

Integrated Reporting Consultation Draft Submission

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Not applicable

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This submission relates to Section “4C Opportunities and Risks” and consequential amendments only.

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Section 4C Opportunities and Risks

1. Overview

We have three major concerns with this section of the Consultation Draft:

- **Positioning** - concepts and terminology need to be better aligned to the organizational context
- **Disclosures** - the focus is too narrow for many modern organizations
- **Criteria** - the definition of risks that should be reported is too restrictive

Further detail on each of these concerns is set out below and Appendix 1 includes marked-up suggestions to amend Section 4C of the Consultation Draft and Appendix 2 the consequential amendments in the rest of the Consultation Draft.

2. Aligning concepts and terminology

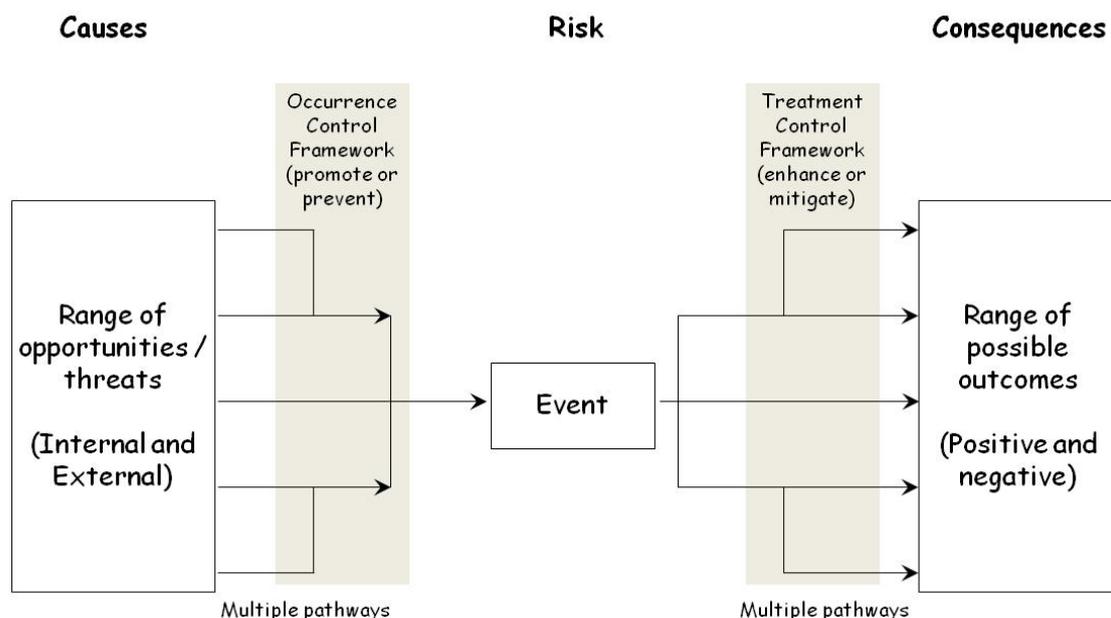
Introduction

Some important concepts and terminology used in Section 4C need to be better aligned to the mechanics of how risk arises and is managed in an organizational context. These mechanics are explained below to add clarity to the specific comments on Section 4C that follow.

Risk mechanics

The most universally accepted definition of risk comes from ISO 31000¹, “the effect of uncertainty on objectives”, which for an organization is best described as an event or a change in circumstances (or situation) impacting its objectives. This concept of risk, which involves events that may cause both positive and negative variations from achieving objectives, is consistent with one of the fundamental concepts of the Consultation Draft about the creation of value.

The mechanics of risk in an organizational context are illustrated below:



¹ ISO 31000:2009 Risk management - Principles and guidelines issued by ISO, the International Organization for Standardization.

Risk arises in an organization from a range of causes (opportunities and threats) that follow multiple pathways hopefully encountering occurrence controls (or actions to promote the occurrence of opportunities or prevent the occurrence of threats) that an organization puts in place before the risk event occurs. The risk event has a range of outcomes that also follow multiple pathways hopefully encountering treatment controls (or actions to enhance positive consequences or mitigate negative consequences) that an organization puts in place. The end result is a range of possible outcomes or consequences from a single risk event with varying frequencies, severities and probabilities or likelihoods.

Specific comments

The term ‘opportunities and risks’ is therefore confusing two concepts: ‘opportunities’ being a cause of a risk event and ‘risk’ being an event or change in situation. This is more than just an issue of definitions of terminology, key concepts are being muddled. In an organizational context ‘risk’ is not the inverse of ‘opportunity’, the inverse is ‘threat’ or ‘hazard’. It is important to describe the causes correctly and to refer to risk when the intended meaning is ‘the effect of uncertainty on objectives’.

