November 2019

Risk reporting

Reporting tips

pwc

Risk reporting and accountability

Risk reporting remains a challenging area where a natural conservatism holds sway: companies tell us that their priority is to avoid giving away anything that is commercially prejudicial and that the rewards of breaking free from the pack are just not there.

Also, risk professionals in the business can find their insights being toned down by compliance or legal management – or the board. They believe that giving real insights into company-specific risks would actually be a risk in itself: too many shareholders (and other stakeholders) would be likely to take away the wrong message.

It is no wonder therefore, that the majority of risk disclosures we see tend to be at the compliance focused end of the spectrum of approaches. In our view, transparency around risk reporting has many benefits, including but not limited to:

- better stakeholder management;
- opportunities to enhance trust by showing what you are doing about each risk;
- greater accountability; and
- the opportunity to provide real insight into your business that investors call for.

A range of possible approaches

Compliance-focused	Selective	Value-adding
• Information with limited interpretation or explanation • Focus on completeness of topics • Solely focused on downside of risk	• Information that is somewhat tailored to the company • Some disclosures may be generic and ‘boilerplate’ • Dynamics of the risk may be discussed	• Information placed in context, with significance explained • Risks clearly linked to strategy/ purpose and other areas of the annual report • Discuss fundamental uncertainties that drive their business and the possible upsides as well as the downsides

A new age of accountability

The 2018 UK Corporate Governance Code, with its focus on how boards engage with their stakeholders and consider the matters set out in section 172 of the Companies Act, naturally leads to questions about how risk management and reporting will be affected.

Our view is that this is a positive initiative which will help companies enhance the effectiveness and quality of risk policies, processes and reporting.

This document provides tips on how companies can join this direction of travel and improve their risk reporting disclosures in three major areas of risk reporting:

1. risk management;
2. principal risks and uncertainties; and
3. risk appetite.

It also suggests ways to incorporate the stakeholder lens through effective risk management. This is not just an add-on, however; the impact of businesses on stakeholders and stakeholders on businesses should be an integral consideration of any risk management system and the disclosures associated with it.

Preparer views of risk reporting

We surveyed preparers of annual reports and company directors from across the FTSE 350 about their views on corporate reporting. On risk reporting we asked:

To what extent does your annual report provide readers with sufficient information to understand the relevance of risk and uncertainty to the company's position and prospects?

Most of those responding recognised the limitations in their reporting but wanted to do more:

Only **14%** disclose significantly more than the strict requirements

But **55%** thought that the annual report could do more in this regard

When we asked what is preventing them going further in their reporting of risk and uncertainty:

59% thought that better or more established legal protection would help

And **96%** thought that there needed to be a change in the attitude of investors and other stakeholders

Investor views on risk reporting

84% of respondents agreed that 'Understanding management's view of potential risks and their mitigation strategies is important for my analysis and decision making.'

2018 Investor Survey

"We need to be able to see a wider set of risks than just the financial risks. Companies should be reporting on risks they are exposed to because of their impact on communities, the environment and other factors."

Portfolio manager

Risk management

Often a process-heavy disclosure, there is a real opportunity to show how effective risk management is driving good decision making and safeguarding investment.

Reporting tips

Embedding

Give a good sense of how risk management is embedded in the business by showing that:

- Risk-based thinking is 'baked' into how managers and teams operate on a daily basis
- Risk management is factored into strategic decisions (such as new market entry, M&A, restructuring, innovation/portfolio, workforce-related opex and other capital allocation)
- Risk management drives other repeating processes (such as health and safety, regulatory compliance, or quality control)
- Risk management guides the internal audit programme

1

Learnings

- Discuss experience of risks crystallising (or near misses):
  - What was learned from this?
  - What will be done differently in future?
- Discuss objectives for improving the effectiveness of risk management in the strategic report, instead of leaving this for the board or audit committee reporting

2

Remember that risks associated with stakeholders can be particularly fast moving, especially when social media is involved.

