THE DISCLOSURE OF ENTERPRISE RISK MANAGEMENT (ERM) INFORMATION: AN OVERVIEW OF CANADIAN REGULATIONS FOR RISK DISCLOSURE

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Abstract

This paper discusses the mandatory risk disclosures in Canada under International Financial Reporting Standards (IFRS). U.S. mandatory accounting disclosures of risk are also briefly examined, since some Canadian companies are cross-listed in the US. Mandatory disclosures of risk under the Basel II and Basel III Accords for the international regulation of banks are discussed as well as the assessment of ERM by Standard & Poor's. The risk disclosures in the Management Discussion & Analysis (MD&A) section of the annual report prescribed by the Canadian Securities Administrators (CSA) in National Instrument 51-102 Continuous Disclosure Obligations are examined. Since these risk disclosures are voluntary, the actual disclosures in the MD&A section of the annual report are entirely at the discretion of management subject to effective board oversight.***

Keywords: ERM; IFRS; BASEL II and III; MD&A

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1. Introduction

There is a growing demand for better reporting of risks, especially after the financial crisis of 2007 and beyond. Good risk disclosures assist in enabling investors to evaluate the quality and prospective volatility of company earnings and cash flows. They also enable investors to assess a company's resiliency – its ability to respond to risk events (CICA, 2008).

Investors need to understand the risks that a company takes to create value and they want to have information on the sustainability of current value-creation strategies (Beretta and Bozzolan, 2004). Top managers must therefore be in a position to assure investors that risks and uncertainties are well managed (De Loach, 2000). This requires not only the implementation of firm-wide risk management systems, but also effective communication about risks that affect a firm's strategies (Beretta and Bozzolan, 2004).

The aim of this paper is twofold. The first is to discuss the mandatory rules for risk disclosures in Canada under the requirements of the International Financial Reporting Standards (IFRS). The Canadian Institute of Chartered Accountants (CICA), the standard setter for accounting in Canada, adopted IFRS on January 1, 2011. IFRS replaces current Canadian GAAP for most publicly accountable enterprises[1] listed on a Canadian stock exchange. Since a large number of Canadian companies are also cross-listed on the New York Stock Exchange (NYSE) and other US stock exchanges, mandatory disclosures of risk reporting by the Financial Accounting Standards Board (FASB), and the Securities and Exchange Commission (SEC) are examined. In addition, the NYSE requirements for risk reporting, mandatory disclosures of risks under the Basel II and III Accords for the international regulation of banks and the assessment of enterprise risk management by Standard and Poor's (S&P) Rating Services are discussed.

The second aim of the paper is to discuss the risk disclosures in the Management Discussion and Analysis (MD&A) section of the annual report as prescribed by the Canadian Securities Administrators (CSA) in National Instrument 51-102 Continuous Disclosure Obligations. These mostly nonfinancial types of risk are currently disclosed on a voluntary basis. It is important to note that the risk disclosures in the MD&A are at the discretion of management in terms of what they actually disclose (Lajili and Zeghal, 2005).

The paper is organized into nine sections. The next section gives some background on enterprise risk management (ERM). Section three looks at risk disclosures embedded in IFRS. Section four discusses the Basel II and III Accords, while section five examines the Standard and Poor's position on ERM. Section six discusses the US accounting disclosures on risk, while section seven examines the risk disclosures in prospectuses and annual reports. Section eight highlights the MD&A, while section nine presents the conclusion.

2. Background On Enterprise Risk Management (ERM)

According to the AICPA/CICA (1999), risk is the chance of something adverse occurring that will have an impact on the achievement of objectives. It is measured in terms of likelihood and consequences. The challenge for companies is how best to disclose the risks they face in a way that is clear and sufficient – focusing on information that is material to investors, while not exhaustive or overwhelming (CICA, 2008; ICAEW, 2011).

