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Fast Facts

ASX CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS

REACHING NEW HEIGHTS FOR RISK MANAGEMENT GOVERNANCE

Principle 7: Recognise and manage risk: provides recommendations in regard to establishing a sound risk management framework and the periodic review of its effectiveness. Failure to recognise or manage risks can adversely impact shareholders and other stakeholders. Good risk management can not only protect but enhance value for stakeholders.

On 27 March 2014, the Australian Securities Exchange Corporate Governance Council (ASX CGC) released the 3rd edition of its ASX Corporate Governance Principles and Recommendations. These changes include a shift in how listed entities need to structure their governance and management of risk. The revised recommendations become effective for the entities first full financial year commencing on or after 1 July 2014.

REFRESH YOUR RISK MANAGEMENT GOVERNANCE FRAMEWORK: FOCUS ON INDEPENDENT JUDGEMENT

Recommendation 7.1

Historically there hasn't been a requirement for the board to establish a dedicated risk subcommittee, purely a recommendation that the board have oversight of a number of risk matters. The latest edition recommends that the Board establish a dedicated risk committee to focus on the role of risk oversight.

The committee should have an independent chair and a majority of independent directors. It may be a stand-alone risk committee, a combined audit & risk committee or a combination of board committees addressing different elements of risk.

The intention is to raise the bar by bringing the focus and independent judgement needed to oversee entities risk management framework.

You will need to:

- Determine whether a separate risk committee should be established or the responsibilities delegated to a combined risk & audit committee or a combination of board committees.
- Consider factors such as:
  - existing workload of the audit committee
  - breadth and complexity of risk oversight task
  - skills and knowledge required by members of a risk committee
  - degree of information to be shared across different committees.
- If a combination of committees is chosen, you will need to disclose the division of responsibility for overseeing risk between these committees and explain the process adopted for overseeing the risk management framework.
- Oversee your risk management framework.

"Under the ASX listing rules, all listed entities are required to consider the Principles and Recommendations and disclose how they comply, or if an alternative practice is adopted, why that alternative is considered to be appropriate."

RUN THE RULER OVER YOUR RISK MANAGEMENT FRAMEWORK ANNUALLY

Recommendation 7.2

Requirements have broadened. The board or a board committee are now required to review the risk management framework with management at least annually and be satisfied that it continues to be sound.

While ultimate responsibility for management of risks always rested with the board, the previous edition focused on the board requirement for management to design and implement the risk management and internal control system and report to the board on whether material business risks are being managed effectively.

The onus on directors has expanded as the recommendation now requires the board to consider the risk management framework as a whole and not be limited to consideration of material business risks.

REVISED RISK MANAGEMENT FRAMEWORK FOR LISTED ENTITIES

Removed	The specific focus on material business risks has been removed from the revised recommendations.
Changed	Material business risk is now incorporated into the Operating and Financial Review (OFR) disclosure. ASIC's guidance requires the OFR to describe the material business risks that could adversely affect the financial performance or outcomes.
New	When disclosing whether a review has been undertaken, where appropriate, the entity should disclose any insights it has gained from the review and any changes it has made to the risk management framework as a result.

"SMART" QUESTIONS FOR DIRECTORS TO ASK?

- Is the Chief Risk Officer involved in the consideration of risk in key decisions?
- Is risk embedded within the 'every day' processes?
- Are risks associated with outsourcing and major transformation projects specifically considered and documented?
- Does the scope of risk assessment include economic, environmental and social sustainability risks?
- Has a Code of Conduct been implemented?
- Has the risk appetite been set with risk limits and tolerances established and monitored?
- Is the remuneration model promoting the right behaviours and providing the right incentives?
- Has the effectiveness of the internal audit function been recently assessed?

CONSIDER YOUR OPTIONS FOR MONITORING THE ADEQUACY AND EFFECTIVENESS OF CONTROLS TO MITIGATE YOUR KEY RISKS.