Example: BBA Aviation, 2017

Why we like this: This example discusses – how this risk was foreseen and planned for in advance, how it was managed once it materialised and what was done afterwards to ensure lessons are learned for the future.

Case Study – response to Hurricanes Harvey, Irma and Maria
For a 30-day period in August and September 2017, 17 Signature Flight Support locations in the United States and the Caribbean were directly impacted by three Category 4 and 5 hurricanes: Harvey, Irma and Maria. Systematic planning and implementation was the key to employee safety, successful recovery and the fast re-opening of locations, confirming that, while not every risk can be controlled or prevented, identifying and understanding risk enables the turning of a high-risk situation into a manageable event.

A robust and effective hurricane plan had been in train before the start of the 2017 hurricane season when Signature locations undertook their annual pre-hurricane review. Then, as the hurricanes developed, they were tracked to ensure that all locations potentially in their paths were alert and prepared. Signature executive leadership had plans in place to monitor and manage the crisis while ensuring the ongoing business of the rest of the network was not disrupted.

Three to four days ahead of anticipated landfall, Signature's Hurricane Response Plan & Checklist was initiated, and daily status calls commenced. The Response Plan & Checklist is a detailed step by step guide to ready the entire FBO complex for the coming storm. Fuel supplies are checked and verified; customers are notified to re-locate their aircraft; Ground Support Equipment is prepared and staged; any aircraft remaining on the ground are secured as much as possible; buildings and grounds are battened down; all administration and supplies are confirmed; and emergency equipment such as generators and satellite phones are deployed.

At the corporate offices in Orlando a review was undertaken to ensure that all required financial matters, including payroll, were dealt with in advance. Communication was maintained throughout the storm period and continued until all employees, facilities and equipment were confirmed safe. Insurance adjusters were quickly dispatched to the affected locations and teams were mobilised to provide assistance to employees and to those facilities needing additional expertise and/or personnel.

While 17 locations were directly impacted, only three were seriously affected and Signature was able to move very quickly to re-open its FBOs, using social media to keep customers informed of progress. Post-event reviews were undertaken to identify learnings, and these have been fed into BBA Aviation's Business Continuity and Crisis Management Plans to further improve resilience in the future.

Principal and emerging risks

Principal risk disclosures are particularly affected by caution and conservatism. However, saying as little as possible is no longer the best approach to reporting.

Reporting tips

Focus

Reporting should identify specific rather than generic risks, and tie them to the organisation's individual circumstances. Consider:

- Is the risk clearly explained?
- Is the cause(s) of the risk discussed?
- How does the risk relate to the business model and/or strategy?

1

Relevance/Materiality

The organisation's estimate of how likely each risk is to materialise and how and when its consequences would be felt, should be clear. Consider:

- Would the consequence(s) be direct and/or indirect and what would they be?
- Would the consequence(s) be short-term, medium-term or long-term?
- Which stakeholders are interested and/or affected?

2

Status

What is being done about the risk in terms of active management or other mitigation? Specifically:

- Is the risk currently within the risk appetite parameters?
- Are there any failings or weaknesses of risk management or internal control in connection with the risk? Are they significant?
- What has changed in relation to the assessment and management of the risk since the last reporting period, and what is expected to change going forward?

3

Remember to consider how stakeholder interests may increase the impact/likelihood of your current and emerging risk profile. By incorporating stakeholder views and agendas into the risk management process you may also get early warning of incoming risks before they fully materialise.

Example: Royal Mail, 2018-19 (extracts)

Why we like this: This example provides a clear description of the risk, its impact, status and mitigations. It also illustrates the dynamics of the risk severity and risk velocity (speed at which the risk could impact).