Balancing risk and reward has always been a challenge for companies. This has become more pronounced today against the background of the global financial crisis and the great uncertainty in the global economy (Price Waterhouse Coopers, 2009). Effective enterprise risk management (ERM) has emerged as a key, if not the most important priority for companies (Protiviti, 2007; Accenture, 2011). Organizations that take risks and manage risks well are more likely to achieve or exceed their objectives (AICPA/CICA, 1999; Lamm-Tennant and Lightfoot, 2010). Risk can be viewed as both an opportunity and a threat. In the past, organizations tended to take a defensive position towards risks, viewing them as situations to be minimized or avoided. Increasingly, organizations have come to recognize the opportunistic side and the value-creating potential of risk (CAS, 2003; Nocco and Stulz, 2006; Lamm-Tennant and Lightfoot, 2010).

Today, the practice of risk management has shifted in a fundamental way. In the past, companies managed risk by "silos", in which different types of risk – strategic, business, credit, market, operational – were managed by different organizational units (Lam, 2006; Fabozzi and Drake, 2009). Over time, risk management professionals recognized that risks, by their nature, are highly interconnected and interdependent. Major corporate disasters are often caused not by a single risk factor but by a convergence of risk factors. This new approach views all risks together, within a coordinated and strategic framework known as ERM (Lam, 2006; Nocco and Stulz, 2006). While there is no single right way to manage risk, there is a strong consensus that ERM should be integrated throughout the organization. This adds reality to risk management, as well as engaging more of the organization in an integrated process (Conference Board of Canada, 1997).

Companies need to align corporate governance with risk management (Sobel and Reding, 2004). This means that directors, senior management, internal and external auditors and risk owners[2] must work interdependently. What is the appropriate role of the board in enterprise risk management? According to Caldwell (2012), traditional models support the notion that boards cannot and should not be involved in day-to-day risk management. Rather, through their risk oversight role, directors should be able to satisfy themselves that effective risk management processes are in place and functioning effectively. The risk management system should allow management to bring to the board's attention the company's material risks. Sheath (2010) and Caldwell (2012), however, hold the view that boards must take a more active and direct role in ERM, well beyond traditional oversight of typical risk management processes. Lindsay (2003) made this point earlier, by emphasizing that the role of the director includes asking management tough questions to ensure that risk has been fully considered in the strategic and business planning processes. Recently, there have been criticisms that board members do not have an understanding of the material risks the company faces (Harvard Law School Forum, 2009). Board training and tutorials are suggested for these board members. The CICA's A Framework for Board Oversight of Enterprise Risk (Caldwell, 2012) focuses specifically on the board's role in terms of risk, providing valuable guidance and tools to help directors discharge their responsibilities.

Fabozzi and Drake (2009) conclude that internal controls (ICs) provide a mechanism for mitigating risks and increase the likelihood that a firm will achieve its financial objectives. The AICPA (2010) Audit Committee brief explores the relationship between governance, ERM and internal control. Corporate governance functions essentially to enable an organization to reach long-term goals and objectives. ERM exists as a subset of corporate governance. ICs focus on a smaller scale within the company, sometimes ignoring the strategic objectives that ERM includes.

3. International Financial Reporting Standards (IFRS)

There are some requirements in IFRS that require risk disclosures without necessarily mentioning the word "risk". In other cases, they refer to "uncertainties" rather than "risks" (ICAEW, 2011). International Accounting Standard (IAS), **IAS 37, Provisions, Contingent Liabilities and Contingent Assets**, requires that:

- an indication of the uncertainties about the amount or timing of expected outflows should be disclosed, and

- for each class of contingent liability… an indication of the uncertainties relating to the amount or timing of any outflow should be disclosed.

The objective of this standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to enable users to understand their nature, timing and amount (Jeffrey, 2012).

IAS 1, Presentation of Financial Statements

IAS 1 requires companies to disclose information on the assumptions it makes about the future, and other major sources of estimation uncertainty (ICAEW, 2011). An example of this is going-concern uncertainties. This requires that management make an assessment of an entity's ability to continue as a going-concern when preparing financial statements. If there are uncertainties that cast doubt on the entity's ability to continue as a going-concern, the entity has to disclose those uncertainties. Management has to take into account all available information about the future continuation of the entity and make the required disclosures (Maingot and Zeghal, 2010).

