Addressing business resilience

Mario Abela
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1. Introduction
Why things need to change
Why even bother? Well, BlackRock does.
Redefining Value

Business Decision Making
- Risk Management
- Natural Capital Protocol
- Social Capital Protocol
- Integrating NCP and SCP

External disclosure
- Reporting matters
- The Reporting Exchange
- Purpose-driven Disclosure
- Assurance and Internal Controls
- TCFD

Investor decision making
- Ranking & Ratings
- Pensions
Conservation and Financial Markets Initiative
What is sustainability?
2. Reframing risk management
Taking a longer term perspective
Fiduciaries must ensure that their decision-making processes **balance allocation of capital** between near-term needs and future wealth creation and consider the potential transfer of risks between participant generations. **Intergenerational wealth maximization requires** active consideration of a range of factors beyond narrow financial criteria.

*Steve Lydenberg, Initiative for Responsible Investment*
Risk management – “in the eye of the beholder”

- For ESG, the investor is the most important audience
- For the ESG investor, integrated ERM, materiality assessment and IFRS 7 Reporting would be useful and show company connectivity
- It would though require most risk assessments to be more concrete and monetized
- What is the value-impact of the risk?
- When will it potentially hit the company?
- What is done to prevent it?
- It would require collaboration between financial and non-financial colleagues
### Changing landscape of global risks

#### Top 5 Global Risks in terms of likelihood

<table>
<thead>
<tr>
<th>2007</th>
<th>2012</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Breakdown of critical information</td>
<td>Severe income disparity</td>
<td>Extreme weather events</td>
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<tr>
<td>infrastructure</td>
<td></td>
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<tr>
<td>Chronic disease in developed countries</td>
<td>Chronic fiscal imbalances</td>
<td>Large scale involuntary migration</td>
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<tr>
<td>Oil price shock</td>
<td>Rising greenhouse gas emissions</td>
<td>Major natural disasters</td>
</tr>
<tr>
<td>China economic hard landing</td>
<td>Cyber attacks</td>
<td>Large-scale terrorist attacks</td>
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<tr>
<td>Asset price collapse</td>
<td>Water supply crises</td>
<td>Massive incident of data fraud/theft</td>
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</tbody>
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#### Top 5 Global Risks in terms of impact

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<td>Asset price collapse</td>
<td>Major systemic financial failure</td>
<td>Weapons of mass destruction</td>
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<tr>
<td>Retrenchment from globalization</td>
<td>Water supply crises</td>
<td>Extreme weather events</td>
</tr>
<tr>
<td>Interstate and civil wars</td>
<td>Food shortage crises</td>
<td>Water crises</td>
</tr>
<tr>
<td>Pandemics</td>
<td>Chronic fiscal imbalances</td>
<td>Major natural disasters</td>
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<tr>
<td>Oil price shock</td>
<td>Extreme volatility in energy and agriculture prices</td>
<td>Failure of climate-change mitigation and adaptation</td>
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**Categories:**
- Economic
- Environmental
- Geopolitical
- Societal
- Technological
Sustainability risks are, at the end of the day, business risks. Although they can be new and emerging, complex and longer term, issues such as climate change, human rights or resource scarcity all have the ability to impact an organization’s profitability, success or even survival.

Bob Hirth, COSO
What is enterprise risk management?

Enterprise Risk Management (ERM) is defined by the Committee of Sponsoring Organizations (COSO) as:

“...The culture, capabilities and practices, integrated with strategy-setting and its performance, that organizations rely on to manage risk in creating, preserving and realizing value.”¹
29%

average alignment between risks or aspects reported as material in the sustainability report and the risks identified in the risk disclosure section of legal filings
Findings from updated risk research

Level of alignment from 321 companies (2015-2017)

- None: 31%
- Partial: 65%
- Average: 31%
- Full: 4%
Companies using COSO as ERM Framework

69%

of Forbes’ 100 largest companies by market cap
# The business case for better ERM

## Factors causing the sustainability ERM breakdown*

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<th>Factor</th>
<th>Risk management process</th>
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<tr>
<td>1 Limited knowledge of sustainability risks</td>
<td>Risk identification</td>
</tr>
<tr>
<td>2 Omission of opportunities or strategic risks</td>
<td>Risk evaluation</td>
</tr>
<tr>
<td>3 Difficulty quantifying sustainability risks</td>
<td>Risk response</td>
</tr>
<tr>
<td>4 Limited cross-functional collaboration</td>
<td>Communication and disclosure</td>
</tr>
<tr>
<td>5 Longer time horizons for sustainability risks</td>
<td></td>
</tr>
<tr>
<td>6 Differing language used for ERM versus disclosures</td>
<td></td>
</tr>
<tr>
<td>7 Differing purposes for sustainability versus risk disclosures</td>
<td></td>
</tr>
<tr>
<td>8 Limited guidance for implementing risk management framework</td>
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*Bar width refers to level of agreement of sustainability and risk professionals from interviews
The business case for better ERM

- COSO ERM Framework
- Working group members
- Case studies and company examples
- ESG frameworks (e.g., TCFD, NCP, SCP)
- Subject matter experts

Adapting, surviving andprospering in a new era: Draft guidance for incorporating ESG risks into Enterprise Risk Management

Coming early 2018 (working title)
3. Importance of internal controls (Even for non-financial information)
WBCSD: Assurance Maturity Model

**Scope of Assurance**
- **Data**: Receiving limited assurance on a few KPIs.
- **Materiality**: Receiving limited and/or reasonable assurance on material disclosures and possibly process.
- **Balance & Integration**: Receiving limited and/or reasonable assurance that the full report meets generally accepted principles, including balance and materiality.

**Desired Outcome of Assurance**
- **Compliance**: Responding to requirements, market mechanisms, pressure and expectations.
- **Performance**: Enhancing internal control, data collection and performance.
- **Competitive Edge**: Strategically differentiating by enhancing transparency and reliability.

**Stage 1:** Responsive
- **Stage 2:** Enhanced
- **Stage 3:** Leveraged

**Value of Assurance**
Evidence has the following attributes:

- Sufficient – deals with the amount of evidence;
- Suitable - deals with the quality of evidence; and
- Reliable - affected by the source and nature of the evidence.

Strong evidence is typically:

- Written;
- From external sources;
- Controlled effectively;
- Direct and not inferences drawn from other material;
- Original or in a form in which the audit trail will show any alterations.
The Controlling Toolkit – Light Pathway

1. Define Chart of Accounts (1)
2. Company GAAP incl. consolidation rules (3)
3. Risk Assessment of wrong data reporting (5)
4. Year End HQ Controlling (use 7.2)
5. Year End data and explanation collection (8)
6. Control Catalogue and SOPs for HQ (7.2)
7. Feedback from/to BUs and Best Practice Sharing sessions (11)
The Controlling Toolkit – Best Practice Pathway

1. Define Chart of Accounts
2. Expand/extend financial Consolidation System
3. Company GAAP incl. consolidation rules, evidence demands, etc.
4. Training – and meet & greet
5. Risk Assessment of wrong data reporting
6. Best Practice Sharing sessions
7. Control Catalogues and SOPs
8. Interim data and explanation collection
9. Monitoring – feedback to BUs and reporting to Audit Committee
10. Year End (repeat use 7 + 8)
11. Feedback from/to BUs and Best Practice Sharing sessions
Thank you
Mario Abela
Director, Redefining Value
abela@wbcsd.org