

# RISK REPORTING: CLARITY, RELEVANCE AND LOCATION

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# Risk reporting: Clarity, relevance and location

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## Foreword

How can annual reports provide the information which users require for both stewardship and decision-making purposes? Recently there has been much debate about improving narrative, and specifically risk, reporting to ensure that key information about a business is disclosed in its annual report. Policy developments in this area are being undertaken by the IASB, the FRC and BIS. Such initiatives also coincide with a concern about information overload with annual reports getting longer and longer. For example, there has been an initiative by the FRC called ‘Cutting the Clutter’ and various projects undertaken by ICAS including Losing the excess baggage (with the NZICA) and Making corporate reports relevant. Balancing these two forces is a difficult task and risk reporting is a prime example of this problem – the volume of risk reporting has increased in recent years but is this additional disclosure beneficial?

This project involved interviews with users, both buy-side and sell-side analysts, and preparers of risk information. The interviews covered three broad themes: the sources of risk information; the impact of regulatory initiatives on risk disclosure; and the types of risk information disclosed and the constraints on disclosure. An analysis of risk disclosure in the annual reports of companies in the food and beverage sector of the FTSE was also undertaken.

The project finds, not unsurprisingly, that for analysts one-to one meetings are the most useful source of risk information. However, there is a very much mixed view about the usefulness of risk disclosures in the annual reports, with some analysts considering them to be useful while others see them as too general or boilerplate. Whilst risk disclosure has increased there is concern over an emphasis on quantity rather than quality.

This project was funded by the Scottish Accountancy Trust for Education and Research (SATER – see page 85). The Research Committee of ICAS has also been happy to support this project. The Committee

recognises that the views expressed do not necessarily represent those of ICAS itself, but hopes that the project will provide some evidence to contribute to the development of narrative, and specifically risk reporting, policy.

Allister Wilson  
Convener ICAS Research Committee

March 2012

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# Executive summary

## Introduction

This project is concerned with the usefulness of risk information disclosed by listed companies. Views from investment analysts as a primary user of corporate information and from preparers of company annual reports are elicited. The project also examines risk disclosure in a sample of UK listed company annual reports.

Corporate risk reporting is important in helping investors assess the risk profile of a company and enables them to align holdings to suit their risk tolerance. Rules on risk disclosure in company reports are designed to improve transparency of information for investors. Any improvement in transparency should reduce market distortions and increase the efficiency of capital markets.

The amount of information disclosed by public listed companies has increased substantially over the past few years, partly due to regulation and partly due to the increase in voluntary information provided by these companies (Campbell and Slack, 2008). While the quantity of information has increased, questions have been raised over the quality of information disclosed (FRC, 2009, Campbell and Slack, 2008).

To the best of our knowledge, this project is the first study to compare views of users and preparers of corporate information specifically on risk disclosure. This facilitates comparisons between the perceived usefulness of risk information from both a user and a preparer perspective, which is important in light of the communications gap, between companies and investors.

The present study should be of interest to policy makers in formulating best practice and guidelines on risk reporting. The results will also be of direct interest to user groups such as investment analysts, individual shareholders and other stakeholders who rely on company reporting to make commercial decisions.

The following eight questions are addressed in this report. The questions fall under three broad themes.

Themes	Questions to analysts	Questions to annual report preparers
<b>Risk information sources</b>	<p>Q1. How important are various information sources to analysts in their risk assessment?</p> <p>Q2. How important is the information available in the annual report to analysts' risk assessment?</p>	<p>Q5. What disclosure vehicles do companies consider important when it comes to helping users understand risk factors and risk management practices within a company?</p> <p>Q6. Who are the key audiences for risk information and is the information used in decision making?</p>
<b>Regulation and risk information</b>	<p>Q3. Have recent regulatory initiatives improved analysts' ability to assess risk?</p>	<p>Q8. How far do regulatory policy initiatives encourage disclosure of more forward-looking information?</p>
<b>Type of risk information disclosed in corporate annual reports and constraints on risk disclosure</b>	<p>Q4. What types of risk related information are companies disclosing in their annual report and how does annual report risk disclosure compare with the risk information requirements of investment analysts?</p>	<p>Q7. How do companies decide whether or not to disclose a risk?</p>

## Research approach

The study uses:

- Interviews with investment analysts and annual report preparers; and
- Content analysis of company annual reports.

Thirty two user interviews were conducted with a total of 35 analysts (21 buy-side and 11 sell-side) and 16 preparer interviews were conducted with representatives of 16 FTSE-listed companies (representing the

FTSE 100, 250 and AIM markets). Content analysis of annual reports was also conducted to identify the type of risk information disclosed in 18 company annual reports. These reports were from companies listed under the Food & Beverages sector of the Financial Times Share Service. The choice of a single sector for the annual reports is for comparability purposes and also because firms in the same industry might be expected to be affected by similar factors. However, it is recognised that differences between companies would still exist, due to factors such as size, US listing and geographic spread.

## Findings

### Risk information sources

Results from a short questionnaire administered to analysts as part of the interview process reveal that meetings with management are considered to be more important than the annual report as a source of information in risk analysis. Within the annual report, the 'Business Risk Factor Statement' is considered to be the 14th most important of 26 sections, with the 'cash flow statement' being the most important. The interview results reveal that analysts have different perceptions. The majority of analysts find face-to-face meetings very important in understanding the risk of an investment but a minority are sceptical of their value. Annual reports are historic and lack timeliness but provide an important source of reference material. Analysts do not always have the time to read them from cover to cover. Views on risk factor statements within the annual report are mixed. Some groups consider these statements to be too general, others consider them to be useful and a minority consider them to be very useful.

Preparers consider annual reports to be important although other sources such as announcements, conference calls and one-to-one meetings are also useful. The annual report is considered important by private investors. Risk information is important for analysts and professional and private investors. However companies are rarely asked about the risk information included in their annual reports. There are

problems with selection of the number of risks to be included. The distinction between general risks and company-specific risks is also an issue.

## Regulation and risk information

The general view of analysts is that risk information has increased as a result of regulatory initiatives. There is an acknowledgement that regulation is effective in theory but difficult to implement in practice because of unintended consequences. For example, while an increase in mandated information might be seen generally as a good thing, for the individual analyst more disclosure means less chance to find out what other analysts do not know.

Internal control disclosures are not considered to be important although some of the buy-side analysts do read them. Preparers have mixed views on the value of internal control disclosures although some receive questions on them. Financial instrument disclosures are considered to be useful by some sell-side analysts. Buy-side analysts consider them useful but difficult to understand. Sensitivity analysis is read by some analysts but they may need to ask the company for further explanation. Preparers agree that disclosures on financial instruments are difficult to understand. The disclosures are required by the relevant IFRS, and there is little that companies can do about this. At the moment, they are able to provide clarification when analysts raise questions, but this is not satisfactory, as the market as a whole needs to understand the situation.

Analysts are particularly interested in forward-looking information, but the efficacy of the safe harbour provision in encouraging more forward-looking disclosure by preparers is not yet clear. The overall view of annual report preparers is that there has been no step-change in disclosure.

## Type of risk information disclosed in corporate annual reports and constraints on disclosure

The content analysis of 18 complete annual reports finds a large variation in the amount of risk disclosure and this is related, as expected, to company size. A large amount of information on financial and strategic risks is provided. Information on management remuneration, which may be relevant to risk taking, is also extensive. Disclosures relating to 'historical performance/economic cycles' and 'targets' are provided, but to a lesser extent.

The analysis of narrative information shows that non-monetary disclosure is more frequent than monetary disclosure. Only a small percentage (16%) of narrative disclosures relate to the future. The tone of the disclosures is mainly neutral (41%) with 39% being good news and 20% bad news.

Content analysis of the statement of principal risk factors within the annual reports found that 17 of the 18 companies provided a clear statement of risk factors. Fourteen provided information on risk mitigation. The number of risks disclosed ranged from five to 31. No company ranked risks and most of the risks disclosed were general in nature.

The interviews with analysts and preparers reveal that debt covenant disclosure is an issue worthy of further consideration; however preparers are constrained by the banks' desire for confidentiality.

As part of their broader risk analysis, analysts are also interested in understanding managerial remuneration criteria. This is seen as important in risk analysis because it helps analysts understand an important factor that drives managerial decisions. Analysts believe that current disclosures on remuneration are adequate in general terms although there could be better disclosure of incentives further down the organisation.

## Recommendations and policy implications

Regulators and standard setters including the UK government, the Financial Reporting Council (FRC) and the International Accounting Standards Board (IASB) have achieved increases in risk disclosure but this has come at a price. Companies bear the initial costs of preparing and disseminating information that is considered by most analysts to be too general in nature or almost completely ‘boiler-plate’ and of no interest.

Analysts have a vested interest in gleaning information which has not been disclosed and thus the one-to-one meeting is likely to continue even if the regulators require even more extensive disclosures about risks. It is also clear that analysts differ in their views on the usefulness of annual report risk disclosure so any regulation about disclosure is likely to meet with a mixed response.

Thus the key recommendation is for regulators to refrain from requiring more disclosure but to consider some minor clarifications or best practice guidance notes. It would appear that certain regulators are already following this approach. Five specific areas for consideration are noted below:

### 1. Risk factor statements

Apart from disclosing principal risk factors, companies should consider providing a clear layout of the specific risks and mitigations, possibly in the form of a table with columns headed risk, impact and mitigation. Some companies in the sample are already doing this. The analysts interviewed recognised the importance of the location and layout of risk disclosures. Additionally, in respect of the risk factor statements the FRC could consider asking companies to provide information on risk mitigation strategies as a part of a ‘best practice’ guidance note. Also if a risk is removed or a new one is added this should be highlighted and explained.

Analysts are aware that some risks are more important than others but are unable to ascertain which from the current information. Companies themselves maintain detailed risk registers with rankings of the risks and

assessments of their impact. Thus, it would be easy and useful for companies to provide this extra information without going so far as to disclose the probabilities of the risks occurring. Companies putting this suggestion into practice can obtain protection under the safe harbour provisions if the information is found to be incorrect. However, as information overload in annual reports is now a severe problem, the possibility of providing this extra information in a separate report on the company website could be considered. Links could also be provided to recent offer documents that contain a comprehensive list of risks.

## **2. Internal control reporting**

Internal control reporting following the implementation of the Turnbull Guidance in the Combined Code on Corporate Governance (FRC, 2005 & FRC, 2010) appears to have very little impact on analysts. There is only muted demand for more information on how companies deal with internal control problems in the reporting period. Analysts are sceptical about the value of these disclosures, although the disclosures appear to at least offer some reassurance. The recommendation arising here is that no further burden should be placed on reporting companies in respect of internal controls until firm evidence is available to justify this.

## **3. Forward-looking information**

Although annual reports lack timeliness and are mainly historical, the findings show that the safe harbour provisions in the Companies Act 2006 have done little to encourage companies to provide more forward-looking information. The UK government has no need to revise the safe harbour provisions at this early stage because there was no demand for this from the annual report preparers or users. Once the legislation has been tested in the courts, there will be more evidence on whether or not the provision needs amending. However, companies need to consider the benefits of increasing the amount of forward-looking information.

#### **4. Financial instruments and pension risk disclosure**

There is evidence of dissatisfaction from both users and preparers with the clarity of risk disclosures required by the IASB in relation to financial instruments and pensions. Given that financial instruments and pensions are by their nature complex and difficult to understand, unless a person is a financial expert. Companies can consider offering plain language explanations as separate documents on their web-sites. This might reduce the level of questions received from analysts and provide all investors with some help.

#### **5. The IASB and management commentary**

The IASB decided to develop a guidance document (a non-binding practice statement) on management commentary instead of mandatory IFRS. Based on the findings, we believe that an IFRS is preferable to a guidance document. While it is important that companies are provided with the freedom to discuss issues that are unique to their environment, regulation is important in providing them with a basic platform to report information. One risk is that non-compliance will be high if disclosure is voluntary, as documented in previous research on risk disclosure (Abraham and Cox, 2007). Disclosure regulation results in companies providing some information rather than no information and analysts can then use this as a basis to further question company management. Additionally, the UK companies selected for analysis in this project comply with section 417 (3) (b) of the Companies Act 2006 and provide a description of the principal risks and uncertainties facing them. In all but one of the cases this is in the form of a separate statement. This demonstrates the effectiveness of regulation in the UK. Moreover our results show that analysts' place more importance on the regulated parts of the annual reports than on the voluntary sections.

From the findings, a suggested addition to paragraph 31 of the IFRS practice statement (IASB, 2010), is that companies should be required to highlight how risk changes over time, clearly discussing why new risk factors have been added and why certain risk factors have been dropped from the list of key risk factors.