IFRS 7, Financial Instruments: Disclosures

IFRS 7 has extensive risk disclosure requirements. The standard became effective for financial years beginning after December 31, 2006. The standard applies to all companies engaged in financial instruments and it has a particularly strong effect on the banking industry where financial instruments account, on average, for more than 90 percent of total assets and liabilities (Bischof, 2009). IFRS 7 is not a bank-specific regulation; instead, it applies to all entities that use financial instruments. The extent of disclosure is thus determined by the extent of an entity's use of financial instruments rather than by an entity's industrial sector (Gornik-Tomaszewski, 2006; Spooner, 2007).

IFRS 7's objective is to provide information to users of financial statements about an entity's exposure to risks and how the entity manages those risks (McDonnell, 2007). To this end, the standard requires an entity to provide disclosures in its financial statements that enable users to evaluate:

(a) the significance of financial instruments for the entity's financial position and performance disclosures about the figures in the balance sheet and the income statement; and

(b) the nature and extent of risks arising from financial instruments to which the entity is exposed (quantitive disclosure) and how the entity manages those risks (qualitative disclosures).

McDonnell (2007) indicates that these disclosures incorporate many of the requirements of IAS 32, Financial Instruments: Disclosures, but IFRS 7 goes further. He claims that it is in this area, the disclosure of qualitative and quantitative information and of an entity's exposure to risks arising from financial instruments, that IFRS takes a different approach from the previous standard. IFRS 7 expands the qualitative disclosure to include information on the process that an entity uses to manage and measure risk. IFRS 7 introduces new quantitative risk disclosures that should be given "through the eyes of management". This is based on information provided internally to key management personnel.

It is mandatory to disclose qualitative as well as quantitative information about exposures to market risk, credit risk and liquidity risk. Market risk is the risk that a fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk (such as equity and commodity risks).

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The credit risk disclosures could be a combination of qualitative discussion and extensive quantitative information provided in the risk management section of the notes to the financial statements or the Management Discussion and Analysis (MD&A) section of the annual report (McDonnell, 2007; Condon, 2008; Bischof, 2009). Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. IFRS 7 requires disclosure of a contractual maturity analysis for all financial liabilities on an undiscounted basis (Condon, 2008).

IFRS 7 also has extensive disclosure requirements for hedges (described in IAS 39) which should provide useful information for assessing how far certain risks have or have not been mitigated (ICAEW, 2011). Under IFRS 7, an entity should disclose the following separately for each type of hedge. These include fair value hedges, cash flow hedges and hedges of net investments in foreign operations (McDonnell, 2007).

In fair value hedges, an entity should disclose separately, gains and losses on the hedging instruments and the hedged item attributable to the hedged risk. For cash flow hedges, an entity should disclose the periods when the cash flows are expected to occur and when they are expected to affect the profit and loss. The same applies to hedges of net investments in foreign operations. For each hedge, there should be a description of the hedge, a description of the financial instrument designated as hedging instruments, and their fair values at the reporting date, and the nature of the risks being hedged (McDonnell, 2007).

IFRS 8, Operating Segments

IAS 14, Segment Reporting, used to define both business segments and geographical segments in terms of their risks and returns. IFRS 8, Operating Segments no longer defines reporting segments in terms of risk and returns. However, segmental information on the new basis remains relevant to the assessment of risk (ICAEW, 2011).

The key principle of IFRS 8 is that it requires disclosures that enable users to evaluate the nature and financial effects of the activities in which a business engages and the economic environment in which it operates (Dennis, 2009). It would appear from this key principle that the risks have to be "inferred" from the disclosures.

4. Basel II and III Accords

The 2004 Basel II Accord established minimum standards for the international regulation of banks (ICAEW, 2011). Basel II organizes the supervision of banks by regulators into three pillars. Pillar 1 sets minimum capital requirements which are calculated to reflect credit risk, operational risk and market risk. Pillar 2 deals with prudential surveillance of the minimum capital requirements. Under Pillar 3, banks must disclose more financial information to the market. This increases the transparency of banks' risks. These requirements had not come into effect before the financial crisis. Most European Banks, for example, did not have to comply with them until 2008 (ICAEW, 2011).