KEY

Link to strategy	Relative severity	Change during the year	Speed at which the risk could impact
Winning in parcels	High	Increasing risk	Fast: 6 months
Defending letters	Medium	Decreasing risk	Medium: 6-12 months
Growing in new areas	Low	Stable	Slow: >12 months
		New	

Principal risk	Status	How we are mitigating the risk
Environment and sustainability		
	NEW	
Climate change and governmental actions to reduce its impact may have adverse operational, financial and reputational consequences. The cost of operations is likely to increase as we adapt our business in response to government action to reduce the effect of harmful emissions such as the introduction of Clean Air Zones in UK cities. An increase in the frequency of extreme weather events may result in disruption to our operational pipeline and impact our ability to meet USO requirements. We may also see price rises as a result of resource scarcity such as water shortages. This risk is now being included as a principal risk given its major significance both internally and externally.	With the UK's largest 'feet on the street' network of around 90,000 postmen and women, Royal Mail plays a key role in keeping carbon emissions low. We have a requirement to maintain a large fleet of vehicles. Growth in parcels is also driving up our energy demand. We recognise our responsibility to reduce the energy we use and emissions associated with our fleet to help improve air quality in the communities in which we operate.	We are investing in new vehicles and technologies, changing driving styles, and making our transport network more efficient. We are undertaking trials and initiatives in our current fleet to drive down fuel consumption. Our fleet also includes electric and liquefied natural gas vehicles. Over time, we plan to increase the number of alternative fuel or advanced technology vehicles to meet current and future legislation. We are also taking proactive steps to reduce our energy and water consumption and to reduce the amount of waste we send to landfill.

Risk appetite

The organisation's appetite and tolerance for taking risks is the starting point for embedding effective risk management into decision-making. Recognising this, an increasing proportion of large listed companies are choosing to report at least some insights on this topic despite it not being a specific requirement of the UK Corporate Governance Code. However, few of these disclosures go beyond a high-level generic statement.

Reporting tips

Process

Give insight into the risk management process by showing:

- How risk appetite is not only set but revised and adjusted
- How tolerance limits for this agreed appetite are communicated and integrated into underlying processes and decision making
- Where appetite is centrally determined and where there is local responsibility
- How the board monitors adherence to its stated appetite

1

Risks addressed

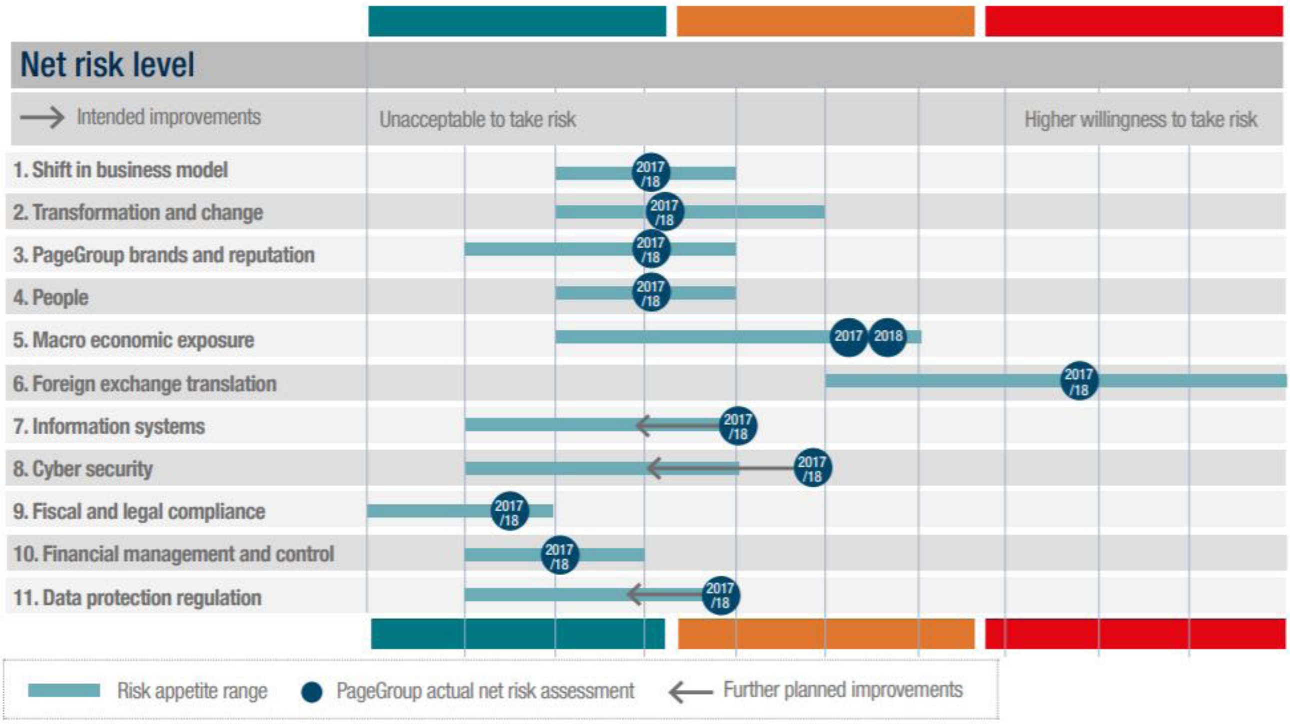
- Focus on areas that are strategically significant; appetite does not have to be stated for each and every principal risk