# 1. Introduction

This project is concerned with the usefulness of risk information disclosed by listed companies. Views from investment analysts as a primary user of corporate information and from preparers of company annual reports are elicited. The project also examines risk disclosure in annual reports from a sample of UK listed companies in the food and beverage sector.

Corporate risk reporting is important in helping investors assess the risk profile of a company and enables them to align holdings to suit their risk tolerance. Holland (2005) and Solomon *et al.* (2000) document evidence of user groups relying on annual report disclosure and risk disclosure in particular as a key source of information in decision making. Rules on risk disclosure in company reports are designed to improve transparency of information for investors and analysts. Any improvement in transparency should reduce market distortions and increase the efficiency of capital markets. This in turn will enhance economic productivity and gross domestic product.

The amount of information disclosed by companies has increased substantially over the past few years, partly due to regulation and partly due to the increase in voluntary information disclosed by companies (Campbell and Slack, 2008). While the quantity of information has increased, questions have been raised over the quality of information disclosed and, in particular, the identification of principal risks (FRC, 2009, Campbell and Slack, 2008). Two surveys by the Accounting Standards Board (2009, 2007) on narrative reporting highlights risk reporting as an area for improvement:

*Companies need to assess carefully what are their principal risks and uncertainties, and report on those, together with the approach to managing and mitigating those risks, rather than simply provide a list of all their risks and uncertainties. (ASB, 2007, p.3)*

This research project makes a number of important contributions to our understanding of the demand and supply of risk information.

The Financial Reporting Council emphasises that ‘corporate reporting by listed companies is principally about preparers (who need capital) providing information to users (who have capital to invest)’ (FRC, 2009, p.11). To the best of our knowledge this is the first study to compare views of users and preparers of corporate information specifically on risk disclosure.

The importance of analysts as users of corporate information is well documented in the literature (see Johansson, 2007; Lui *et al.*, 2007; Campbell and Slack, 2008). The IASB’s conceptual framework also identifies equity analysts as a primary user of corporate reports. Relatively less is known of the specific type of information that aids analysts in their assessment of risk and how they use information in annual reports to develop risk perceptions (Botosan, 2004). In addition to interview findings with investment analysts a sample of annual reports were also examined in order to comment on actual risk disclosure practices. Previous studies that examine the entire annual report are based on annual reports published in 2002 and 2001 (Abraham and Cox, 2007; Linsley and Shrives, 2006) which do not reflect current reporting practice.

Understanding risk disclosure from the perspective of suppliers of corporate information is also very important (Pike *et al.*, 1994; Barker, 1998). This facilitates comparisons between the perceived usefulness of risk information from both a user and a preparer perspective, which is important in light of the communications gap, identified by Eccles and Mavrinac (1995), between companies and investors.

The present study should be of interest to policy makers in formulating best practice and mandatory reporting guidelines on risk reporting. The results will also be of direct interest to user groups such as investment analysts, individual shareholders and other stakeholders who rely on company reporting to make commercial decisions. Specifically:

- Insights into the requirements of investment analysts are of interest to company directors and policy makers;
- Findings from interviews with company directors provide evidence of factors that may inhibit full disclosure, such as commercial

sensitivity and civil liability. The project also provides evidence on the effectiveness of policy initiatives, such as the 'safe harbour provisions' introduced in the recent update of Company Law (Companies Act, HMSO, 2006), which are meant to encourage directors to be more forthcoming about forward-looking information;

- The study also contributes evidence on recent policy initiatives that have been and are being enacted to encourage better reporting of risk information, in particular:
  - » the effectiveness of recently introduced mandatory requirements for companies to report on principal risks and uncertainties in their operations; for example the Enhanced Business Review requirements, part of the Companies Act (2006) ([HMSO], 2006).
  - » the effectiveness of risk management disclosure under the revised Turnbull guidance on internal control (Financial Reporting Council [FRC], 2005, paras. 33–38), which falls under section C.2 of the UK Corporate Governance Code (FRC, 2010).
  - » the future of narrative reporting under the government's proposals for a 'Strategic Report' (Department for Business, Innovation and Skills, 2011).
- The international importance of narrative risk disclosure is evidenced by the International Accounting Standards Board (IASB) publication of a Practice Statement Management Commentary in December 2010 (IASB, 2010). Findings from the present study will be instrumental in providing evidence to the Board on the effectiveness of voluntary disclosure and the types of information that most interest investors.

The rest of this report is structured as follows. A brief review of the literature and specific research questions are addressed in the next section, followed by a discussion of the research methods and the main findings. Conclusions and recommendations are discussed in the final section of the report.

## 2. Literature review and research questions

The literature review is divided into three sections corresponding to the eight research questions in this report. A comprehensive analysis of each theme addressed is beyond the scope of this report; however the aim is to focus on the main studies that inform the research findings. These studies contribute to an understanding of the demand for and supply of corporate information. The research questions in this project are also provided in the discussion below.

### The relevance of information sources to analyst decision making

One strand of the literature on the demand for external corporate information focuses on the relative importance of various information sources used by analysts in their decision making process (Pike *et al.*, 1994; Barker, 1998; Bence *et al.*, 1995; Day, 1986). A common finding across these studies is that direct contact with company management is rated as the most important source of information by investment analysts followed by annual reports and other forms of communication from the company including the results announcement and interim statements. Other more general information sources such as the annual general meeting and news media are considered unimportant. A key finding from the prior research therefore is that the company itself is the major source of information for analysts. Direct contact with management provides investment analysts with an opportunity to enhance their understanding of company strategy, to test management's ability to achieve their strategy and to clarify issues (Barker, 1998). While annual reports are not seen as a timely source of information there is general consensus in the literature that they are still important as a source of information for investment analysts (Pike *et al.*, 1994; Barker, 1998; Bence *et al.*, 1995). Analysts are usually aware of the key financial results through the results announcements but the annual report provides an important confirmatory role and also provides further information through the notes to the accounts. Moreover, for analysts interested in studying trends over time the annual report serves

as an important information source. These studies focus on investment decision making in general rather than on risk analysis in particular. Relatively less is known of the specific type of information that aids analysts in their assessment of risk and how they use information in the annual report to develop risk perceptions (Botosan, 2004). This leads to our first question:

**Q1: How important are the various information sources available to analysts in their risk assessment?**

Another strand of research examines the importance of information contained within the various sections of the annual report (Rowbottom and Lymer, 2010; Campbell and Slack, 2008; Rogers and Grant, 1997; Day, 1985). Rowbottom and Lymer document the web page usage of a sample of 15 annual reports and find that the traditional financial statements and the notes to the accounts are used more frequently than the narrative sections of the annual reports. Campbell and Slack's (2008) interviews with investment analysts corroborates this finding. Earlier work by Day (1985) using protocol analysis also finds that financial statements (but not the notes to the accounts) are considered more important by investment analysts than the chairman's statement and the directors' report. Work by Rogers and Grant (1997) reports that analyst use information from the narrative twice as often as that from financial statements. Rowbottom and Lymer (2010) attribute this to analysts obtaining the information from sources other than the annual report. Ranking of the various information sources is helpful to obtain a general view of their relative importance. Bence *et al.* (1995), however note that rather than focus on individual information sources it is more appropriate to consider a cluster of information sources as being complementary to each other. Our second research question follows from this review:

## **Q2: How important is the information available in the annual report to analysts' risk assessment?**

The following questions address this topic in more depth:

- Q2.1: What is the relative importance of quantitative and qualitative information available within the annual report?
- Q2.2: How useful is the information available in the annual report risk factor statements?
- Q2.3: How important is information on managerial remuneration in risk assessment?
- Q2.4: How important are face-to-face meetings to risk assessment and what role does the annual report play in these meetings?
- Q2.5: What type of information on risk would analysts like to see in the annual report?

### [Annual report risk disclosure studies](#)

Prior research into annual report risk disclosure practices can be categorised as follows: disclosure changes in response to new regulatory requirements; the type of risk information disclosed; factors associated with risk disclosure; and differences in risk reporting practices between countries. The first three groups of studies relate to the research questions posed in this report.

In relation to new regulatory requirements, one area of exploration examines the disclosure of market-based risk in relation to the usage of financial instruments (Abraham and Cox, 2007). Dunne *et al.* (2004) finds a significant increase in information disclosed on derivative usage by the FTSE 350 companies after the introduction of FRS 13 in the UK and Roulstone (1999) also finds an increase in market risk disclosure among a sample of SEC registrants after the adoption of FRR 48 in the US. In a more recent study Bamber and McMeeking (2010) also find high levels of compliance with the disclosure requirements of IFRS 7 which focuses on financial instrument disclosures and resultant risks. Abraham and

Cox (2007) report high levels of compliance with the internal control reporting requirements of the Combined Code among their sample of FTSE 100 companies.

While there is a trend towards increased risk disclosure after the introduction of new reporting requirements, there is also evidence of incomplete disclosure. Marshall and Weetman (2002, 2007), note that companies in the UK and the US do not disclose more than 50% of the available information on foreign exchange risk management in their annual reports. They use results from a questionnaire on foreign exchange risk management sent to finance directors and treasury managers to develop an annual report coding checklist. Woods and Marginson (2004) provide further evidence of incomplete market risk disclosure in their study of FTSE 100 banks following the introduction of FRS 13. Bamber and McMeeking (2010) also note that there is some non-compliance with IFRS 7, including the disclosure of sensitivity analysis in the annual report. While previous studies examine annual report disclosure changes in relation to regulatory initiatives, we investigate analysts' views on regulatory initiatives. This leads to our third question:

**Q3: Have recent regulatory initiatives improved analysts' ability to assess risk?**

The following questions address this topic in more depth:

- Q3.1: Does regulation improve the quality of risk disclosure?
- Q3.2: How useful is information on internal controls such as that required by the Turnbull report?
- Q3.3: How important and how useful is financial instrument risk disclosure as required by IFRS 7?
- Q3.4: What are the constraints on full disclosure?

While the quantity of risk information has been increasing in the annual report, concerns have been raised over its quality. A common

criticism is that risk disclosure is dominated by generic disclosure statements which are not useful for investors seeking company specific information (Lajili and Zeghal, 2005; Linsley and Shrive, 2006; Abraham and Cox, 2007; ASB, 2009). This view regarding generic risk disclosures is supported by findings from Campbell and Slack's (2008) interviews with investment analysts. Other criticisms from annual report studies are that risk disclosure is usually qualitative in nature with information lacking on the potential impact of future risk related events. In this research we use the findings from our interviews with investment analysts to create a coding grid which is used to examine the current state of risk reporting in a sample of UK companies. This leads to our fourth question:

**Q4: What types of risk related information do companies disclose in their annual report and how does this compare to analysts' requirements?**

### Annual report preparer perspectives on risk disclosure

Company managers are required to disclose information by the legal and regulatory regimes in which they operate. The requirements relating to risk disclosure have increased for UK companies in recent years. Preparers have a range of choices from disclosing the minimum required to achieve compliance (box-ticking) to providing enhanced disclosures (best practice).

Theories of disclosure assert that managerial motivations influence the quantity and quality of disclosure. While these theories apply to disclosure in general they are also applicable to risk disclosure.

Linsley and Shrive (2000) explain four theories that can be applied to risk disclosure. Agency theory suggests that disclosure reduces owner/manager contracting costs. Signalling theory states that good companies use disclosure to signal their quality to the market. Political costs theory explains disclosure as an attempt by companies to avoid political interference in their activities. Legitimacy theory applies when a company tries to redeem itself after a breach of its contract with society by disclosure of additional information. However, Linsley and Shrive

(2000) also consider that non-disclosure is explained by proprietary cost theory which recognises that companies will not disclose information if it can be of use to their competitors. Previous interview based research with company managers has focused on disclosure in general rather than risk reporting in particular.