It is interesting to note a study by Colmant et. al. (2007). It concluded that the IFRS that address financial instruments (IAS 32, IAS 39 and IFRS 7) pose application problems in the banking sector, notably in the way they interact with Basel II. Moving to IFRS has modified the calculation of the solvency ratio for banks, in particular as regards the re-measurement of available for sale financial instruments and the unrealized results of cash flow hedges.

Basel II disclosures do not necessarily form part of the financial statements and some banks publish them as a separate statement which may overlap, to some extent, with financial reporting disclosures (ICAEW, 2011).

Politically it was difficult to implement Basel II in the regulatory environment prior to 2008. Progress was generally slow until that year's major banking crisis caused mostly by credit default swaps, mortgage-backed securities and similar derivatives (Dionne, 2009; McLean and Nocera, 2010; Jeon and Lovo, 2013). In response to the financial crisis, the Basel Committee on Banking Supervision published revised global standards known as Basel III. This accord adds new adequate capital rules to protect banks and improve control of liquidity risk. It requires even more risk management for banks and increases bank supervision (Wikipedia, 2011; OECD, 2011).

Basel III is a global regulatory standard on bank capital adequacy, stress testing and market liquidity risk. It is scheduled to be introduced from 2013 to 2019. According to a global study conducted by the Institute of International Finance (IIF) and Ernst & Young (2012), of 69 banks and 6 insurance companies, the regulatory requirements of Basel III are driving fundamental changes to business and creating a very uncertain time for the banking industry. The majority of firms surveyed believe that the more stringent liquidity and capital requirements under Basel III will have a fundamental impact on the business models, and ultimately the profitability of the industry. They believe that complying with the new rules will require significant investment in people, technology and processes. As one executive stated, "Basel III is taking a huge amount of board and senior management time to figure out what to do, and an enormous amount of employee time and money to implement."

Canada was an early adopter of Basel II Capital Accord as the basis for establishing the capital requirements for domestic banks. Canada will fully implement Basel III requirements on all banks. The Office of the Superintendent of Financial Institutions (OSFI) which regulates and supervises banks, has advised Canadian banks to maintain prudent retention policies and sound management practices to meet the new requirements in advance of 2019 (Keefe and Sodhi, 2011). The OSFI has declared the big six Canadian banks as too big to fail (systemic banks). The thinking is that identifying and subjecting them to tighter regulation will lower the risk to the financial system (Greenwood, March, 27, 2013).

5. Credit Rating Agencies

In May 2008, Standard and Poor's Rating Services (S&P) announced its intention to include enterprise risk management (ERM) assessments in ratings of non-financial companies. S&P has been reviewing risk management structures, the role of staff responsible for risk management, internal and external communication, risk management policies and metrics. S&P claim that their sharpened focus on ERM is part of the evolution in how they look at companies they rate. As with financial companies in the past, they have always assessed risks and management capabilities across an enterprise as part of their evaluation of a borrower. Financial risk and business risk profiles are the two main parts of their credit analysis (Standard & Poor's, Ratings Direct, July, 2009).

6. U.S. Accounting Disclosures of Risk

Since companies listed on the Toronto Stock Exchange (TSX) may be cross-listed on the New

York Stock Exchange (NYSE) or other US exchanges, a brief review of the requirements of the Financial Accounting Standards Board (FASB), the Securities and Exchange Commission (SEC) and the NYSE with regard to risk disclosure is appropriate. The FASB and the NYSE require companies to provide information about their exposure to risk, financial and market risk disclosures and financial instruments disclosures. The U.S. GAAP regulations require detailed disclosures for fair value of financial instruments (FASB, 2010), accounting for derivative instruments and hedging activities (FASB, 1998). Against the backdrop of the global financial crisis, fair value began to be blamed for causing the crisis (Véron; 2008; Bischof, 2009; André et. al., 2009; Magnan, 2009; Magnan and Markarian, 2011; Gillard and Khatri, 2011). Differences in fair value rules according to the FASB and the International Accounting Standards Board (IASB) were also considered as part of the problem (André et. al., 2009; Gillard and Khatri, 2011). Furthermore, there are risks in using a valuation model for instruments for which there is no liquid market in which prices can be observed (André et. al. 2009). To address these criticisms, the IASB and the FASB had to do something to placate the critics.