There are three options to adjust the Consultation Draft:

- 1 Use ‘risk’ - we don’t favour this option because ‘risk’ is often mistakenly seen as just having negative consequences. We strongly agree with the theme throughout the Consultation Draft of the communication about creation of value which involves positive consequences as well as negative consequences.
- 2 Use “opportunity and hazard” - whilst this term is technically correct, the risk management profession seems to have moved away from the term ‘hazard’.
- 3 Use ‘opportunity and threat’ - we suggest that this terms be used.

3. Broadening disclosures

The disclosures for an integrated report in paragraph 4.15 of the Consultation Draft include:

“The organization’s assessment of the likelihood that the opportunity or risk will come to fruition and the magnitude of its effect if it does. This includes consideration of the specific circumstances that would cause the opportunity or risk to come to fruition.”

Appendix 1 includes our marked-up suggestions to amend this disclosure as follows:

- 1 Concept alignment - the use of ‘risk’ is corrected to ‘threat’ as suggested in section 2 above and the term ‘risk’ is included when it relates to an event.
- 2 Individual assessments - the assessment of each individual ‘opportunity’ and ‘risk’ (now referred to as ‘threat’) is changed to an assessment of the level of risk that may be caused by ‘opportunities or threats’. This better reflects the mechanics of how risk arises in an organization. As illustrated above, risk events arise from a range of causes (opportunities and threats) so the disclosure guideline should be focused on those opportunities and threats that are assessed by the reporter as causing risk events.
- 3 The likelihood and the magnitude - the assessment of the likelihood that the opportunity or risk (now referred to as ‘threat’) will come to fruition and the magnitude of its effect if it does is changed to an assessment of ‘the level of risk’ that may be caused by opportunities or threats. This better reflects the mechanics of how

risk arises in an organization and does not limit the methodology used for this assessment.

Many organizations, including the larger listed companies to whom the Consultation Draft is directed, have more sophisticated risk assessments than the qualitative likelihood and consequence matrix that is implied in paragraph 4.15. Those companies that have more sophisticated risk assessment data such as value at risk and quantified risk values, particularly in the finance industry, should not be brought back to the lowest common denominator. Use of 'the level of risk' accommodates the more sophisticated risk assessments as well as users of the likelihood and consequence matrix.

4. Expanding the disclosure criteria

Paragraph 4.17 of the Consultation Draft restricts its application to any 'risks' that are fundamental to the ongoing ability of the organization to create value **AND** that could have extreme consequences, even where the likelihood of their occurrence might be considered quite small. With the more appropriate use of the term 'risk' in this context, as suggested in section 2 above and the refinement of the risk assessment as suggested in section 3 above, the second leg of the criteria is not needed. We suggest the second leg be deleted.

5. Flow on changes

There are many references to 'opportunities and risks' and 'risk' outside Section 4C of the Consultation Draft. Our suggestions for the flow-on changes are included in Appendix 2.

Appendix 1: Marked-up suggestions for section 4C

(Note: deletions are shown as ~~delete~~ and additions shown as add)

4C Opportunities and ~~threats~~ risks

- 4.13 An integrated report should answer the question: What are the specific opportunities and ~~threats~~ risks that affect the organization's ability to create value over the short, medium and long term, and how is the organization dealing with them?
- 4.14 An integrated report identifies the key opportunities and ~~threats~~ risks that are specific to the organization, including those that relate to the organization's effects on, and the continued availability, quality and affordability of, relevant capitals.
- 4.15 An integrated report identifies:
- The specific source of opportunities and ~~threats~~ risks, which may be internal, external or, commonly, a mix of the two. External sources include those stemming from the external environment, as discussed in paragraphs 4.8-4.9. Internal sources include those stemming from the organization's business activities, as discussed in paragraphs 2.30-2.33.
 - The organization's assessment of the effect of uncertainty on its objectives, being the level of risk, that may be caused by likelihood that the opportunities or threats ~~risk will come to fruition and the magnitude of its effect if it does~~. This includes consideration of the specific circumstances that would cause ~~the opportunities or threats~~ risk to come to fruition. Such disclosure will invariably involve a degree of uncertainty. Guidance on likelihood and magnitude of effect is included in Section 5B, and guidance on disclosures with respect to uncertainty is included in Section 5C.
 - The specific risk management steps being taken to create value from key opportunities, minimise loss of value from threats and to mitigate or manage key risks, including the identification of the associated strategic objectives, strategies, policies, targets and KPIs.
- 4.16 Care is needed to avoid "boilerplate" disclosures about opportunities, ~~threats~~ risks and risks. Information is only included in an integrated report when it is of practical use to the intended report users. This requires that disclosures be specific to the circumstances of the organization.
- 4.17 An integrated report identifies the organization's approach to ~~any~~ risks that are fundamental to the ongoing ability of the organization to create value and achieve its objectives that could have extreme consequences, even where the likelihood of their occurrence might be considered quite small.