Armitage and Marston (2008) investigate whether disclosure is perceived to reduce the cost of equity. They investigate the importance of different types of disclosure in conveying information to the market. Group presentation to analysts, one-to-one meetings and announcements to the Regulatory News Service (RNS) are identified as important channels. However, annual and interim reports are also considered important as they contain background information. For the purpose of this study the following research question is put to company managers:

**Q5: What disclosure vehicles do companies consider important when it comes to helping users understand risk factors and risk management practices within a company?**

The audience for corporate information is another issue found in the disclosure literature. Holland (1997) investigates the relationships between companies, institutional investors and analysts. His research concentrates on private communication channels but also discusses the interaction between public and private disclosure. Marston (1999) surveys investor relations from the point of view of companies and the key audiences of institutional investors and analysts. Both studies, although dated, view expert investors and analysts as the key users of company information but there are other users. A wider group of stakeholders (e.g. individual investors and environmental groups) could use the risk information in the Business Review and Operating and Financial Review. It is therefore of interest to ask preparers:

**Q6: Who are the key audience for risk information in annual reports and is the information used in decision making?**

Companies are in business to earn a return which involves taking and managing risks. Risk information can potentially be of use to competitors. Any type of risk related information that allows competitors to obtain specific insights into the company's opportunities or threats could be used to their advantage. For example, if a company discusses the risk of losing a particular group of contracts, a competitor could attempt to target those customers with proposals to take over the contracts. This problem would be worse if companies were to name the companies in question. Armitage and Marston (2008) in their study of general corporate disclosure practices, find that companies do not disclose information that would be useful to competitors. However, they identify a tension between disclosure and protection of sensitive information. Furthermore they state 'the evidence suggests that release of sensitive information would be seen as a major cost, were companies required or expected to disclose more than they do at present' (p.328). Given the imposition of the Business Review and the requirement to provide details of principal risks and uncertainties the following research question arises:

**Q7: How do companies decide whether or not to disclose a risk?**

Disclosure of forward-looking information in the Business Review has been encouraged by the UK government by the introduction of a safe harbour provision (section 463 Companies Act 2006, [HMSO], 2006,). Without such a provision a company is exposed to potential litigation costs. Meetings with investors have traditionally been used to discuss future prospects, subject to the requirement to avoid the release of price-sensitive insider information (Marston, 2004). Armitage and Marston (2008) identify a reluctance to provide targets regarding key performance indicators and forward projections of financial variables in the OFR. In respect of this regulatory change it is therefore of interest to ask:

**Q8: How far do government policy initiatives encourage disclosure of more forward-looking information?**

While the safe harbour provision should, in theory, lead to disclosure of more forward-looking information there may be problems for the preparers. Collins, Davie and Weetman (1993) explain that in the US context the safe harbour rule creates numerous problems for SEC registrants and their auditors. Deciding how far to go in terms of forward-looking disclosure while remaining within the rules and avoiding legal penalties or litigation is also likely to be a problem for UK companies.

### 3. Research approach

Two elements were used in this study: interviews with investment analysts and annual report preparers; and content analysis of company annual reports. A flow chart representing the research approach including the construction of the instruments is contained in Appendix one.

#### Interviews with investment analysts and annual report preparers

##### Interview approach

Confidential semi-structured interviews were conducted with investment analysts and preparers of annual reports over the period August 2009 to March 2010. A list of questions was prepared informed by a review of the literature; the authors' experiences; then these were discussed with three experts from professional accountancy and finance bodies and with an investment analyst. The questions were broad in nature, allowing interviewees to express their views on wider issues.

Thirty two interviews (21 buy-side and 11 sell-side) were eventually obtained, with a total of 35 analysts, exceeding the initial expectation of 15 interviews. Two analysts were present in three of the interviews. The interviewees were also asked to fill in a short questionnaire in which they rated: the importance of various information sources to their risk assessment; and the importance of different sections of the annual report to their risk assessment. Case reference codes and interview dates are provided in Appendix two.

On the preparer side, interviews were conducted with representatives of 16 FTSE-listed companies. At the time of interviewing, eight were FTSE-100 companies, seven FTSE-250 and one an AIM-listed company. The participants are individuals in a position to comment on the risk disclosure practices of their companies. Case reference codes and sector details are provided in Appendix two.

A letter explaining the nature of the project and the list of questions for the interview were sent out in advance to the interviewees. The interview time ranged from forty minutes to one hour. One researcher was present for all the interviews and the majority of interviews were conducted with at least two researchers present. The interviews were recorded and later transcribed except in one preparer case where recording was not allowed and instead detailed notes were taken. Interviewees were assured anonymity.

### Analysis of interview transcripts

The case data was used in two ways. Firstly, two coding instruments to quantify risk disclosure in 18 UK listed companies were based on the transcripts (research question 4). Secondly, the transcripts were used to provide qualitative insights into the risk information requirements of investment analysts and to understand risk disclosure from a preparer perspective (research questions 1-3, 5-8).

The coding instrument development began with the random selection of ten transcripts which each of the three researchers analysed in detail. Analysts were asked about the type of information they would use in their risk assessment and the type of risk information they would like to see in annual reports; related discussions were coded on the transcripts. A list of risk information categories and information on an ideal risk report were identified in the transcripts. Over a series of meetings each list item was discussed by the three principal researchers to reach agreement on the risk disclosure requirements of investment analysts. Similarities were noted between items identified in the transcripts and those found in published work on annual report risk reporting by Linsley and Shrivess (2006). The remaining transcripts were then coded and any additional items identified in the interviews, were appended to the coding instrument. The suitability of the coding instrument was verified by an expert academic on financial reporting. The final coding scheme consists of two separate coding instruments: 'Risk detail' and 'Risk overview'.

The second part of the transcript analysis draws on a version of the staged approach suggested in Easterby-Smith *et al.* (2008, p.175-181)

and also used in Armitage and Marston (2008, p.320). Initially all of the transcripts were read by the researchers to be familiar with the general findings in the interview. As a second step, the interview transcripts were interrogated using the interview questions as the main themes. For each theme, summary notes were made of the views of each interviewee and the main opinion of each interviewee on each question was established. As part of the conceptualisation process the findings from the study were linked to findings from the literature review.

## Content analysis of company annual reports

Content analysis was used to identify and analyse the risk disclosure practices in the sample company annual reports (Bowman, 1984; Krippendorff, 2004; Beattie and Thomson, 2007). Content analysis is popular in financial accounting research and has been used in a number of previous risk disclosure studies (Linsley and Shrives, 2006; Abraham and Cox, 2007; Woods *et al.*, 2009). In order to document the disclosure of risk information in company annual reports a classification system based on the two separate coding instruments 'Risk detail' and 'Risk overview' was used. The main difference between the two coding instruments is that 'Risk detail' analyses the entire annual report while 'Risk overview' focuses only on the section in the annual report narratives that explicitly highlights risk factors.

### Risk detail

The risk detail coding scheme is similar to the coding scheme used in Linsley and Shrives (2006) but modified in light of the analyst interviews (Ryan and Taffler, 2004, pp.58-59). Risk detail captures two dimensions of disclosure: the category of information disclosed; and the characteristics of the information disclosed based on the coded annual reports.

The categories used are: financial risks; strategic risks; empowerment risks; operations risks; historical performance/economic cycles; targets; integrity; and information processing and technology. An additional two categories ('historical performance/economic cycles' and 'targets')

and five sub-categories were added compared to the coding scheme used in Linsley and Shrives (2006). There were a total of eight categories and 45 sub-categories in which to place each disclosure item. The list of categories and sub-categories can be found in Appendix three.

The characteristics are: whether or not the disclosure contains monetary information; the time frame of the disclosure (past, future or no time frame); and the tone of the disclosure (good, neutral or bad news).

Disclosures are judged as risk disclosures if the reader is informed of any opportunity or prospect of any hazard, danger, harm, threat or exposure that has already impacted upon the company or may impact the company in the future or of the management of any such opportunity, prospect, hazard harm, threat or exposure. The definition of risk and the characteristics are the same as those used in risk-reporting research by Linsley and Shrives (2006, p.389).

A coding guide and grid was prepared and a sample company was coded independently by two of the principal researchers and by the research assistant. A few discrepancies that emerged were discussed, and the coding guide and grid were refined to accommodate this. Coding was then performed by the research assistant on the full sample of companies.

Risk disclosure information is spread across multiple sections of the annual report (Abraham and Cox, 2007; Woods *et al.*, 2009) and therefore the entire annual report was examined. Woods *et al.* (2009) highlight that risk disclosure information can be provided in a number of formats including narratives, tables and graphs and therefore content analysis on the narratives will only partially capture the ways in which risk information will be useful, a theme reinforced by Beattie and Thomson in their discussion of content analysis (Beattie and Thomson, 2007). It is also clear from the interviews that analysts find information in other formats, such as tables, to be useful. Sentences are used as the unit of analysis and measurement for narrative information in line with suggestions by Milne and Adler (1999). For other formats, headings are used as the unit of analysis, and text units for measurement (See Beattie and Thomson, 2007, pp.154-155 for an example of using text units for measurement). Coding was performed manually on the annual report and the results

electronically scanned for ease of sharing primary data. Primary financial statements we excluded from the coding but the notes were included.

### Risk overview

After completing a detailed analysis of the annual report, a second coding instrument, 'Risk overview', was used to code information explicitly titled as risk factors in the narrative reports. Under the Companies Act 2006, companies are required to disclose their principal risks and uncertainties in the annual report. These were found in the reports under sections entitled 'Principal risks and uncertainties', 'Key risks' or 'Risk factors'. While risk detail (the coding instrument discussed above) codes the entire annual report, the focus of risk overview is the explicit disclosure of significant risk factors. Robert Wiseman Dairies plc. (RWD) makes this clear in its report: 'These are not all of the risks which the Directors have identified, but only those that the Directors currently consider are likely to be material' (p.12). Campbell and Slack (2008) note that 'the segregation of risk information into a dedicated section is a relatively recent innovation' (p.20).

The risks reported by individual companies were summarised. This includes the number of risks in the risk section and the risks for which no mitigations are in place. A record was kept of any company-specific risks such as negotiations, legal disputes or extreme pension deficits. In addition, a general commentary was written on risk reporting, to encapsulate findings not captured in the rigid structure of the data table. The analysis of risk overview was performed by one of the principal researchers and was verified by another principal researcher.

### Annual report sector and time period examined

The analysis aimed to use the annual reports of the 19 UK-based companies listed in April 2009 under the food & beverages sector of the Financial Times Share Service. Of these reports, 18 were successfully located, as one of the companies had subsequently delisted. The analysis was conducted for the year end 2009, which was after the Companies

Act 2006 came into effect. The Enhanced Business Review (part of the Companies Act 2006) applies to the annual reports of all quoted companies released after October 2008 (Companies House, 2009). The choice of a single sector is for comparability purposes and also because firms in the same industry are expected to be affected by similar factors.

## 4. Findings: Analyst questionnaire and interview results

The findings related to the first three research questions are discussed in this chapter. The questions are:

- Q1: How important are the various information sources available to analysts in their risk assessment?**
- Q2: How important is the information available in the annual report to analysts' risk assessment?**
- Q3: Do analysts perceive recent risk reporting regulatory initiatives as useful in providing information that is relevant to their risk assessment?**

### Importance of various information sources in risk analysis

Table 1 summarises the analysts' ratings of risk information sources appearing in the questionnaire, on a scale of 1–5, with 5 signifying high importance and 1 denoting low importance. Meetings with management and results announcements are rated as most important, whereas financial news channels and internet bulletins are rated as least important. While some information sources are considered more important than others, it is clear from the interview discussions that opinions on risk are synthesised from a variety of complementary sources. Commonly discussed sources include meetings with company management, third-party research, annual reports and interim announcements. Analysts note that risk analysis is seldom conducted as a separate exercise and tends to be integrated into the investment decision-making process.

**Table 1 Importance ratings for risk information sources (Mean, spread and distribution)**

Information source	Mean	S.D.	Importance rating (1–5)				
			1	2	3	4	5
Meetings with management	4.5	0.7		1		16	<b>20</b>
Results announcements	4.2	0.9	1		5	<b>16</b>	15
Trading statements	4.1	0.8	1		6	<b>19</b>	11
Peer companies	4.0	0.5			5	<b>25</b>	4
Annual report & accounts	3.9	1.0		4	10	10	<b>13</b>
Industry experts	3.8	1.0	1	4	6	<b>18</b>	8
Analysts	3.6	1.1	2	5	7	<b>15</b>	7
Interim statements & quarterly reports	3.6	1.0	1	4	<b>13</b>	11	8
Interim reports and accounts	3.4	1.0	1	5	<b>18</b>	6	7
Market news	3.2	1.0	2	4	<b>19</b>	8	4
Newspapers	3.0	0.9	1	10	<b>16</b>	9	1
Financial news channels	2.8	0.9	2	11	<b>17</b>	6	1
Internet bulletins	2.3	1.1	9	<b>13</b>	7	5	1

Notes

1. Modal counts shown in bold.
2. Not all sections were rated by the 37 respondents.
3. Two analysts filled in the questionnaire but did not take part in the interviews.
4. Rating: where 1 = low importance and 5 = high importance.
5. SD = standard deviation.

Importance of face-to-face meetings as a source of risk information

Meetings with management are ranked by the investment analysts as the most important source of information in the questionnaire (See Table 1). The analysts note in the interviews they meet management at the results announcement or soon after. Risk is one of many issues discussed during the meetings. Analysts prepare by reading annual

reports, results announcements, broker reports (in the case of buy-side analysts) and other publicly available information sources and use them in formulating questions to ask during these meetings. Analysts were asked approximately how long they spend preparing for the meeting; responses vary from one hour to three to four hours, half a day, one day and one week. The most common response is three to four hours; this is a short amount of time considering the volume of information available to digest. The time spent depends on whether the analysts already have experience of following the company, in which case they spend less time studying it prior to the meetings. Analysts on both the buy-side and the sell-side note that, owing to time pressures, it is difficult to devote a significant portion of their time to preparing for meetings.