In response, the IASB and the FASB issued new guidance in May, 2011 on fair value measurement and disclosure requirements for IFRS and US GAAP. The guidance, set out in IFRS 13 is Fair Value Measurement, and an update to Topic 820 in the FASB's Accounting Standards Codification, brings about convergence of the IFRS and U.S. GAAP. IFRS 13[3] is effective on and after January 1, 2013 (Gillard and Khatri, 2011).

The NYSE rules impose risk oversight obligations on the audit committee of a listed company. They require that the audit committee discuss guidelines and policies that govern the process by which risk assessment and management is undertaken (Harvard Law School Forum, 2009).

Discussions should address major financial risk exposures and the steps the board has taken to monitor and control such exposures, including a general review of the company's risk management programs. The NYSE rules permit the creation of a separate committee or subcommittee to be charged with the primary risk oversight function (Harvard Law School Forum, 2009).

The SEC requires companies to implement new disclosures on risk in proxy and information statements, annual reports and registration statements. In particular, it requires disclosure of the board's role in risk oversight and compensation risk (SEC, 2009).

7. Prospectus And Annual Reports

Firms disclose more about risks in their prospectuses than in their annual reports and do so without excessive boilerplate (ICAEW, 2011). There is a view that prospectus disclosures about risks are rightly more extensive than those found in the annual report since it is not expected that the annual report would keep up the disclosure requirements found in the prospectus. The risk considerations are wide-ranging. Topics include environmental, operational, pricing, foreign exchange, labour relations, competition and all other relevant mattes (AICPA⁄CICA, 199; Beretta and Bozzolan, 2004).

According to ICAEW (2011), the prospectus is an attempt to raise money from people who are deemed to be in a state of ignorance about the business. The annual report addresses those who have already decided to become investors in the business and, therefore, they can be reasonably assumed not to be in a state of ignorance about it. Therefore, it should not be surprising to find that annual report requirements are currently less demanding than those of prospectuses (AICPA⁄CICA, 1999; Beretta and Bozzolan, 2004; ICAEW, 2011).

8. Management Discussion and Analysis (Md&A)

The CICA's Management Discussion & Analysis – Guidance on Preparation and Disclosure (MD&A Guidance) recommends that a company:

> *"disclose its principal risks and describe related risk management systems to enable MD&A report readers to understand and evaluate the company's risks and its decision regarding the management of such risks."*
>
> (CICA, 2008)

MD&A has become a core element of the communication package for external reporting purposes (CICA, 2009). The Canadian Securities Administrators (CSA) set out the rules for the preparation and disclosures in the MD&A in National Instrument 51-102 Continuous Disclosure Obligations. Securities regulators from each of the 10 Canadian provinces and the 3 territories have teamed up to form the Canadian Securities Administrators (CSA). The Ontario Securities Commission (OSC) is a regulatory agency which administers and enforces securities legislation in the Canadian Province of Ontario. It is a Crown Corporation which reports to the Government of Ontario through the Minister of Finance. It is the largest securities regulator in Canada, has the Toronto Stock Exchange (TSX) under its jurisdiction, and is responsible for investor protection and market integrity.

The TSX guideline IB advocates that boards assume responsibility for the identification of the principal risks of the corporation's business and ensure the implementation of appropriate systems to manage these risks. The TSX guideline 1B considers the above as required disclosure for companies listed on the Toronto Stock Exchange (TSX). The same

guideline suggests enhanced disclosures for companies to:

- describe the principal risks that the board identified
- identify the committee responsible for ERM
- describe the process that the board or committee follows to evaluate risk
- discuss the structures and procedures in place to manage risks

The TSX also requires all listed companies to disclose their corporate governance practices each year in their annual report (TSX, 1999). However, disclosure of the principal risks by the TSX is voluntary according to the CSA National Policy (NP) 58-201 Corporate Governance Guidelines (2005). It is interesting to note that the TSX only requires the companies to explain their practices, not to adopt the practices in the guidelines (TSX, 1999).

