STATEMENT ON

RISK MANAGEMENT &

INTERNAL CONTROL

Guidelines for Directors of Listed Issuers
Foreword

The Statement on Internal Control - Guidance for Directors of Public Listed Companies was first issued in December 2000. The objective of the document is to provide guidance to directors in formulating the Statement on Internal Control in their annual report in accordance with Bursa Malaysia's Listing Requirements.

An industry led Task Force was established to revise the Guidance to reflect the changing regulatory environment and evolving approaches to corporate governance issues that have made disclosure an important regulatory tool. Reporting by boards of directors on the risk management and internal control system within their companies has become an important part of corporate governance disclosure requirements.

Public consultation has become a regular feature of the process of regulatory change of corporate governance and financial reporting in laying the foundations of a good corporate governance framework. This document has undergone due consultative process including focus group meetings attended by company directors. We would like to thank the many companies, professional bodies and individuals who provided input and shared their experiences in order to improve earlier drafts of this document.

These guidelines are intended to guide directors of listed issuers in making disclosures concerning risk management and internal control in their company’s annual report pursuant to the paragraph 15.26(b) of the Listing Requirements. In making the statement, companies are required to explain their governance policies, including any special circumstances which have led them to adopting a particular approach. It sets out the obligations of management and the board of directors with respect to risk management and internal control. It also provides guidance on the key elements needed in maintaining a sound system of risk management and internal control, and describes the process that should be considered in reviewing its effectiveness.

We trust that these guidelines will provide directors with the necessary information to assist them in complying with the specific provisions of the Listing Requirements and aid in good corporate governance.

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Introduction

1. The guidance on the Statement on Internal Control (Guidance for Directors of Public Listed Companies) was first issued in December 2000 and these current guidelines on the Statement on Risk Management & Internal Control (Guidelines for Directors of Listed Issuers) replace them.

2. These guidelines are intended to guide directors of listed issuers in making disclosures concerning risk management and internal control in their company’s annual report pursuant to paragraph 15.26(b) of the Listing Requirements (LR). In making the statement, companies are required to explain their governance policies, including any special circumstances which have led them to adopting a particular approach.

3. These guidelines set out the obligations of management and the board of directors with respect to risk management and internal control. It also provides guidance on the key elements needed in maintaining a sound system of risk management and internal control, and describes the process that should be considered in reviewing its effectiveness.

4. The revised guidelines require the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) to provide assurance to the board stating whether the company’s risk management and internal control system is operating adequately and effectively.

For the purpose of applying these guidelines,

- A CEO is defined as the highest ranking executive in a company, responsible for carrying out corporate policies established by the board and whose main responsibilities include developing and implementing high-level strategies, making major corporate decisions, managing the overall operations and resources of a company, and acting as the main point of communication between the board and corporate operations.

- A CFO is defined as the person primarily responsible for the management of the financial affairs of the company (such as record keeping, financial planning and financial reporting), by whatever name called.

5. The revised guidelines also make reference to the Malaysian Code on Corporate Governance issued in March 2012 (the Code). Principle 6 of the Code states that the board should establish a sound risk management framework and internal control system.

6. Recommendation 6.1 states that the board should establish a sound framework to manage risk. The commentary to the recommendation provides guidance to the listed issuers on how to achieve this:

- The board should determine the company’s level of risk tolerance and actively identify, assess and monitor key business risks to safeguard shareholders’ investments and the company’s assets;

- The board should be committed to articulating, implementing and reviewing the company’s internal control system;

- Periodic testing of the effectiveness and efficiency of the internal control procedures and processes must be conducted to ensure that the system is viable and robust; and

- The board should disclose in the annual report the main features of the company’s risk management framework and internal control system.
7. Throughout these guidelines, where reference is made to a ‘company’ it should be taken, where applicable, as referring to the group of which the reporting company is the parent company. For groups of companies, the review of effectiveness of risk management and internal control and the report to the shareholders should be from the perspective of the group as a whole. Where material joint ventures and associated companies have not been dealt with as part of the group for purposes of applying these guidelines, this should be disclosed.

8. The Appendix to this document contains questions that boards may wish to consider in applying these guidelines.

**Governance, Risk Management and Control**

9. A company cannot achieve its objectives and sustain success without effective governance, risk management and internal control processes. Risk management and internal control are embedded in the governance framework.