Analysts were asked about the importance of face-to-face meetings to overall risk assessment, with the discussion focusing on whether meetings with management act as a substitute or complement other external sources of information in their risk assessment. Five analysts did not comment on this. The interview responses can be grouped into two categories:

- Face-to-face meetings are very important in understanding the overall risk to an investment. The majority of analysts fall into this category (22). Meetings provide an opportunity for them to glean more information than is available from public information sources, such as the annual report. In particular, they point out that the meetings provide them with an opportunity to understand strategy and to question management about associated risks. The meetings are also used by analysts to gauge the quality of management, albeit in an intangible way.

*They're complementary, the company meetings are really useful when you've done a lot of homework and you can ask exactly the right questions. If you go to a company meeting without having done the homework then they're useless. (BS18)*

- A few of the analysts are sceptical about the value added by face-to-face meetings (5). One view is that only limited information is gained from subsequent meetings unless there is a major change within the company.

*I think it's interesting and useful but I believe that after I've met a company two or three times, the marginal utility of me meeting them again is quite low. I don't think that I extract any particular new information from an hour-long meeting with the CEO unless the guy's changed or if there's been a strategic change it's useful. If every six months I meet the CEO, we just sit there and talk about how's the weather, so I don't find it particularly useful, but the initial meeting where you can judge whether this is an aggressive company, or a long-term focused company, that's useful, but on an ongoing basis I don't find them useful. (BS4)*

## Importance of the annual report in risk analysis

### General findings

The annual report has an average rating of 3.9, and no respondent gave it the lowest rating (see Table 1). In the interviews the analysts note that annual reports are seen as useful in understanding trends in operating performance and associated risks and particularly so when assessing an investment for the first time. However, analysts find that annual reports lack timeliness as information in the primary financial statements is already provided through results announcements. As analyst SS4 notes: 'There's no doubt that that [the results announcement] is what drives markets'.

For most of the analysts (23), the annual report is of secondary importance since its release has no immediate impact on share prices. Extra information such as that available in the notes to the accounts, the management commentary and information on remuneration is seen to be useful for detailed risk analysis. Nine analysts view the annual report as being of primary importance in understanding overall

investment risk. They note that it is the most comprehensive source of information available about a company and is therefore critical to their risk assessment.

*There are times when we ask to wait. We say we would rather wait till you have produced the [annual] report and then we will have our meeting. (BS20)*

*I would start with the annual report; I guess it's a little bit classical, and I would try to read it cover to cover. (BS15)*

### Risk information sources within the annual report

Analysts were asked about the relative importance of quantitative information compared to narrative information in their overall risk assessment. Table 2 presents the respondents' importance ratings for various sections of the annual report.

**Table 2 Importance ratings in relation to risk for the annual report sections**

Annual report section	Mean	S.D.	Importance rating (1–5)				
			1	2	3	4	5
Cash flow statement	4.5	1.0	2		1	8	<b>26</b>
Balance sheet	4.5	0.9	1		4	7	<b>25</b>
Income statement	4.4	0.9	1		3	12	<b>21</b>
Segmental information	4.3	0.8		1	6	11	<b>18</b>
Accounting policies	4.3	1.0		3	4	10	<b>20</b>
Notes to the accounts	4.1	0.9		1	8	12	<b>15</b>
Financial risk factors	4.1	0.9		3	5	<b>16</b>	13
Accounting estimates & judgements	3.9	0.9		2	11	<b>12</b>	<b>12</b>
Chief Executive review	3.7	0.9		3	<b>15</b>	10	9
Five to ten year summary	3.5	1.1	2	5	10	<b>12</b>	8
Other - Operating & financial review	3.4	1.0	1	4	<b>16</b>	11	5
Directors' remuneration report	3.3	0.9		8	<b>13</b>	12	4
Statement of gains and losses	3.3	1.2	3	7	9	<b>11</b>	7
Business risk factor statement	3.3	0.9		7	<b>17</b>	8	5
Auditors' report	3.3	1.2	1	<b>11</b>	10	6	9
Chairman's statement	3.2	1.0		<b>12</b>	9	<b>12</b>	4
Financial risk controls (qualitative)	3.2	0.9	1	6	<b>17</b>	11	2
Directors' report	3.2	0.8	1	6	<b>17</b>	12	1
Performance highlights	3.0	0.9	3	7	<b>15</b>	12	
Directors' profile	2.9	1.1	4	9	<b>13</b>	9	2
Risk management & internal control	2.9	1.1	4	9	<b>14</b>	7	3
Shareholder information	2.8	1.1	2	<b>16</b>	9	7	3
Company profile ('What we do')	2.8	1.1	5	9	<b>15</b>	6	2
Compliance with combined code	2.6	1.0	5	<b>13</b>	11	7	1
Other - Corporate governance report	2.6	0.9	4	<b>14</b>	12	6	
Corporate social responsibility report	2.2	1.0	10	<b>13</b>	10	4	

Notes

1. Modal counts shown in bold.
2. Not all sections were rated by the 37 respondents.
3. Two analysts filled in the questionnaire but did not take part in the interviews.
4. Rating: where 1 = low importance and 5 = high importance.
5. SD = standard deviation.

In general, analysts consider the information available in the financial statements and in the notes to the accounts to be of higher importance than the narrative reports within the annual report. Reasons provided for this in the interviews include:

- **Factual information:** Since the financial statements and the accompanying notes are audited, the analysts have more faith in this information than in the narrative reports, which are not audited and hence are seen as biased.
- **Risk measures:** The key measures used to assess the risk profile of a company are quantitative measures such as earnings growth, earnings revisions, debt ratios and the cost of capital.
- **Time:** Given the limited time available, analysts tend to focus on what they consider to be the most important information. Rather than having to read and process large chunks of narratives, they can obtain a quick snapshot of the company's financial performance from the numerical information provided in the financial statements.

The following quote summarises the view of the majority of analysts on this issue:

*There's an old adage in the industry whereby for the report and accounts you read the report and accounts from the back to the front so the most important part of the report and accounts for most analysts is actually the factual information of reported p&l [profit & loss], cashflow, balance sheet and the supporting notes as well ... less weight is actually attributed to Chairman's statements because that is quite often skewed shall we say and weighted to a greater degree of marketing speak and could we say spin as well. (SS7)*

Nine of the analysts take a differing view and find the narrative information to be equally important in assessing the overall risk profile of the company.

*I suppose as an investor, you believe that the numbers have to be there or thereabouts, but the chances of you getting them 100% right are next to zero, and what's more important is the journey of those numbers, and then the journey of the valuation attached to those numbers if you like ... And a lot of that will come from the qualitative sort of discussion around how you're going to achieve your forward-looking strategy, and what you can infer the numbers to be, so that's very important. (BS18)*

There are three governance specialists in our sample of investment analysts and we examined the questionnaire results to test whether there were any differences of opinion between this group and the rest of the analysts. We find that there were no significant differences of opinion concerning the various sources of risk information between the two groups. However, some differences were found in relation to the importance of sections within the annual report. We find that the governance specialists rate the chairman's statement more highly than the other analysts. There are also differences in the importance of the financial statements (Income Statement, Balance Sheet and cash flow statement). In each case the non-governance specialists valued these sections more highly. However, having only three governance specialists in our sample means that it is difficult to generalise the results.

#### Importance of the risk factor statements as a source of risk information

Analysts were asked in the interviews whether they found the risk factor statements in the annual reports to be useful in their risk assessment of the company. Twelve analysts did not comment on this aspect. Responses vary and are arranged into three strands:

- Annual report risk disclosure is very general and therefore provides no additional relevant information to that known via external sources and prior knowledge of the company (7 analysts).

*They're not that helpful. They will merely point out that the company does most of its trading in the form of former Soviet Union states*

*then it's subject to risks pertinent to Russia, so well ... you know you would have understood that by the time you get there ... I think a lot of the risk statements within report and accounts are sort of mother statements. (BS14)*

- A second group of analysts (9) note that the annual reports are useful because occasionally a risk factor that they had not considered is highlighted by management.

*I want to make sure that there isn't like in my XX mining company example where there was something that actually was mentioned .... And it was quite interesting because the sell side wasn't aware of that so I gave a call to a couple of analysts and they were quite surprised with the fact that I noted. (BS16)*

- A minority of analysts (4) note that annual report risk factor statements are very useful in evaluating the key risks involved in their investment. They point out that a large list of risk factors is helpful in evaluating the broader risks affecting the company.

*Normally they're not, they're seen as just a sop, just something that's been thrown together, but I actually find them quite useful because somebody's had to think about what the risks are here, and invariably if things go wrong they have been covered in the risk side somewhere. (SS11)*

The same analyst was asked whether risk factor disclosures had been borne out in actual events:

*Well, every single annual report... It's in there. I agree though that I've been an analyst for ten years and I wouldn't have spent a long time reading the annual report when I started out but in the last few years I've realised that actually reading it cover to cover is quite useful because there is stuff in there that people don't bother with. (SS11)*

## Importance of remuneration disclosure as a source of risk information

The importance of information on managerial remuneration is a theme highlighted in the discussions with experts conducted prior to the interviews with analysts. In some cases (four of the buy-side analysts and one sell-side analyst) analysts discussed this issue without even being specifically asked.

It is clear from the interviews that information on remuneration is not central to the investment case but is of second-order importance.

*Remuneration is important, and that's another reason why the annual reports are very useful, and clearly in that situation for investors who want compensation aligned as much as possible to shareholder interests ... so yes it is important but in terms of a risk perspective, and I don't know if it really comes into my thinking there in terms of the cash flow streams of the business. (SS4)*

From a risk perspective it is not solely the magnitude of remuneration that is of interest but also the remuneration criteria. Analysts are interested in understanding how remuneration criteria affect managerial behaviour and hence the overall risk of an investment. In particular, they wish to identify whether the remuneration criteria are aligned to the company's overall strategy.

*What I think about is where could profits get to, because if there's a profit-related pay element, then it's important, so if you know that if the company achieves 20 million profit then the directors get a big payout, then you know there's a good chance they'll get there. You know, if they're close, that they'll push it and try and get there, so that can be very valuable in knowing what the company targets are. (SS11)*

Interviewees note that the annual report provides most of the information they need on remuneration. Some of the buy-side analysts (7) also rely on their corporate governance specialists to supply them with information on remuneration parameters.

While both sets of analysts show interest in understanding remuneration parameters, there is more interest from the buy-side analysts. Some of the sell-side analysts (5) note that remuneration is not seen as a factor that has an immediate impact on share prices and that therefore there are limited incentives to focus on this aspect given their time constraints.

### Analysts views on risk reporting regulatory initiatives

The main questions centred on the effectiveness of regulation in general, the importance of internal control disclosures and financial instrument disclosure. Some of the analysts discussed issues in relation to pension disclosure and the constraints on disclosure.

#### General issues

A general feeling is that the amount of information has increased as a result of various regulatory initiatives, including the implementation of IFRS. The Enhanced Business Review and OFR are not specifically mentioned by most interviewees, although one analyst (SS4) confirms that key performance indicators are useful. Another (BS18) feels that regulation is effective in theory but difficult in practice, noting that the value of the Business Review is impaired by the problem of litigation risk despite the safe harbour provisions. More information is generally considered to be a good thing. However, as the following quote shows, this can be a mixed blessing for sell-side analysts who are in competition with each other:

*The amount of the required data that has to be published has gone up in recent years. We will never say they produce enough because there is always more. What would I really like? I would like to receive a company's subsidiary and group management accounts on a monthly basis which is an unrealistic desire. Though the regulatory process has*

*made it a lot more open. However, it doesn't help us if everybody else [analysts] has the same information. (SS2)*

Some interviewees express negative views about regulation. The effects of regulations are viewed as 'mixed' (BS21), 'ineffective and having unintended consequences' (BS7), 'hard to evidence' (BS2) and of 'doubtful value' (BS1). Another interviewee (BS12) states that, as long as companies are reporting something, this can then be discussed with management, indicating that more compulsorily reported information cannot replace direct contact with management.

One interviewee (BS3) considers this to be a hard question to answer overall and that, while regulation is essential, so is enforcement, and regulation has to be clear. Despite initially giving an unequivocal 'yes' in response, another interviewee goes on to mention the unintended consequences of the implementation of IFRS:

*Yes, I mean that's 100% yes. There's no doubt about it. The problem is in setting accounting standards there's lot of unintended consequences in what they put into place, and IFRS has many issues across certainly the financial sector for example and it doesn't impact other sectors as much, so the question is how do you create a homogenous set of accounting standards across many different industries that have different driving factors and different risks? (BS18)*

## Internal control disclosures

In respect of internal control disclosures required by the Turnbull Guidance section of the Combined Code on Corporate Governance (FRC, 2005 & FRC, 2010), none of the sell-side analysts considers them important to read. One rarely reads them, while another states that the assertions are difficult to check. The general feeling is that they offer reassurance along with the audit report but that the details are of no interest.