The MD&A should be written for current and prospective investors to help them decide whether to invest or continue to invest in an entity. It should provide a narrative description "through the eyes of management".

National Instrument 51-102 provides a disclosure framework. These include: (1) Core business and strategy, (2) Key Performance Drivers i.e. Key Performance Indicators (KPIs), (3) Capability to deliver results, (4) Results and outlook and (5) Risk.

Under the risk section of the framework one finds the following about risk disclosure:

"Disclose the principal risks for the entity as a whole and each of its core business." The guidance also recommends a discussion of the strategies employed for managing these risks including the relationship of executive compensation arrangements to risk mitigation and the potential impact of these risks on results and capabilities.

The MD&A complements and supplements the financial statements, but does not form part of the financial statements.

The National Instrument 51-102 makes the following disclosure recommendations:

(a) An entity should disclose its principal risks and its related risk management strategies to enable MD&A report readers to understand and evaluate the entity's risks and its decisions regarding the management of such risks. Such disclosure should include:

- the principal risks and uncertainties facing the entity and its core business including significant segments
- the strategy employed to manage these risks
- the potential specific impact of these risks on results

(b) Management disclosures about risks and risk management should be included within the MD&A, even if these are required elsewhere. The risk disclosures in the MD&A should be consistent with risks and risk management strategies identified and dealt with by the board of directors.

(c) The CSA recognize that specific disclosures about risk present a challenge to most entities. Different companies use different models or approaches to identify, manage and discuss risks. But they should disclose strategic, operational and financial risks.

For example, in the case of an off-balance sheet financial relationship, the company must disclose and discuss how they plan to mitigate those risks.

(d) Whatever the model or approach used, risk disclosures should be as specific as possible. It is important to provide investors with an explanation of each major risk, the likelihood it will materialize and how it can affect the business if it materializes.

(e) Risks should be summarized in a separate section of the MD&A. The risks disclosed should not be a boilerplate listing of all risks. Rather, it should include the most important risks. Also, quantitative information on significant risks and their potential impacts should be disclosed. Furthermore, there should be continuity and consistency from one period to another regarding risk disclosures and how the risks impact results.

The CSA has the authority to conduct reviews of the MD&A. It carried out such a review in 2010 related to going-concern disclosures. It reviewed 105 companies and, generally, it found that the discussion in the MD&A, relating to going-concern risk, needed improvement. They made suggestions to the companies (with examples) of what should be included in the MD&A, for the companies that were lacking. Most companies provide a description of risks rather than an analysis of how the risks affect the business, according to the CSA (CICA, 2008).

Both the CSA and the CICA conduct periodic reviews of corporate disclosures with the objective of identifying "best practices" and helping companies to ensure that they are in compliance with the securities regulations.

Risk disclosures by the TSX (or other stock exchanges in Canada) as well as risk disclosures in the MD&A are voluntary and tend to follow best practices. There are good reasons for this approach. Risk disclosure is inherently a very challenging exercise and it is often perceived as a boilerplate list of disclosure, including a laundry list, of which not all are relevant to the reader (investor). Also, there is no generic or one size fits all template to create high quality risk disclosures because of the great diversity in risk reporting (CICA, 2012).

The MD&A disclosures in the U.S. required by the SEC are similar to those required in Canada.

9. Conclusion

Before the adoption of IFRS in Canada, the accounting rules and regulations on risk disclosures tended to be somewhat sparse, according to the Chair

of Canada's Accounting Standards Board (Jeffrey, 2012). At that time, mandatory risk disclosures concerned primarily the use of financial instruments and risk exposure to financial and market risk. These were reported in the footnotes to the financial statements. Any qualitative or quantitative discussion of the risks associated with the use of financial instruments and management's policies to manage those risks were voluntary to a great extent (Lajili and Zeghal, 2005).