Recommendation 7.3

Listed entities are now required to disclose if they have an internal audit function or if not describe the process employed for evaluating and continually improving the effectiveness of risk management and internal control processes.

Historically the board was required to receive assurance from the CEO and CFO that the organisations controls are founded on a sound system of risk management and internal control. The assurance was provided via a declaration to the board in accordance with section 295A of the Corporations Act.

Now the board has to take a more "hands on" approach and consider the need for a dedicated internal audit function, or an equivalent alternative arrangement, to independently assess controls.

In considering alternatives to establishing an internal audit function boards will need to be satisfyied themselves that:

- management and the board has the capability and time to fully assess the risks and internal control systems of key areas of the organisation such as compliance fraud prevention , IT security
- the costs of other options outweigh the likely benefits
- the board is comfortable disclosing and explaining this decision to the market.

RESOURCING YOUR INTERNAL AUDIT FUNCTION

What is the right approach for you?

What is your best option?

	Reasons to adopt model	Reasons for not adopting model
In-house	• Corporate knowledge is retained • Cost effective for larger organisations • Internal audit can be an excellent training ground	• Limited to specialist skills for smaller audit teams • Difficult to cost-justify for smaller organisations
Co-sourcing	• Access to specialist skills knowledge and expertise • Access to current best practice trends and thinking • Access to additional resources to balance resourcing requirements • Can be a cost effective alternative to hiring full-time specialist resources • Skills transfer to internal audit team	• Service providers may cost more than in-house resources • Availability of co-sourced provider resources as and when required
Outsourced	• Independence of external service providers • Improved access to best practice insights and practices • Advantages of 'outsourcing' – focus on core activities	• Service providers may cost more than full-time staff • Loss of corporate knowledge • Difficulty in gaining access to outsourced specialists in remote locations

INCLUDE SUSTAINABILITY RISKS IN THE SCOPE OF YOUR RISK MANAGEMENT FRAMEWORK

Recommendation 7.4

Due to increasing demands from investors and other stakeholders for greater transparency on matters of sustainability, the recommendations include a requirement to disclose whether you have any material exposure to economic, environmental and social sustainability risks and if so you must disclose how you intend to manage the risk.

START YOUR REFRESH OF RISK MANAGEMENT EFFECTIVENESS NOW!

The revised Recommendations to Principle 7 become effective for listed entities first full financial year commencing on or after 1 July 2014. That's not a lot of time to implement changes required. We recommend undertaking a review comprised of the following steps to ensure you are prepared for the change in reporting requirements.

1. **Undertake a gap analysis of your existing risk management framework**
2. **Decide your approach to each 'Recommendation'**
3. **Develop a plan to implement the changes required so you are compliant as soon as posible from 1 July 2014**

Task	How Grant Thornton can assist
Establish a Risk Committee (Recommendation 7.1)	• Develop a Risk Committee Charter • Provide advice on governance structure
Board review of risk management framework (Recommendation 7.2)	• Perform a gap analysis of your current risk management framework • Provide assistance /advice to develop your risk management framework • Assist the board to identify, assess and monitor key risks and move away from the 'compliance burden' • Support the board's annual assessment the risk management framework by conducting an independent and report to the Board
Establish an internal audit function (Recommendation 7.3)	• Provide assistance in establishing an in-house internal audit function (e.g. develop an internal audit charter, internal audit plans, methodology etc.) • Provide outsourced internal audit services • Provide co-sourced internal audit services to support and strengthen your existing internal audit function
Implement alternative arrangements to establishing an internal audit function (Recommendation 7.3)	• Support the board and management by conducting independent targeted reviews of specific areas.
Reporting	• Assistance drafting disclosure statements

HOW WE'RE HELPING OUR CLIENTS

Grant Thornton can help you understand the impact of the changes to Principle 7: Recognise and Manage Risk for your business. We can work alongside you to design and implement the changes required to ensure you are not only compliant under the ASX Governance Principles but reap the strategic benefits of enhanced governance.

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