Nine buy-side interviewees agree that internal control disclosures are not important reading. Additional comments indicate that they are 'irrelevant' (BS5), 'add no value' and are merely there for 'assurance' (BS15). A frequent reason given for not reading them is lack of time.

Others on the buy-side state that they sometimes read the disclosures or at least part of them. Internal control over derivatives is mentioned as being an important disclosure (BS4). For small-cap companies the disclosures are particularly important, according to BS1. Others state that they do not read them apart from ‘at the extremes’ (BS16) or ‘unless there is a concern’ (BS21). One comment is that the disclosures are ‘too much’ and that the interviewee is ‘only interested in the exceptions’ (BS10).

Some interviewees discussed whether internal control disclosures are more interesting for analysts if companies disclose where controls fail and how they are rectified. Views on this are mixed with no clear opinion either way. Several interviewees note that some companies are doing this anyway, particularly if it is material. Eight interviewees agree that such disclosure may be interesting, while others point out the difficulties of putting the idea into practice.

*No, I think they would always pick up nice things, they would always pick up things which tend to prove that they are very good and once again the ability to understand that, to check that would be very small. (SS8)*

## Financial instruments disclosures

A number of comments related to the disclosures associated with financial instruments required by IFRS 7. Three sell-side analysts state that they are definitely useful. The general feeling of buy-side analysts is that these disclosures are important but difficult to understand. Others believe that the disclosures are inadequate or misleading.

*Most of the financial instruments disclosures currently give you no flavour whatsoever. Quite a lot of them are over the counter instruments, and you’ve no idea what’s written into the actual over the counter contract, and therefore you may blithely think it’s a plain vanilla interest rate swap, and it turns out it’s not and that’s where companies again and again get blown up. (BS14)*

*I find this quite a hard question... there's a danger if you add another 50 pages on here of regulatory requirements that nobody's going to read it, that's a huge danger, so I think that regulation is essential, and I think that enforcement is essential, and I think that the regulator is being exceptionally weak really in terms of genuinely disciplining people. (BS3)*

Three sell-side analysts agree that they read the sensitivity analysis despite reservations about the information. Eight of the buy-side interviewees specifically mention sensitivity analysis. Six are in favour of the provision of this analysis, one (BS2) feels it is difficult to understand and the other does not look at it (BS5).

*If we're looking at a high-debt company then I would certainly look at sensitivity analysis on debt instruments. If it's a company that's got a hedging policy and has got a very high level of overseas trade then of course I would look at the sensitivity to foreign exchange swaps and hedging instruments and those types of statements. So I do pay some heed to them, but I do probably question some of the assumptions behind them, after all these aren't externally verified, they're illustrative. (SS7)*

One analyst prefers to obtain information by asking the company rather than looking at the notes in the annual report.

*I think exposure to foreign currencies is something you look at but you generally talk to a company about that, get their percentage sales, in China for example, and you model that out. So that's important. If you go to the annual report for it, it's not the financial instruments note, that's very complex, and very lengthy, and I'd say very little attention is placed on that. (SS4)*

## Pensions disclosures

Six interviewees mention pensions disclosures. Extensive disclosure is now required since implementation of International Accounting Standard 19. Two interviewees (BS21 and BS11) find the disclosures difficult to understand. One other mentions that pensions accounting can cause distortions:

*Pension liabilities... yes I suspect we need to be a little more sophisticated on that in terms of... I mean my personal preference is to take the liabilities and assets and put them on the balance sheet and just see what happens. But in so many companies that's such a huge distorting factor that you do just wonder how relevant it is. (BS7)*

## Constraints on disclosure

Five interviewees comment on the realistic constraints on disclosure. The danger of releasing information to competitors is mentioned by one interviewee (BS11). Another discusses the problems around segmental disclosure (BS19). The confidentiality surrounding covenants is a bar to more disclosure, according to BS18. It is noted by another interviewee that companies do not like to disclose unappetising facts and that principles-based regulations therefore do not work (BS8). There is also a suggestion that many top-level managers of large companies are aggressive and therefore it is not in their nature or interests to describe failings in the business (BS20).

## Summary

Investment analysts use a number of information sources concurrently in their risk analysis. While the annual report suffers from a lack of timeliness, some analysts still find it very important to their risk analysis because it offers extensive information. In general, analysts prefer to use numerical information, but a few analysts emphasise the importance of narrative information in the annual reports. While

face-to-face meetings are important to risk analysis, publicly available information sources are key in formulating questions to ask during the meetings.

There is no overall feeling that regulatory initiatives increasing disclosure of risk-related information are an unqualified success. In view of the problems of regulating in an increasingly complex business environment, this is to be expected. The complexity of disclosures required by the IASB is a particular problem for users of information, and there is still a desire to talk to management rather than relying on the annual report.

## 5. Findings: Summary of annual report content analysis

This chapter analyses the findings related to the fourth research question:

**Q4: What type of risk related information do companies disclose in their annual report and how does this compare to analysts' requirements?**

As discussed in the methods section, two instruments, 'risk detail' and 'risk overview', are used to analyse the 18 annual reports.

### Risk detail

The number of risk items disclosed in the 18 annual reports range from 200 to 1,651, with an average of 786. This is dominated by information in tables since each cell counts as one piece of information. The average is reduced to 198 (57-418) if only narrative disclosures are included. This indicates that non-narrative information contains approximately three times as many disclosure items as the narrative.

Table 3 presents the disclosure by category using two additional criteria. The first criterion is that the disclosure is found in any section of the annual report or only in the narrative of the annual report. The second criterion is that the disclosure can be either in any subcategory or only in a subcategory mentioned by analysts during the interviews. Any subcategory refers to items in the Linsley and Shrides (2006) coding scheme and any additional items mentioned by analysts during the interviews as discussed in the research methods chapter. The four combinations of these two criteria are displayed in Table 3. Only 438 items (3.1%) were omitted when considering items only mentioned by the analysts during the interviews. Removing sub-categories not mentioned by analysts appears to have little impact, and subsequent analysis is therefore based on all the categories.

Of the total disclosures, 37.1% relate to ‘financial’ disclosure, 24.3% to ‘Strategic’, 18.4% to ‘empowerment’ and 16.1% to ‘operations’. Far fewer items concern ‘historical performance’ (1.9%), ‘targets’ (1.7%), ‘integrity’ (0.3%) and ‘information processing’ (0.2%).

**Table 3 Risk disclosure items by category**

	All categories				Analyst sub-categories			
	All information		Narrative only		All information		Narrative only	
Category	Total	%	Total	%	Total	%	Total	%
Financial	5,245	37.1	720	20.2	5,245	38.3	720	22.0
Strategic	3,441	24.3	1,085	30.4	3,427	25.0	1073	32.7
Empowerment	2,599	18.4	313	8.9	2,495	18.2	302	8.9
Operations	2,269	16.1	1,250	35.0	1,952	14.3	999	30.5
Historical performance/ Economic cycles	269	1.9	5	0.1	269	2.0	5	0.2
Targets	235	1.7	126	3.5	235	1.7	126	3.8
Integrity	42	0.3	42	1.2	39	0.3	39	1.2
Information processing and technology	26	0.2	24	0.7	26	0.2	24	0.7
<b>Total</b>	<b>14,126</b>	<b>100.0</b>	<b>3,565</b>	<b>100.0</b>	<b>13,688</b>	<b>100.0</b>	<b>3,288</b>	<b>100.0</b>

Notes

1. ‘All categories’ refers to categories and sub-categories used in previous research but modified using findings from the analyst interviews.
2. Analyst categories focus only on the categories and sub-categories mentioned by the analysts in the interviews.
3. ‘All information’ refers to risk disclosure coded in the annual reports, including disclosure in the form of sentences, tables and insets.
4. ‘Narrative only’ refers to risk disclosure only in the form of sentences.

N = 18 annual reports

The predominance of financial information is a consequence of the coding system. The summary of only narrative information reduces the importance of financial disclosure, with ‘operations’ becoming the largest category with 35% of disclosure, followed by ‘strategic’ with 30.4% and ‘financial’ disclosure third with 20.2% of disclosure items.

**Table 4 Risk disclosure items by characteristics**

Panel A All information

Category	Total	Monetary		Time			Tone		
		Yes	No	Past	Future	n/s	Bad	Good	Neutral
Financial	5,245	86%	14%	88%	6%	6%	7%	2%	91%
Strategic	3,441	67%	33%	89%	8%	3%	12%	15%	73%
Empowerment	2,599	60%	40%	88%	3%	9%	3%	0.3%	96.7%
Operations	2,269	52%	48%	90%	7%	3%	15%	52%	33%
Historical performance/ Economic cycles	269	17%	83%	99%	0%	1%	1%	5%	94%
Targets	235	2%	98%	6%	91%	3%	1%	42%	57%
Integrity	42	0%	100%	24%	17%	59%	10%	19%	71%
Information processing and technology	26	0%	100%	31%	69%	0%	8%	63%	29%
<b>Grand total</b>	<b>14,126</b>	<b>68%</b>	<b>32%</b>	<b>88%</b>	<b>7%</b>	<b>5%</b>	<b>8%</b>	<b>14%</b>	<b>78%</b>

Panel B Narratives only

Category	Total	Monetary		Time			Tone		
		Yes	No	Past	Future	n/s	Bad	Good	Neutral
Financial	720	43%	57%	55%	14%	31%	17%	14%	69%
Strategic	1,085	6%	94%	71%	22%	7%	30%	42%	28%
Empowerment	313	8%	92%	23%	16%	61%	2%	3%	95%
Operations	1,250	33%	67%	85%	10%	5%	20%	58%	22%
Historical performance/ Economic cycles	5	0%	100%	100%	0%	0%	20%	0%	80%
Targets	126	4%	96%	11%	85%	4%	2%	50%	48%
Integrity	42	0%	100%	24%	17%	59%	10%	19%	71%
Information processing and technology	24	0%	100%	33%	67%	0%	8%	63%	29%
<b>Grand total</b>	<b>3,565</b>	<b>23%</b>	<b>77%</b>	<b>66%</b>	<b>18%</b>	<b>16%</b>	<b>20%</b>	<b>39%</b>	<b>41%</b>

Notes

1. 'All information' refers to risk disclosure coded in the annual reports, including disclosure in the form of sentences, tables and insets.
2. 'Narrative only' refers to risk disclosure only in the form of sentences.
3. Disclosures are considered monetary if a monetary value is attached.
4. 'Time' refers to whether the disclosure primarily contains information on the past, future or is not time specific ('n/s').
5. 'Tone' refers to whether the tone of disclosure suggests good news, bad news or neutral news.

N = 18 annual reports

Table 4 (Panel A and B) provides information on the characteristics of disclosure, which are whether or not the information contains monetary disclosure, the time frame of the disclosure and the tone of disclosure.

Of the information coded, 68% is classified as monetary information. Of 'financial' disclosures, 86% are monetary, while over half those in the categories 'strategic', 'empowerment' and 'operations' are monetary (Table 4 – Panel A). This contrasts with the narrative-only disclosures, where only 23% of the information items are monetary (Table 4 - Panel B).

The majority of all the risk information disclosed relates to the past (88%) (Table 4 – Panel A). The same applies to narrative disclosures, though there is a larger proportion of future oriented disclosures within the narratives.

Most of the risk information disclosed has no particular tone, with 78% of disclosure being neutral news, 14% good news and 8% bad news (Table 4 - Panel A). However, narrative-only disclosures have a higher proportion of good news (39%) compared to the all disclosure sections (Table 4 - Panel B).

The final analysis considers the coverage of sub-categories contained within annual reports. The annual reports potentially contain disclosure over all 45 of the identified sub-categories (see Appendix three). Table 5 summarises by company the fraction of the sub-categories for which there was at least 1 narrative item and at least 1 item of any type.

On average, 54% (29–78%) of the categories have some narrative disclosure, and 57% (33–80%) contain disclosure of any type. The larger companies tend to provide more complete coverage of the disclosure sub-categories than the smaller companies.

