

# King Report on Corporate Governance for South Africa 2002

## Risk Management

### 1 WHAT IS RISK MANAGEMENT?

- 1.1 Risk management is the identification and evaluation of actual and potential areas of risk as they pertain to a company, followed by a procedure of termination, transfer, acceptance (tolerance) or mitigation of each risk.
- 1.2 Risk management is therefore a process that utilises internal controls as a measure to mitigate and control risk.

### 2 WHO IS RESPONSIBLE FOR RISK MANAGEMENT?

- 2.1 The board is responsible for ensuring that the company has implemented an effective ongoing process to identify risk, measure its potential impact against a set of assumptions, and then activate what it believes is necessary to proactively manage these risks.
- 2.2 The board should therefore decide on what risk that company is prepared to take and what risks it will not take in pursuance of its goals and objectives.
- 2.3 The risk management process requires an inclusive team based approach which is effective across the company. A committee consisting of executive directors and members of senior management, who are accountable to the board, are best placed to evaluate risk in the company and report to the board.

### **3 WHAT SHOULD RISK ASSESSMENT ADDRESS?**

3.1 Risk assessment should address the company's exposure to the following

- 3.1.1 physical and operational risks;
- 3.1.2 human resource risks;
- 3.1.3 technical risks;
- 3.1.4 business continuity and disaster recovery;
- 3.1.5 credit and market risks;
- 3.1.6 compliance risks.

### **4 WHAT IS THE ROLE OF THE INTERNAL AUDIT FUNCTION IN RISK MANAGEMENT?**

The internal audit function should be used to provide independent assurance in relation to the board's assertion surrounding the effectiveness of risk management and internal control.

### **5 ASSIMILATING RISK TO THE CONTROL ENVIRONMENT**

- 5.1 The board should implement a comprehensive system of controls to ensure that risks are mitigated and that the company's objectives are attained.
- 5.2 The control environment should set the tone of the company and cover ethical values, management's philosophy and the competence of employees.
- 5.3 Five essential aspects of control are identified, namely -
  - 5.3.1 control environment;
  - 5.3.2 risk assessment;
  - 5.3.3 control activities;
  - 5.3.4 information and communications;
  - 5.3.5 monitoring.

- 5.4 Any vulnerability in the achievement of the company's objectives, whether caused by internal or external risk factors, should be detected in good time and reported by the systems of control in place and met with appropriate intervention. Not only will this improve the company's risk profile, thereby enhancing the company's attraction as a worthwhile investment, but it will also enhance the positive influences of risk on the business.
- 5.5 The company should also consider the need for a confidential reporting process (whistle blowing) covering fraud and other risks.

## **6 HOW IS RISK MANAGEMENT APPLIED?**

- 6.1 The board is responsible for setting risk tolerance and related strategies and policies. It is also the board's responsibility to review the effectiveness of these policies on a regular basis and in a manner in which its objectives are clearly defined for the benefit of management to guide them in carrying out their responsibilities.
- 6.2 In reviewing the reports on risk management and internal control in the course of a financial year, the board should -
- 6.2.1 consider what the company's risks are and how they have been identified, evaluated and controlled;
  - 6.2.2 assess the effectiveness of the related process of risk management, and particularly reports of significant failings or weaknesses in the process;
  - 6.2.3 consider if the necessary action is being taken timeously to rectify any significant failings or weaknesses;
  - 6.2.4 consider whether the results obtained from the review process indicate that more extensive monitoring is required.

## **7 WHERE SHOULD A COMPANY'S POLICY ON RISK MANAGEMENT BE REPORTED?**

- 7.1 The board should disclose how the company has dealt with risk and control in its annual report.
- 7.2 At a minimum, the board should disclose -
- 7.2.1 that it is accountable for the process of risk management and the system of internal control, which is regularly reviewed for effectiveness and for establishing appropriate risk and control

policies and communicating these throughout the company;

- 7.2.2 that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company, which has been in place for the year under review and up to the date of approval of the annual report and financial statements;
  - 7.2.3 that there is an adequate and effective system of internal control in place to mitigate the significant risks faced by the company to an acceptable level;
  - 7.2.4 that there is a documented and tested process in place that will allow the company to continue its critical business processes in the event of a disastrous incident impacting on its activities;
  - 7.2.5 where material joint ventures and associates have not been dealt with as part of the group for the purposes of applying these recommendations;
  - 7.2.6 that any additional information in the annual report to assist in the understanding of the company's risk management processes and system of internal control.
- 7.3 Where the board cannot make any of the disclosures set out above, it should state this fact and provide a suitable explanation.

## **8 SUMMARY OF RISK MANAGEMENT**

- 8.1 The risk management review processes may identify areas of opportunity, such as where effective risk management can be turned into a competitive advantage for the company, and it should therefore not only be viewed from a negative perspective.
- 8.2 Risk management goes beyond the control of financial risks. Reputation and a company's future survival are also at stake.
- 8.2 Companies must ensure that the governance surrounding risk management is transparent and disclosed to its stakeholders.
- 8.3 Risk management is a continuous process of identifying, evaluating and managing risk. Unless companies see risk management as more than just an act of compliance, they are unlikely to reap the benefits it can offer.