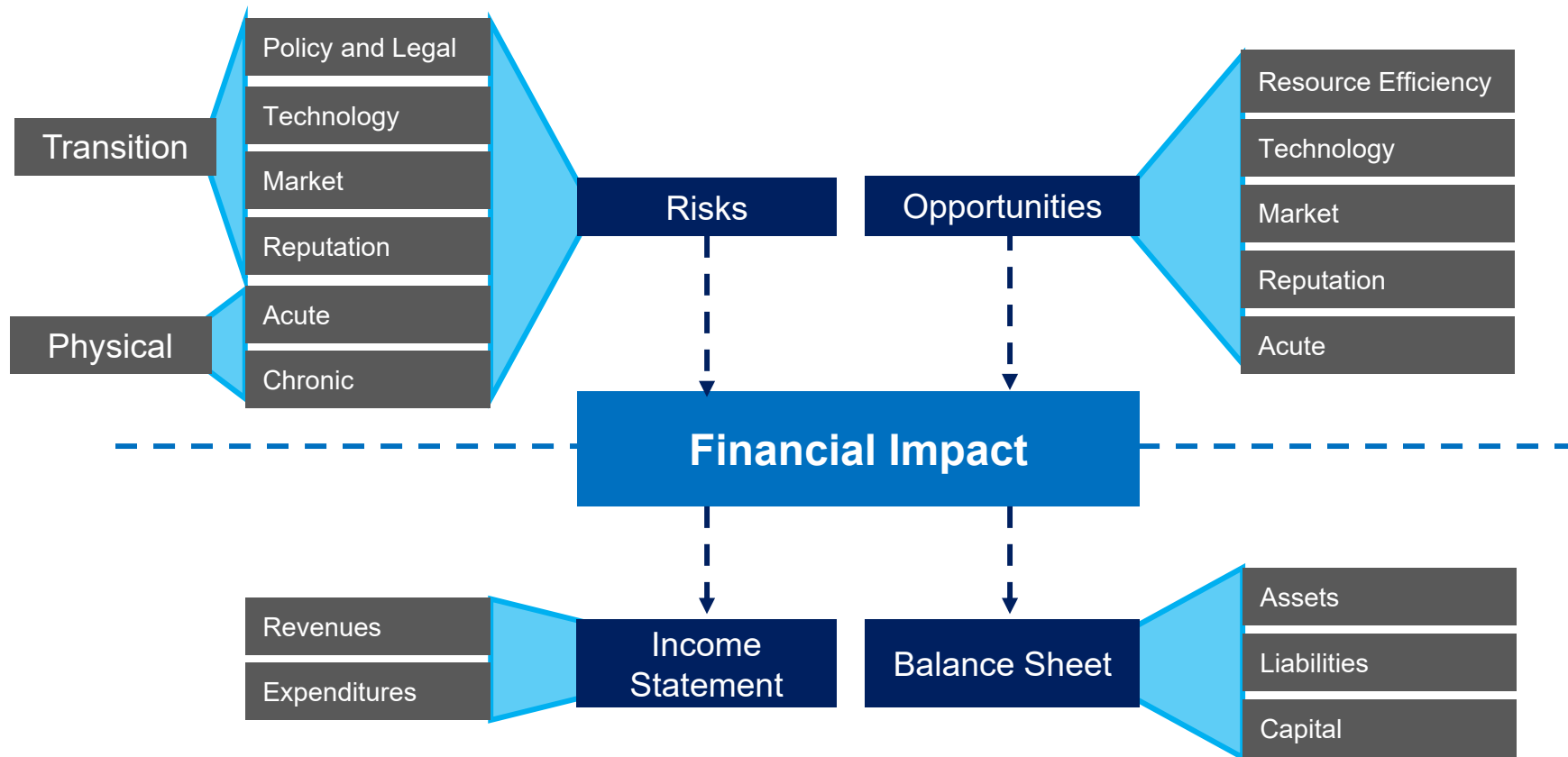
## DESIRED WAY FORWARD

- Adoption of EDTF and TCFD seven fundamental principles ( *include all relevant and material risks; timely; consistent over time; comparable; clear, balanced and understandable; relevant for business model; convey how risk is managed*)
- Prioritization of principal risks
- Quantify risks (i.e. probability and severity of risks, scenario analysis)
- Integrated reporting principles- Connectivity, Tell a story that links business model, strategy, risk and performance or financial impacts
- Distinguish impacts across different time horizons (short, medium and long-term)
- Delineate risk interconnectedness of risk factors

# FSB-TCFD FRAMEWORK: A WAY FORWARD

## LINK TO STRATEGY, TRANSLATION TO FINANCIAL IMPACT

Climate-related risks and opportunities can impact organizations' financial performance.



# USEFUL WAY FORWARD: CONVEY INTERCONNECTED NATURE OF RISK FACTORS

## BANK RISK- ( SOURCE 2017 SHAREACTION PUBLICATION)

BankingOnLowCarbonFinal1.pdf - Adobe Acrobat Reader DC

File Edit View Window Help

Home Tools BankingOnLowCar... x

9 (9 of 44)

Type of risk	Possible effect of climate change
Credit risk	<p>Under low carbon scenarios, loans to high carbon companies risk becoming impaired where clients have failed to transition to a low carbon business model and are left with stranded assets and other financial losses.</p> <p>Under high carbon scenarios, financial commitments made to clients in vulnerable sectors are likely to be the first to become impaired. Taking a longer-term view, high carbon scenarios are likely to increase credit risk across all sectors and regions. Moody's Heat Map has shown that credit impact from environmental issues varies widely across sectors globally, both in terms of materiality and timing.<sup>17</sup></p>
Market risk	<p>Climate change could contribute to a wide range of market risks – affecting commodities, currency valuations and creating equity risk. Physical and transitional risks are likely to impact commodity prices (such as oil and agricultural commodities), and extreme weather events can reduce the value of currencies in countries where there is wide-spread economic disruption.</p> <p>The output of crop production will be affected by climate change in the short- to medium-term, thus providing a particularly salient example.<sup>18</sup> Increased food prices affect general inflation, with food being a large component of the consumer price index.<sup>19</sup> Recent recurrent droughts have affected agricultural output in Australia, leading to an increase in prices globally.<sup>20</sup></p>
Liquidity risk	<p>As seen in the housing market in 2008, liquid markets can become illiquid very quickly.<sup>21</sup> Transitional risks could cause assets linked to high carbon sectors to become illiquid if there are capitulations, panic selling and bankruptcies. Under high carbon scenarios, companies severely affected by the physical impacts of climate change might find themselves in financial difficulty, and assets linked to those companies risk becoming illiquid.</p>
Reputational risk	<p>For banks wishing to attract and retain customers and staff, there could be</p>

**THANK YOU!**