**Table 5 Coverage of the 45 sub-categories for each company**

Company	Percent of sub-categories with:	
	Narrative only	Any information
Unilever plc.	62%	80%
Tate & Lyle plc.	78%	78%
Associated British Foods plc.	76%	76%
Premier Foods plc.	73%	73%
Britvic plc.	64%	69%
A.G. Barr plc	67%	67%
SABMiller plc.	60%	62%
Dairy Crest Group plc.	58%	60%
Devro plc.	58%	60%
Cranswick plc.	56%	58%
Uniq plc.	42%	53%
Northern Foods plc.	49%	49%
R.E.A Holdings plc.	47%	49%
Hilton Food Group plc.	38%	47%
Anglo-Eastern Plantations plc.	36%	42%
Robert Wiseman Dairies plc.	42%	42%
New Britain Palm Oil Ltd.	33%	36%
Carr's Milling Industries plc.	29%	33%
<b>Average</b>	<b>54%</b>	<b>57%</b>

**Notes:**

1. 'Narrative only' refers to risk disclosure only in the form of sentences.
2. 'Any information' refers to risk disclosure coded in the annual report, including disclosure in the form of sentences, tables and insets.

There are eight categories and 45 sub-categories in the coding grid. 'Pension obligation' is an example of a subcategory that falls under the main category 'financial'. Appendix three lists all the categories and sub-categories.

## Summary of risk detail

There is high variation in risk reporting among the sample companies, with larger companies reporting more information, as expected. Companies disclose a large proportion of information on financial and strategic risks, categories that analysts consider to be important. However, based on the 45 sub-categories used in the coding scheme, overall there is substantial non-disclosure. In general, annual reports contain an extensive amount of information on remuneration parameters under the category 'empowerment', an area important to analysts in overall risk assessment. Previous studies on risk reporting document a predominance of non-monetary information because researchers focus exclusively on narrative-only information. The present study finds that a significant amount of monetary information is disclosed in annual reports in non-narrative formats. Much of this information is mandated by the relevant International Financial Reporting Standards (IFRS). One reason that analysts prefer non-narrative information is because it provides them with the necessary monetary inputs to use in their valuation models. The findings support their view that annual reports summarise historical information. However, more forward-looking information is available in the narratives. The findings also support analysts' view that narrative information is either very general in nature or positively biased in favour of management.

## Risk overview

'Risk overview' focuses only on the principal risk factors, as discussed in the research approach (chapter two). The 18 annual reports contain a wide range of approaches to risk reporting. This is unsurprising given that the companies range from multinational conglomerates (Anglo-Eastern Plantations plc. and Unilever plc.) to those with a much narrower focus (Robert Wiseman Dairies plc. and New Britain Palm Oil Ltd.). Table 6 provides information on the number of principal risk factors, the title used to identify the risk factors and the location of the risk factors in the annual report for each company examined in this study.

**Table 6 Disclosure of principal risks**

Company	Number of principal risk factors	Risks with no mitigation disclosed	Heading/title in annual report	Location
Anglo-Eastern Plantations plc.	7	7	Risks and uncertainties	Business review
Associated British Foods plc.	13	0	Principal risks and uncertainties	Corporate governance report
A.G. Barr plc	20	17	Principal risks and uncertainties	Business review
Britvic plc.	31	31	Risks and uncertainties	Business review
Carr's Milling Industries plc.	6	6	Principal risks and uncertainties	Business review
Cranswick plc.	6	0	Principal risks and uncertainties	Business review
Dairy Crest Group plc.	13	0	Principal risks and uncertainties	Business review
Devro plc.	8	0	Principal risks and uncertainties	Business review
Hilton Food Group plc.	6	0	Principal risks and uncertainties	Business review
New Britain Palm Oil Ltd.	0	0	None	n/a
Northern Foods plc.	11	0	Risks and uncertainties	Business review
Premier Foods plc.	16	0	Risk factors	Business review
R.E.A Holdings plc.	16	0	Risks and uncertainties	Business review
Robert Wiseman Dairies plc.	11	0	Principal risks and uncertainties	Business review
SABMiller plc.	6	0	Principal risks	Business review
Tate & Lyle plc.	11	0	Key risks	About the business
Unilever plc.	22 <sup>1</sup>	0	Principal risk factors	About the business
Uniq plc	6	3	Principal risks	Business review

Note:

1. There are 10 extra factors that Unilever has included without any further discussion under the title 'Other risks' within the principal risk factor statement.

Nearly all companies report on principal risk factors, and only the report of New Britain Palm Oil Ltd has no section on principal risks. On average, 12 such risks are reported, with Britvic plc. having the maximum of 31, and a number of companies reporting the minimum of six such factors.

### General information or company-specific information?

Principal risk reporting tends to be formulaic, with obvious risks and mitigations included. For example Tate and Lyle plc. state: 'Our success depends upon our employees and the recruitment and retention of key personnel' (p.28, Tate & Lyle plc. report). In some cases, companies discussed regulation as a risk factor but without providing specific examples. For instance, two companies in our sample were investigated by the Office of Fair Trading (OFT), and while this issue is discussed in other sections of the annual report, there is no mention of this in the principal risk statement.

Notably, a few companies break from this format and discuss deeper underlying risks for which no mitigation is offered:

*A decline in the size and prosperity of the dairy farming industry in north west England and south west Scotland, in particular through a reduction in the farm-gate milk price. (p.14, Carr's Milling Industries plc. report)*

On rare occasions, a very company-specific risk is declared, with the consequences spelt out. For example Uniq plc. state:

*A long term funding agreement has been reached with the Trustee which requires clearance from the Pensions Regulator. If clearance cannot be obtained and the parties are unable to find an agreed solution to funding the deficit of the pension scheme, there is a risk that the Trustee may decide to exercise its power to wind up the scheme which in turn would lead to the winding up of the company. (p.20, Uniq plc. report)*

## Mitigation

Of the 17 companies that disclosed principal risk factors, 14 also provide information on strategies to mitigate the risks. Some also supply a clear layout of the specific risks and mitigations. These are mostly in the form of a table with the headings 'Risk', 'Impact' and 'Mitigation'. The location and layout of risk disclosure is seen to be very important by the analysts interviewed. Analysts expressed a desire for risk disclosure to be grouped together in one section of the annual report, rather than spread out throughout the report. The remainder of the companies provide no specific information on mitigation within the risk factor statements.

## Risk rankings

No company in the sample gives explicit risk rankings or ratings, although the order of risk reporting in some cases may be inferred as a ranking. In general, the risks are arranged by category, for example 'operational' and 'financial'. Although Premier Foods plc. mentions the use of internal risk ratings, these are not detailed in its annual report.

## Summary of risk overview

Of the 18 companies, 17 provide a list of risk factors in line with the requirements of the Companies Act 2006. Most of the information disclosed is general and therefore known to an informed investor. However, in a few cases, company-specific information is provided in the principal risk factor statements. Analysts note that the location and presentation of risk information is important: some companies choose to present information using clear headings with links to other pages where further information on risk is provided. Companies provide no specific ranking of the risks and do not highlight the most significant risk factors, which would be useful particularly when more than ten factors are listed.

## 6. Findings: Risk reporting – preparer perspectives

This chapter discusses the results of the interviews with representatives of 16 FTSE companies in relation to the following research questions:

- Q5: What disclosure vehicles do companies consider important when it comes to helping users understand risk factors and risk management practices within a company?**
- Q6: Who are the key audience for risk information in annual reports and is the information used in decision making?**
- Q7: How do companies decide whether or not to disclose a risk?**
- Q8: How far do government policy initiatives encourage disclosure of more forward-looking information?**

### Importance of annual reports and other disclosure vehicles

The first question addresses what disclosure vehicles the 16 preparers consider important in helping users understand risk factors and risk management practices within a company. Interviewees comment on the following non-exhaustive list of suggestions: annual reports; regulatory news service (RNS) announcements; conference calls with investment analysts; and one-to-one meetings with fund managers.

Several interviewees mention various categories of information user, including expert users, such as analysts, fund managers, fixed-income investors and corporate governance monitoring officers, and less expert users such as retail investors and employees. Regulators are also considered to be a user group for the regulated sector companies. It is generally recognised that different disclosure vehicles serve different user groups in different ways. For example, retail investors do not have access to one-to-one meetings, so the annual report is likely to be more important for them than for institutional investors and analysts.

Most interviewees (14) acknowledge the importance of the annual report. However, for expert investors, direct contact via one-to-one meetings and presentations are also vital. Two interviewees deem meetings and seminars to be the most important, with the annual report being less relevant. Three interviewees feel that all disclosure vehicles, including the annual report, are essential.

*I think the most important medium is the annual report and accounts because it's the formal universally available reference point. One-on-ones and presentations can usefully amplify and explain the technical data and disclosures in the accounts. (FD6)*

The private investor is viewed as the main user of the annual report by three of the interviewees.

*I think once you know a business, nobody ever looks at the annual report because it's so big. Are you going to find anything new? Which is why we aim our annual report at the private investor. (FD4)*

For expert users the annual report suffers from being historical and containing no new earnings information, as interim reports, interim management statements, trading updates and results announcements enable expert users to predict key accounting numbers prior to the issuance of the annual report. Preparer interviewees feel that analysts are mainly concerned with accounting numbers that can be input into their models. Thus, additional qualitative information and detailed notes in the annual report serve merely as background information.

*The bulk of the substantive information, other than the notes to the financial statements, has been disclosed in the press release that comes out say a month before the annual report is actually published and so the annual report itself, if we're talking about the hard copy that's sent out, it has no new news in it per se. It has merely elaborating details to the financial statement which is not of particular interest to most of our investors. (IR4)*

One interviewee explains that more-timely risk information is issued via the RNS:

*I think there's a slight distinction in the way we report risks in the annual report, I mean they tend to be the ongoing risks in the business but they tend to be the broader, longer-term risks. You know, the ones that exist today and probably won't be much changed as we embark upon business a year from now. And I guess through the Regulatory News Service (RNS) it's more likely to be around things that have changed you know in the nearer term. (IR7)*

Eight of the interviewees comment critically on the increasing length of annual reports. Another interviewee notes that other sources, such as Bloomberg, provide many news flashes which cause information overload.

### Key audience for risk information

The second question for preparers relates to the audience for risk information. Companies are required to provide information on their principal risks as part of the Business Review requirement of the Companies Act 2006. The voluntary OFR may be used in conjunction with this to provide risk information.

Preparers consider analysts and professional and retail investors to comprise the audience for the risk information. Two interviewees deem retail investors compared to professional investors to be more likely to use the information. Four interviewees consider customers to be particularly interested in the information. Corporate governance ranking agencies, the corporate governance departments of institutional investors and social and environmental organisations are also mentioned.

*Well, the analysts certainly are reading it. Corporate governance people which are becoming much more of a feature now of the institutions will be reading it and commenting on it, and you get a lot of the agency groups who will read these things and indeed write to you about them,*

*particularly round the whole corporate social responsibility, health and safety, corporate governance, round that whole compliance area. They will write to you so it's principally analysts and corporate governance people who will read it. (CH1)*

Although most consider the information to be valuable for users, there are some dissenting views and confusion over just who uses this information.

*Well, you know, that is quite a good question, and the fact that nobody asks us about it makes you wonder whether anybody ever even looks at it. (IR1)*

One topic discussed in the interviews was whether investors and analysts ever ask about risk information disclosed in the annual report. Most interviewees state that they are rarely asked for further information; questions arise only when problems occur or when an unusual item appears in the risk information.

*I've been doing this job for 14 and a half years now and we see about 800 shareholders a year, you know, other than in times of market stress which clearly we've been in for the last couple of years, very little time is spent in shareholder meetings talking about risk. I mean it's only when things are going wrong, people say oh my gosh, something happened over here, could that happen to you, but other than in the current environment, risk is taken as something that that we expect you to manage. That's why you're in your job. (IR6)*

## Usefulness of risk reports

The interviews examined the content of the individual companies' risk factor statements. A number of comments concern the problem of having to include both generic and specific risks and deciding how many risks to include. It is clear that companies expend a great deal of effort in compiling their risk information.

*Well, I think it [risk disclosure] is very good, I think, if people took the time to read it. We take a pride in our annual report, and we actually get good feedback from it from one or two people, that it is written in everyday language, there's very little jargon and it gives a very transparent view of our business, both the positives and the potential negatives, and we've put a lot in, my CEO and I write every word of it every year because we see it as part of our mission to communicate with the 70-year-old who owns our shares on a private basis. (FD4)*

### Usefulness of financial instrument disclosures

One area of risk disclosure relates to financial instruments. IFRS 7 requires substantial detail in the notes to the accounts, and companies can discuss issues such as hedging in their narratives. The usefulness of financial instrument disclosures was discussed with all interviewees. Some are in the financial sector and make greater use of financial instruments than those in other sectors such as manufacturing and retail. The discussions reveal a general scepticism about whether anyone actually reads the detailed notes on financial instruments. It is considered that the notes are difficult to understand unless the reader is a financial expert. One interviewee states that mark-to-market is positively misleading for his company as the accounting treatment of forward-sale contracts appears to create a large loss when the company is actually making a profit. This book loss is ignored by expert investors who understand the situation, but smaller investors become alarmed under the misapprehension that the company is about to go under. A finance director asked whether the disclosures about financial instruments in the notes are important commented:

*No, completely irrelevant. We've lost the plot. Nobody understands it and nobody even looks at it and it costs a fortune to do these disclosures every year. It's a complete waste of money; the accountancy profession has just lost leave of its senses. Completely and totally. They may be important for a bank or for a financial business, but for an industrial business like ours they're a complete irrelevance. And nobody has ever*

*asked me a question on it, and nobody to my knowledge has even read it. And even the auditors say it's a complete waste of time. (FD4)*

### Debt covenant disclosures

Another specific area of risk is funding risk and debt covenants. Preparer interviewees generally agree that disclosures in this area are useful and confirm that analysts do ask for information if it is not in the annual report. The topic is particularly relevant in view of the recent credit crunch. One company has started to disclose its covenants after having had to refinance. The majority of companies disclose information only in general terms if it is relevant. The preparers generally feel that if they have a large amount of leeway and are not running up against covenants then detailed disclosure is not necessary. Most also state that the banks do not want them to disclose the details because of commercial sensitivity. For public issues of debt the details of the covenants are in the prospectus, and investors and analysts can carry out their own analysis. It is also the case that an impending breach of covenant is a material event which needs to be disclosed when it becomes notifiable to the RNS.