International Financial Reporting Standards (IFRS), now in use in Canada, have some specific requirements for ERM disclosures. IFRS 7, Financial Instruments: Disclosures, has extensive risk disclosure requirements applicable to all companies engaged in financial instruments. The disclosures of qualitative and quantitative information about exposures to market, credit and liquidity risks are mandatory. IFRS 7 also has extensive disclosure requirements for hedges and hedge accounting.

There are some requirements in IFRS that require risk disclosures without necessarily mentioning the word "risk" but sometimes refer to "uncertainties". For example, if there are numbers in the financial statements based on management estimates, information about the basis of the estimation should be disclosed (Jeffrey, 2012). When dealing with contingent liabilities, the IFRS requires the disclosure of the nature of the contingent liability (for example, litigation), how the estimation was made, and whether the amount had to be recorded as a provision or not.

The Canadian Security Administrators (CSA) have more comprehensive disclosure rules on risks throughout their regulations. The Management Discussion and Analysis (MD&A) and prospectus document, for example, all need to discuss the risks companies face during the course of doing business. National Instrument 51-102 Continuous Disclosure Obligations, through the Annual Information Form[4] (AIF), mandates that companies disclose risk factors relating to their company and their business. Throughout the MD&A form there are requirements to discuss risks associated with liquidity, capital, off-balance-sheet arrangements and financial instruments, including derivatives (Lajili and Zeghal, 2005; Jeffrey, 2012). Since management decides the actual disclosures, one cannot be sure whether they are honestly complying with the rules, and giving a real picture of the risks and their disclosures. One can only hope that, given the recent financial crisis and the need to have an effective ERM system, management will not only comply with the rules of risk disclosures, but also give investors the information to understand the full spectrum of risks facing the company. The board of directors, the auditors (internal and external), the management and the risk owners, all have a key role to play in ensuring that the risks disclosed reflect reality. The governance structure is therefore of paramount importance.

A growing demand for better reporting of business risks has emerged in recent decades. This is based on the belief that improved understanding of business risks by investors and other users of corporate reporting should lead to better stewardship of companies and to a more efficient allocation of resources (ICAEW, 2011).

There are a number of factors driving the growth in, and acceptance of ERM and ERM disclosures in Canada and across the world. The first is the wake-up calls from corporate disasters including the financial crisis. More than ever, board members and corporate executives realize the consequences of ineffective risk management (Kleffner et al, 2003; Lam, 2006; ICAEW, 2011). The second involves the regulatory requirements that impact on ERM disclosures in Canada. These include the CICA, the IASB, the CSA, the FASB, the SEC, Basel II and III, the TSX and the NYSE.

The third factor includes a number of global initiatives on corporate governance and risk management. Canada published the Dey Report in 1994. The UK began with the Cadbury Report (1992), and a number of intervening reports before the publication of the Combined Codes (updated regularly to summarize best practices). In 2004, the Committee of Sponsoring Organizations in the U.S. (COSO, 2004) published a framework incorporating corporate governance and internal controls as part of an overall ERM structure. These industry initiatives have established the role of the board and senior management in risk management (Lam, 2006; CICA, 2012).

Companies that adopted ERM early are reporting tangible benefits from their ERM programs, including stock price improvements, less volatility in earnings, debt-rating upgrades, early warning of risks etc. (Lam, 2006; Pagach and Warr, 2011; Spellman, 2012).

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Endnotes

1. Publicly accountable enterprises include Canadian listed companies, except private companies, not-for-profit organizations, and public sector entities (CICA Exposure Draft, April, 2008).
2. Risk owners are the people in a corporation who are responsible and accountable for managing specific risks. Only senior management and risk owners should be directly responsible for risk management (Sobel and Reding, 2004).
3. IFRS 13 establishes a single source of guidance for fair value measurement where fair value is required or permitted under IFRS (Gillard and Khatri, 2011).
4. The Annual Information Form (AIF) is required to be filed annually by companies under part 6 of the National Instrument 51-102. An AIF is a disclosure document intended to provide material information about the company and its business at a point in time.