2

Understand stakeholder views and how they might impact your risk appetite and monitoring. Then consider whether the position is still within the targeted range.

Example: PageGroup, 2018

Why we like this: This example is very transparent showing that the organisation is currently operating outside or close to the limits of its tolerance in some areas. It also shows a range and movement over multiple years and the direction of travel.



Further information

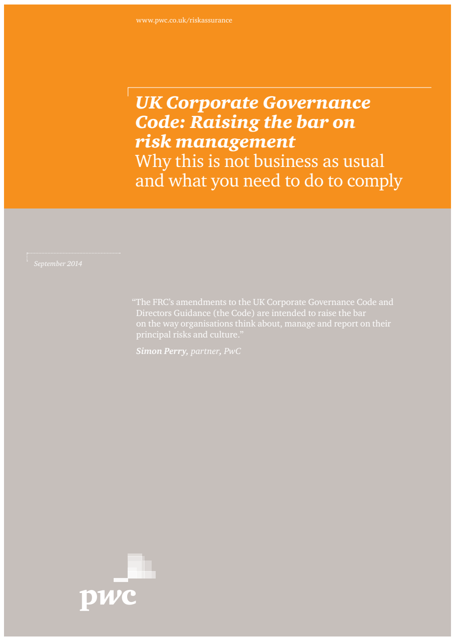
Tackling risk reporting
Practical suggestions, positive thinking

The proposals in this paper will help to move risk reporting forward. What we are suggesting is intended to be challenging. It has to be, because we know from our engagement with investors and other stakeholders that the state of risk reporting today does not meet their needs.

Tackling risk reporting
Reporting on cyber security, climate change and Brexit – a Point of View

Writing to Audit Committee Chairs and Finance Directors in October 2016, the Financial Reporting Council ('FRC') identified three topical areas for companies to consider when determining the principal risks and uncertainties in their annual reports: cyber security, climate change and the UK referendum result, or 'Brexit'. This Point of View sets out our findings in each area, as well as some of the more striking examples of disclosure that we saw during our review or had identified previously.

UK Corporate Governance Code
Raising the bar on risk management



It's important to understand the difference between risk disclosure and risk management. You need to do both well. For audit committees, the 2014 Code meant deriving certainty that Enterprise Risk Management (ERM) has been sufficiently developed and embedded, that they 'can walk the talk'.

Get in touch

Hayley-Beth Peters
Director – Enterprise Risk Management lead
hayley-beth.peters@pwc.com

Gurpreet Kaur
Corporate reporting specialist
gurpreet.kaur@pwc.com

190731-110340-GK-OS