*I can see how it would open up a can of worms in terms of you know you would either all gravitate toward the same severe covenants, and there would be a lot of cross examining why you got a certain covenant and somebody else got another one. The company should be able to give some kind of indication of what degree of headroom they have without giving specific disclosure under the detailed covenant calculation which in a facility agreement might run to five or six pages, but you should be able to give some kind of estimate of headroom or you would say the company would need to lose x percent of value before it's anticipated we'd be in breach of such covenants. (FD1)*

### Internal control disclosures

The disclosures on internal control required by the Turnbull Report were discussed in the interviews, leading to a wide variety of opinions.

Some interviewees feel that the information is useless ‘boilerplating’, whereas others state that it is taken seriously by the board and that good internal control is expected in a large organisation. Companies sometimes receive questions about their internal controls, although in general the information is deemed to be there to act as reassurance supported by the auditor’s report. Comments provided include:

*We’ve had two or three meetings with specific teams within an organisation that want to understand more about internal controls and I think, again in the current climate, I think that is becoming more of an issue. (IR6)*

*It’s all political correctness. I think it’s a complete irrelevance to the annual report. If you want to have it you put it on your website and bring it to life. The way that your annual report forces you to write it is boilerplate and you know it just doesn’t work. (FD4)*

The interviews examined whether the inclusion of information on where internal controls are unsuccessful and how they are fixed would be of interest to investors and other users. Interviewees have mixed views on this idea, and issues raised include materiality, the size of the organisation and the role of the auditor.

## Boundaries to disclosure

Interviewees discussed how they decide on the boundary between what they would or would not disclose about risk. One question is whether commercial sensitivity influences disclosure. Views vary in that around half the interviewees consider commercial sensitivity to be an issue whereas others feel that companies use commercial sensitivity as an excuse.

*When we talk about counter party risk we will have specific counter party limits for each counter party that we deal with, also we monitor daily, on a real time basis what our exposures are to each of those*

counter parties. Now we would be very sensitive about – we’re happy to disclose our overall positions which we do – but we would never go into the detail of who we’ve sold to, or what our market exposures are to people. I think there is very much a risk that we could disclose a lot of information that would be used by our competitors. (IR6)

Our view is if the competitor wants to find out about it, they’ll just hire somebody. There are enough people moving around the industry. There’s no such thing as a secret. If your strategy is robust enough, and your business model is strong enough, having competitors who know what you’re doing is not an issue whatsoever and it’s an excuse that people use not to disclose, I think it’s a sign of a very weak business if somebody uses that. (FD4)

Other factors affecting the boundary include the need to avoid information overload, the unlimited demand for more information, customer confidentiality and disclosures by the company’s peer group.

In respect of peer group disclosures, several interviewees state that they examine the risk disclosures made by companies in their peer group. The main reason for making comparisons seems to be to establish best practice and decide whether to emulate it.

*I certainly compare our reporting more generally on a regular basis against our peer group. With regard to the risk section, I actually did a thorough exercise quite a long time ago now. This was probably 24 months ago and we brought in some new reporting in the 2007 annual report as a consequence of that. (IR7)*

## Preparers’ views on regulatory initiatives

The 16 interviews also discussed whether government policy initiatives included in the Companies Act 2006 encourage disclosure of more forward-looking information. Two main aspects are involved: the introduction of the Enhanced Business Review and the safe harbour provisions. The overall view from the interviews is that there has been

no step change in the disclosure of forward-looking information, as companies are already disclosing some forward-looking information. Nine interviewees believe that the safe harbour provisions are not particularly helpful, and various reasons are given.

*No it hasn't. Our views, as it were, are that we would keep within the boundary that we had already created and look more as to what risk reporting was coming out from peer companies before we decided to break out on our own. (FD2)*

Three interviewees feel that the new provisions are positively helpful, while the remaining interviewees have no clear opinion.

*Yes I think it has. I mean I think it was a very helpful safe harbour because it essentially said as long as you had good faith, judgement that what you were doing was right, even if you were wrong. (DFH)*

## Summary

While preparers clearly take great care in drafting risk information in their annual reports, there are differing views about the extent to which this information is used. At one extreme it is felt that 'box ticking' and information overload are problems and that users do not take the time to read most of the risk information. At the other extreme, the information is felt to help investors and others to appreciate the risks of the business.

The majority of interviewees' view is that the safe harbour provision for the disclosure of forward-looking information in the Enhanced Business Review has had little impact. Only three of 16 interviewees believed it had had an impact.

## 7. Key findings with recommendations and policy implications

The key research findings to the eight research questions provide new insights on the topic of risk reporting. The findings are presented under three broad themes.

### Risk information sources

#### **Q1&2 How important are various information sources to analysts in their risk assessment? How important is the information in the annual report to analysts' risk assessment?**

The post-interview questionnaire reveals that meetings with management are considered to be the most important information source with the annual report only ranked fifth of 13. Within the annual report the business risk factor statement is considered to be less important than 14 other items with the cash flow statement being the most important. The interviews reinforce the impression that risk analysis is not seen as a separate exercise but is part of the overall investment decision process. Thus the recent initiatives increasing the amount of risk reporting in annual reports provide incremental assistance but do not appear to have a large impact on analysts.

The interview results reveal that analysts' perceptions of risk information sources differ. While the majority of analysts find face-to-face meetings very important in understanding the investment risk a minority are sceptical of their value. The annual report is read cover to cover by some analysts depending on their investment cycle, although most do not have the time. Annual reports provide an important source of reference material but are historic and lack timeliness.

Views on risk factor statements are similarly mixed. Some consider these statements to be too general, others consider them to be useful while only a minority consider them to be very useful.

**Q5&6 What disclosure vehicles do companies consider important when it comes to helping users understand risk factors and risk management practices within a company? Who are the key audience for risk information and is the information used in decision making?**

Preparers consider annual reports to be important, however, other sources such as announcements, conference calls and one-to-one meetings are also useful. Companies acknowledge that there are various categories of information user and that different disclosure vehicles serve different user groups in different ways. The annual report is considered to be important but mainly for the private investor. Risk information is important for analysts and both professional and private investors. However, companies are rarely asked about the risk information included in their annual reports.

Risk factor statements are prepared with care although there are problems in deciding which risks to include. The distinction between general risks and company-specific risks is also an issue. Including all general risks is unlikely to be acceptable to preparers who are critical of the increasing length of annual reports and aware of the dangers of information overload. However a risk that is general for one company can be specific for another company (e.g. financing risk when a company is in danger of breaching its debt covenants).

## **Regulation and risk information**

The next set of questions relates to how regulation has affected risk reporting and whether it has been beneficial. This includes the Enhanced Business Review mandated by the Companies Act 2006 (Her Majesty's Stationery Office, 2006) which requires a statement of principal risks and uncertainties; the internal control disclosures required by the UK

*Corporate Governance Code* (Financial Reporting Council, 2010); and specific IFRS disclosure requirements such as those for financial instruments, pensions and segmental reporting.

In respect of forward-looking information the impact of the safe harbour provision introduced by section 463 of the Companies Act 2006 (Her Majesty's Stationery Office, 2006) is of interest.

### **Q3 Have recent regulatory initiatives improved analysts' ability to assess risk?**

The general view of analysts is that risk information has increased as a result of regulatory initiatives. The Enhanced Business Review was not mentioned in this part of the interview by most interviewees perhaps because it was specifically discussed earlier in the interview. There is an acknowledgement that regulation is effective in theory but difficult to implement in practice because of unintended consequences. For example, while an increase in mandated information might be seen generally as a good thing, for the individual analyst more disclosure means less chance to find out what other analysts do not know.

Internal control disclosures are not considered to be important although some buy-side analysts do read them. Preparers have mixed views on the value of internal control disclosures although some receive questions on them. Financial instruments disclosures are considered to be useful by some sell-side analysts while buy-side analysts consider them useful but difficult to understand. Sensitivity analysis is read by some analysts but they may need to ask the company for further explanation. Preparers agree that disclosures on financial instruments are difficult to understand. However, the disclosures are required by the relevant IFRSs, and there is little that companies can do about this. At the moment, they are able to provide clarification when analysts raise questions, but this is not satisfactory, as the market as a whole needs to understand the situation. A minority of analysts mentioned pension disclosures and there were comments that they were also difficult to understand. Five analysts discussed the realistic constraints on

disclosures with one comment relating to the problem of overcoming a reluctance to disclose when principles-based regulation applies.

**Q8 How far do government policy initiatives encourage disclosure of more forward-looking information?**

It is unclear if the safe harbour provision has been effective in encouraging more forward-looking disclosure. The overall view of annual report preparers is that there has not been a step-change with nine interviewees believing that the provisions are not particularly helpful. Three preparers consider the safe harbour provision to be positively helpful while others had no opinion.

**Type of risk information disclosed in corporate annual reports and constraints on disclosure**

**Q4 What type of risk related information do companies disclose in their annual report and how does this compare to analysts' requirements?**

The volume of risk disclosure in each of the 18 annual reports analysed is related to company size and shows large variability. 65.3% of the information is on 'financial' and 'strategic' risks, 18.4% on 'empowerment', most of which is in the sub-category management remuneration. Disclosures relating to 'historical performance/economic cycles' and 'targets' provide only 1.9% of the risks.

The analysis of narrative information only shows that non-monetary disclosure is more frequent than monetary disclosure. Only a small percentage (16%) of narrative disclosures relate to the future. The tone of the disclosures is mainly neutral (41%) or good news (39%), with only 20% being bad news.

Content analysis revealed that only one of the 18 companies did not provide a clear statement of principal risk factors within the annual report. There were between 5 to 31 stated risks with most being of a

general nature but no company provides a risk ranking. Fourteen did provide information on risk mitigation.

## **Q7 How do companies decide whether or not to disclose a risk?**

Annual report preparers have mixed views on how much commercial sensitivity influences disclosure. Given a set of regulations requiring disclosure there is a choice between making minimal or extensive disclosures. Around half the interviewees say they limit the detail in their disclosures because of commercial sensitivity.

### Debt covenant disclosures

The interviews with analysts and preparers reveal that debt covenant disclosure is an issue worthy of further consideration. Covenant details are required in public debt prospectuses but not in annual reports although announcements to the RNS are required if an impending breach of covenant is a material event. The banks cite confidentiality to prevent preparers publishing covenant details which would make the information available to others. Moreover loan agreements are long and complex making it difficult or impossible to summarise adequately in the annual report. One compromise is to disclose some indication of ‘headroom’ before covenants are breached.

### Managerial remuneration

Current regulations require extensive disclosure of directors’ remuneration as documented in the content analysis of annual reports. Analysts believe that current disclosures are adequate in general terms although there could be better disclosure of incentives further down the organisation, such as specific internal controls to prevent rogue trading.

## Theoretical implications of findings

As noted in the literature review Linsley and Shrives (2000) explain that agency theory, signalling theory, legitimacy theory and proprietary cost theory can be used to explain disclosure or non-disclosure of risk information. However regulation has to some extent removed the choices relating to risk disclosure as a great deal of risk related information is now required. Companies retain a choice whether to disclose the bare minimum to achieve compliance or whether to aim for best practice disclosure.

While both agency and signalling theory are normally tested using hypotheses applied to large data sets our interviews reveal some relevant insights.

In respect of agency theory the interviews confirm the importance of managerial remuneration and incentive schemes and the disclosure of relevant information. This information helps analysts determine how the interests of managers are aligned with those of shareholders.