10. The company should remain focused on its business risks and ensure the implementation of appropriate systems to identify and manage those risks. Risk management is not about eliminating all risks; it is about identifying, assessing and responding to risks to achieve the organisation’s objectives.

11. An effective risk management process helps a company to achieve its performance and profitability targets by providing risk information to enable better decisions, both in the setting of company strategy and in daily decision making as that strategy is executed.

12. The system of internal control is defined as “the actions taken by the board and management to manage risk and increase the likelihood that established goals will be achieved”. Internal control encompasses all types of control including those of a financial, operational, environmental and compliance nature.

13. The system of internal control should be structured in such a manner that it provides reasonable assurance that the likelihood of a significant adverse impact on objectives arising from a future event or situation is at a level acceptable to the business. It achieves this through a combination of preventive, detective and corrective measures.
ELEMENTS OF A SOUND RISK MANAGEMENT AND INTERNAL CONTROL SYSTEM

Risk Management

14. In order to achieve a sound system of risk management and internal control, the board and management must ensure that the risk management and control framework is embedded into the culture, processes and structures of the company. The framework should be responsive to changes in the business environment and clearly communicated to all levels.

15. To achieve this, it is important to provide a control environment that includes:

- Written communication of company values, the expected code of conduct, policies and procedures;
- Documentation (generally via a set of charters) of the responsibilities and functions of the board of directors, each of its committees, and the individual directors;
- Management’s philosophy, risk attitude (consistent with the risk appetite or criteria approved by the board) and operating style;
- The company’s organisational structure and methods of assigning authority and responsibility; and
- Clearly defined authority and responsibility for each employee.

16. The board’s ability to oversee a company’s management of risks starts with actively participating in the objective and strategy-setting process, ensuring that the risks inherent in each option are considered. The board should subsequently receive sufficient and timely information concerning both performance and risk levels so that management’s performance in achieving strategies and objectives can be monitored and assessed. Four areas where the board should work with management to achieve this are as follows:

- Determining the company’s risk appetite and tolerance, and ensuring that this is communicated appropriately.
- Understanding and ensuring the adequacy of risk management practices.
- Reviewing the current level of risks in relation to risk appetite as an integral part of monitoring and measuring performance.
- Ensuring that actions are taken in a timely manner when risks are outside tolerable ranges.

Note: Guidance on risk appetite is contained in Appendix 1.
Internal Control

17. An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of a company that, taken together:

- Facilitates an effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the company’s objectives;

- Helps ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the company; and

- Helps ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business.

18. A company’s system of internal control will reflect its control environment which encompasses its organisational structure, governance activities, hiring and related policies and practices, and its code of conduct. The system will also include:

- Control activities;

- Information and communications processes; and

- Processes for monitoring the continuing effectiveness of the system of internal control.

19. In assessing what constitutes a sound system of internal control in the particular circumstances of the company, the board’s deliberations should include consideration of the following factors:

- The nature and extent of the risks facing the company;

- The extent and sources of risk which it regards as acceptable for the company to bear;

- The likelihood of significant risks materialising;

- The company’s ability to reduce the incidence of risks that do materialise and manage their impact on the business; and

- The costs of operating particular controls relative to the benefit derived from managing the related risks.

20. A sound system of internal control reduces, but cannot eliminate, the possibility of poor judgement in decision-making; human error; control processes being deliberately circumvented by employees and others; management overriding controls; and the occurrence of unforeseeable circumstances.
ROLES AND RESPONSIBILITIES FOR
RISK MANAGEMENT AND INTERNAL CONTROL

21. A sound framework of risk management and internal control is fundamental to good corporate governance. For there to be a sound framework for risk management and internal control, various parties within the organisation need to play key roles.

Board’s Role

22. The board’s focus on effective risk oversight is critical to setting the tone and culture towards effective risk management and internal control. The responsibilities of the board for the governance of risk and controls should include:

- Embedding risk management in all aspects of the company’s activities;
- Approving the board’s acceptable risk appetite; and
- Reviewing the risk management framework, processes, responsibilities and assessing whether they provide reasonable assurance that risks are managed within tolerable ranges.

23. Reviewing the effectiveness of risk management and internal control is an essential part of the board’s responsibilities and should be performed at least annually. The board will need to form its own view on effectiveness based on the information and assurances provided to it, and in doing so, it must exercise the standard of care generally applicable to directors in carrying out their duties. Management is accountable to the board for implementing and monitoring the system of risk management and internal control and for providing assurance to the board that it has done so. See item 26 below which sets out the roles of the CEO and CFO in providing such assurance to the board annually.