Appendix 2: Flow on changes

Page	Reference	Existing Terminology	Suggested Terminology
7	Third bullet point (2 instances)	opportunities and risks	opportunities and threats
7	Figure 1	Opportunities and risks	Opportunities and threats
9	Paragraph 1.17	opportunities and risks	opportunities and threats
10	Paragraph 2.7	opportunities and risks	opportunities and threats
11	Paragraph 2.8	maximise opportunities and mitigate or manage risks	maximise opportunities, minimize threats and mitigate or manage risks
11	Figure 3	Opportunities and risks	Opportunities and threats
12	Paragraph 2.17	risk management approach	risk management approach
14	Paragraph 2.28	opportunities and risk	opportunities and threats
16	Paragraph 2.37	opportunities and risks	opportunities and threats
18	Paragraph 3.3	opportunities, risks and dependencies	opportunities, threats and dependencies
18	Paragraph 3.10	opportunities and risks	opportunities and threats
19	Paragraph 3.10	opportunities and risks	opportunities and threats
19	Paragraph 3.10	strategy and risks	strategy and risks
20	Paragraph 3.15	opportunities and risks	opportunities and threats
20	Paragraph 3.15	Manage risks	Manage risks
20	Paragraph 3.18	risk assessment	risk assessment
21	Paragraph 3.26	opportunities and risks	opportunities and threats
22	Paragraph 3.35	the risk	the risk
24	Paragraph 4.1	Opportunities and risks	Opportunities and threats
25	Paragraph 4.11	attitude to risk	attitude to risk
25	Paragraph 4.11	approach to risk management	approach to risk management

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Page	Reference	Existing Terminology	Suggested Terminology
26	Paragraph 4.20	opportunities and risks	opportunities and threats
26	Paragraph 4.20	risk management	risk management
27	Paragraph 4.23	opportunities and risks	opportunities and threats
28	Paragraph 4.28	opportunities and risks	opportunities, threats and risks
29	Paragraph 4.35	to deliver on the opportunities available to it	to deliver on the opportunities available to it and to tackle the threats it confronts
29	Paragraph 4.35	the risks it faces	the risks it faces
29	Paragraph 4.36	opportunities and risks	opportunities and threats
29	Paragraph 4.37	possible risks	possible risks
33	Paragraph 5.25	Opportunities, risks and outcomes	Opportunities, threats and risks
33	Figure 7	Opportunities, risks and outcomes	Opportunities, threats and risks
34	Paragraph 5.28	opportunities, risks and outcomes	opportunities, threats and risks
34	Above paragraph 5.29	Opportunities, risks and outcomes	Opportunities, threats and risks
34	Paragraph 5.29	opportunities, risks and outcomes	opportunities, threats and risks
34	Paragraph 5.30 (4 instances)	Opportunities, risks and outcomes	Opportunities, threats and risks

Appendix 3: About the authors

Rob Hogarth

Rob is an Australian chartered accountant who is an independent member of the board / risk and audit committee of several organizations and consults to a range of organizations on financial and risk management. Rob retired from KPMG in 2009 after being a partner for 27 years in a career focused on business risk in external audit, internal audit and a range of consulting including risk advisory, governance, major projects and sustainability.

Tony Pooley

Tony is a mechanical engineer whose career began in the Oil and Gas industry in the UK before working for more than 20 years as a consultant in business risk management and the creation and management of an enterprise risk framework within an Australian top 15 listed company. He is currently also an adjunct associate professor in risk management at the University of South Australia.

Joint authors of “Risk Bandits” (in late draft for publication)

“Risk Bandits - The Battle Against Inept Organizational Risk Management” is a take-no-prisoners critique of what organizations put in place to manage their risks. It is written for directors and managers to provide some pathways to winning this battle. The book provides a unique insight to a better way in organizational risk management combining Rob’s experience in reporting and the needs of boards governing businesses to create value and Tony’s experience in the dynamics / estimating of risk and the needs of line managers in operational decision making.