Signalling theory predicts that better quality companies will signal this to the market. In the context of risk reporting this can be done by providing high quality informative disclosures rather than 'boiler-plate' disclosures. Additionally, forward-looking information can be used to enable investors to better understand future prospects. Once the signal is confirmed in the future the company will have an enhanced quality rating. A false signal however will result in loss of confidence. The interviews reveal a desire by analysts for high quality informative disclosures and preparers accept the need to provide such information. There is a reluctance expressed by most preparers to provide more forward-looking information for fear of adverse consequences if the predictions are incorrect.

The interviews do not reveal any content directly relating to legitimacy theory. However, satisfactory performance of a company's contract with society does depend on the company complying with regulations imposed by society. Our interviews reveal that compliance with regulations is accepted by annual report preparers as a desirable norm.

Proprietary costs theory is confirmed in a number of interviews where commercial sensitivity is cited as a reason for non-disclosure of information beyond the boundary set by regulation and good practice.

## Recommendations and policy implications

Regulators and standard setters including the UK government, the FRC and the IASB have achieved increases in risk disclosure but this has come at a price. Companies bear the initial costs of preparing and disseminating information that is considered by analysts to be too general in nature (risk factor statements) or almost completely ‘boiler-plate’ and of no interest (internal control disclosures).

Analysts have a vested interest in some information being withheld and thus the one-to-one meeting is likely to continue even if the regulators require even more extensive disclosures about risks. It is also clear that analysts differ on their views on the usefulness of annual report risk disclosure so any regulation of disclosure is likely to meet with a mixed response.

Thus the key recommendation is for regulators to refrain from requiring more disclosure but to consider some minor clarifications or best practice guidance notes. It would appear that certain regulators are already following this approach. Five specific areas for consideration are noted below:

### Risk factor statements

Apart from disclosing principal risk factors, companies should consider providing a clear layout of the specific risks and mitigations, possibly in the form of a table with columns headed ‘risk’, ‘impact’ and ‘mitigation’. Some companies in the sample are already doing this. The analysts interviewed recognised the importance of the location and layout of risk disclosures. Additionally, in respect of the risk factor statements the FRC could consider asking companies to provide information on risk mitigation strategies as a part of a ‘best practice’ guidance note. Also if

a risk is removed or a new one is added this should be highlighted and explained.

Analysts are aware that some risks are more important than others but are unable to ascertain this from the current information. Companies themselves maintain detailed risk registers with rankings of the risks and impact assessments. Thus, it would be easy and useful for companies to provide this extra information without going so far as to disclose the probabilities of the risks occurring. Companies putting this suggestion into practice can obtain protection under the safe harbour provisions if the information is found to be incorrect. However, as information overload in annual reports is now a severe problem, the possibility of providing this extra information in a separate report on the company website could be considered. Links could also be provided to recent offer documents that contain a comprehensive list of risks.

### Internal control reporting

Internal control reporting following the implementation of the Turnbull Guidance in the *Combined Code on Corporate Governance* (FRC, 2005 & FRC, 2010) appears to have very little impact on analysts. There is only muted demand for more information on how companies deal with internal control problems in the reporting period. Analysts are sceptical about the value of these disclosures, although the disclosures appear to at least offer some reassurance. It is recommended that no further burden should be placed on reporting companies in respect of internal controls until firm evidence is available to justify this.

### Forward-looking information

Although annual reports lack timeliness and are mainly historical, the findings show that the safe harbour provisions in the Companies Act 2006 have done little to encourage companies to provide more forward-looking information. The UK government have no need to revise the safe harbour provisions at this early stage but companies need to consider the benefits of increasing the amount of such information.

## Financial instruments and pension risk disclosure

There is evidence of dissatisfaction from both users and preparers with the clarity of risk disclosures required by the IASB in relation to financial instruments and pensions. Given that financial instruments and pensions are by their nature complex and difficult to understand, unless a person is a financial expert. Companies can consider offering plain language explanations as separate documents on their web-sites. This might reduce the level of questions received from analysts and provide all investors with some help.

### The IASB and management commentary

The exposure draft '*Management Commentary*' (IASB, 2009) contained a number of questions for comment. Although the deadline for comments has now passed and the Practice Statement has been issued (IASB, 2010), the present research findings provide some evidence regarding the questions raised in the draft.

The Board has decided to develop a guidance document (a non-binding practice statement) instead of a mandatory IFRS. The findings from this research indicate that an IFRS is preferable to a guidance document. While it is important that companies are provided with the freedom to discuss issues that are unique to their environment, regulation is important in providing them with a basic platform to report information. One risk is that non-compliance will be high if disclosure is voluntary, as documented in previous research on risk disclosure (Abraham and Cox, 2007). Disclosure regulation results in companies providing some information rather than no information and analysts can then use this as a basis to further question company management. Additionally, the UK companies selected for analysis in this project comply with section 417 (3) (b) of the Companies Act 2006. They provide a description of their principal risks and uncertainties which in all but one case is given as a separate statement. This demonstrates the effectiveness of regulation in the UK. Moreover our results show that analysts' place

more importance on the regulated parts of the annual reports than on the voluntary sections (Table 2).

The Board asked for comment on the content elements described in paragraphs 24-39 of the exposure draft.

*It is important that management distinguish the principal risks and uncertainties facing the entity, rather than listing all possible risks and uncertainties. (para. 30)*

The research findings strongly support this statement. Analysts generally believe that disclosure should be concise and relevant and specific to the business rather than a box-ticking exercise covering every possibility.

From the findings, a suggested addition to paragraph 31 of the IFRS Practice Statement (IASB 2010), is that companies should be required to highlight how risk changes over time, clearly discussing why new risk factors have been added and why certain risk factors have been dropped from the list of key risk factors, as noted above.

## Further research

Topics for further research include:

- Annual report preparers and investment analysts identify private investors as a key user of company annual reports. Future research may therefore examine the specific type of information that aids private investors in their assessment of risk and how private investors use information in annual reports and other sources to develop their risk perceptions. In addition, usage of risk information by other stakeholders such as employees, suppliers and customers could be explored in future research.
- The content analysis in this report is based solely on companies in the food & beverages sector and it cannot necessarily be assumed that the findings based on this sector apply across other industry sectors. Examining risk disclosure practices amongst companies in other

sectors would provide a basis for analysing whether trends observed in the present report are common across sectors.

- Examining the developments in communications technology and their implications for enhancing the disclosure of risk related information. The use of company websites and eXtensible Business Reporting Language (XBRL) technology are issues that could be explored further.
- Governance specialists are increasingly becoming a common feature amongst investment institutions. As discussed earlier, our questionnaire results show that governance specialists place different emphasis on sections within the annual report compared to mainstream analysts. Future research could examine the impact of information supplied by this special group of analysts on risk assessment decisions by mainstream analysts.
- Current research on risk-reporting practices focuses on companies based in developed capital markets. An area for future research is to consider risk-reporting practices among companies in the emerging markets of Brazil, Russia, India and China (BRIC). Understanding reporting practices among BRIC companies is particularly important in light of the various economic and regulatory changes that are taking place and the effects these are having on reporting practices. One particular area for research would be the effect on risk disclosure of the IASB's Management Commentary Practice Statement. Interviews with users and preparers of company information in BRIC markets along the lines of those carried out in the present report is another avenue for future research.

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## Appendix 2

Table A2.1 Schedule of analyst interviews

	Job function	Date	Code
1	Investment analyst/Fund manager	08-09	BS1
2	Equity and credit analyst	08-09	SS1
3	Investment analyst/Fund manager	08-09	BS2
4	Investment analyst	08-09	BS3
5	Investment analyst/Fund manager Investment analyst/Fund manager	09-09	BS4 BS5
6	Head of research/Analyst	09-09	SS2
7	Investment analyst/Fund manager	09-09	BS6
8	Investment analyst	09-09	BS7
9	Investment analyst	09-09	BS8
10	Investment analyst/Senior portfolio manager	09-09	BS9
11	Investment analyst/Senior investment manager	09-09	BS10
12	Analyst	09-09	SS3
13	Investment manager	09-09	BS11
14	Investment analyst/Fund manager	09-09	BS12
15	Investment analyst/Fund manager	09-09	BS13
16	Investment analyst/Investment director	09-09	BS14
17	Investment analyst	09-09	BS15
18	Investment analyst	10-09	BS16
19	Analyst	10-09	SS4
20	Analyst	10-09	SS5
21	Analyst	10-09	SS6
22	Investment analyst/Fund manager	10-09	BS17
23	Investment analyst/Head of research	10-09	SS7
24	Investment analyst/Head of research Investment analyst	10-09	BS18 BS19
25	Investment analyst/Head of research Investment analyst/Head of corporate governance	10-09	BS20 BS21
26	Investment analyst/Head of strategy	10-09	BS22
27	Analyst	10-09	SS8
28	Analyst	10-09	BS23
29	Analyst	11-09	SS9
30	Investment analyst/Head of research	12-09	BS24
31	Analyst	12-09	SS10
32	Analyst	12-09	SS11

Notes:

BS = Buy side analyst

SS = Sell side analyst

## Appendix 2 (Cont.)

Table A2.2. Schedule of preparer interviews

	Position	Date	Sector	Code
1	Investor relations officer	10-09	General retailers	IR1
2	Investor relations officer	10-09	Speciality and other finance	IR2
3	Investor relations officer	10-09	Gas distribution	IR3
4	Investor relations officer	10-09	Beverages	IR4
5	Managing director	10-09	Business support service	MD1
6	Investor relations officer	10-09	Computer software & services	IR5
7	Finance director	11-09	Oil & gas	FD1
8	Finance director	11-09	Housing	FD2
9	Investor relations officer	11-09	Electricity	IR6
10	Finance director	11-09	Water	FD3
11	Finance director	11-09	Business support	FD4
12	Investor relations officer	11-09	Oil & gas	IR7
13	Chief accountant	11-09	Electricity	CA1
14	Finance director	12-09	Business support services	FD5
15	Finance director	01-10	Banks	FD6
16	Chairman	03-10	Oil & gas	CH1

## Appendix 3

### Coding instrument: Categories and sub-categories

Category	Subcategory	Category	Subcategory
Financial	Pension obligations	Operations	Efficiency and performance
	Liquidity		Environmental <sup>1</sup>
	Exchange rate		Product development
	General		Health and safety <sup>1</sup>
	Debt		Sourcing <sup>2</sup>
	Interest rate		General
	Credit		Brand name erosion
	Commodity		Customer satisfaction
	Other off-balance sheet financing		Product and service failure
Strategic	Business portfolio	Historical performance/ Economic cycles <sup>2</sup>	Graphic illustration of historical performance
	Environmental scan		Narrative discussion of historical performance
	Valuation	Targets <sup>2</sup>	Future
	Industry		General
	General		Past
	Competitors	Integrity	General
	Regulatory		Reputation
	Pricing		Management and employee fraud <sup>1</sup>
	Planning <sup>1</sup>	Information processing and technology	Infrastructure
Sovereign and political	General		
Performance measurement	Availability		
Empowerment	Performance incentives		Integrity
	Leadership and management <sup>1</sup>		
	Communications		

#### Notes:

1. These five sub-categories were not mentioned in the analyst interviews but are found in the literature.
2. These additional 2 categories were mentioned by analysts but are not found in the literature.

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SATER's objective is to promote research into, and education of, accountancy, finance and management together with all subjects in any way related. In fulfilling its charitable objectives, it also seeks to provide public benefit by making grants for research projects which result in reliable evidence for use in the development of policy – by professional bodies, standard setters, regulators or governments.

SATER is happy to receive grant applications for research projects from within and outwith the University sector, so long as these utilise sufficiently robust research methodology and the results from the project are likely to provide public benefit.

SATER considers a broad range of grant applications from anywhere in the world. These do not have to be solely for research projects but can be for other research or education initiatives within SATER's specific subject areas, and must be expected to provide public benefit.

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Further details about SATER and the ICAS research programme can be found from the SATER and ICAS websites: [scottishaccountancytrust.org.uk/research.html](http://scottishaccountancytrust.org.uk/research.html) and [icas.org.uk/research](http://icas.org.uk/research).

David Spence  
Chairman of SATER

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How can annual reports provide the information which users require for both stewardship and decision-making purposes? Recently there has been much debate about improving narrative, and specifically risk, reporting to ensure that key information about a business is disclosed in its annual report. Policy developments in this area are being undertaken by the IASB, the FRC and BIS. Such initiatives also coincide with a concern about information overload with annual reports getting longer and longer. Balancing these two forces is a difficult task and risk reporting is a prime example of this problem – the volume of risk reporting has increased in recent years but is this additional disclosure beneficial?

This study explores the views of users and preparers of risk information. The interviews cover three broad themes: the sources of risk information; the impact of regulatory initiatives on risk disclosure; and the types of risk information disclosed and the constraints on disclosure. An analysis of risk disclosure in the annual reports of companies in the food and beverage sector of the FTSE is also undertaken.

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