24. The board should solicit formal feedback on the adequacy of risk management and internal control from the head of the internal audit function at least annually, and this should be based primarily on the scope and coverage of internal audit’s remit for the year under review. The board should also solicit the observations of the independent external auditor, recognising that such observations will generally be limited to risks and controls related to the financial statements.

25. The board may delegate its role in the review process to a board committee, for example the Audit and/or Risk Management Committee. However, the board as a whole remains responsible for all the actions of the committee with regard to the execution of the delegated role and this includes the outcome of the review and disclosure on key risks and internal control in the company’s annual report.
Management’s Role

26. Management is responsible for implementing the processes for identifying, evaluating, monitoring and reporting of risks and internal control, taking appropriate and timely corrective actions as needed, and for providing assurance to the board that the processes have been carried out. In this regard, at least annually, the board should receive assurance from the CEO and CFO on whether the company’s risk management and internal control system is operating adequately and effectively, in all material aspects, based on the risk management model adopted by the company.

27. The responsibilities of management in respect of risk management should include:

- Identify the risks relevant to the business of the company and the achievement of objectives and strategies;
- Design, implement and monitor the risk management framework in accordance with the company’s strategic vision and overall risk appetite; and
- Identify changes to risk or emerging risks, take actions as appropriate, and promptly bring these to the attention of the Board.

Internal Audit’s Role

28. Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve a company’s operations. It helps a company accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

29. The internal audit function provides assessments as to whether risks, which may hinder the company from achieving its objectives, are being adequately evaluated, managed and controlled. It further evaluates the effectiveness of the governance, risk management and internal control framework and facilitates enhancement, where appropriate.

30. Paragraph 15.27 of the LR mandates a listed issuer to establish an internal audit function which is independent of the activities it audits, and such internal audit function reports directly to the Audit Committee.

31. Recommendation 6.2 of the Code states that the board should establish an internal audit function which reports directly to the Audit Committee. The commentary to the recommendation provides that:

- The head of internal audit should have the relevant qualification and be responsible for providing assurance to the board that internal control is operating effectively;
- Internal auditors should carry out their functions according to the standards set by recognised professional bodies; and
- Internal auditors should also conduct regular reviews and appraisals of the effectiveness of the governance, risk management and internal control processes within the company.
THE PROCESS FOR REVIEWING EFFECTIVENESS OF THE SYSTEM OF RISK MANAGEMENT AND INTERNAL CONTROL

32. Reviewing the effectiveness of the risk management and internal control system is an essential part of the board’s responsibility.

33. In reviewing the effectiveness of the risk management and internal control system, the board should define the processes to be adopted (both for the ongoing assessment and annual assessment). The annual assessment refers to assessment undertaken for the purposes of making its statement pursuant to 15.26(b) of the LR.

34. When assessing the adequacy of the risk management and internal control system, the board should consider:

■ The processes for establishing the company’s longer and shorter-term objectives and strategies, and whether they give appropriate consideration to risk;

■ The processes for determining the company’s risk appetite, and communicating them appropriately;

■ The company’s risk policies and procedures;

■ The management’s processes for identifying, analysing, evaluating, and treating risks including communication of risk and control information across the business;

■ Management’s processes for monitoring internal control and risk management to provide reasonable assurance that they continue to operate as intended and are modified as business conditions or risks change; and

■ Management’s reporting of risk to provide the board sufficient visibility of risks across the organisation.

Ongoing Assessment

35. On a periodic basis, management should report to the board:

■ The business risks that have impacted or likely to impact the company and its achievement of its objectives and strategies; and

■ The effectiveness of the risk management and internal control system in managing those risks.
36. When reviewing the management reports, the board should:

- Consider what the significant risks are and assess how they have been identified, evaluated and managed;
- Assess the effectiveness of the related system of internal control in managing the significant risks, having regard in particular to any significant failings or weaknesses in internal control that have been reported;
- Consider whether necessary actions are being taken promptly to remedy any significant failings or weaknesses;
- Consider whether early warning indicators are in place to alert management of potential risk events and whether these indicators have been effectively communicated throughout the company;
- Consider whether the findings indicate a need for more extensive monitoring of the system of risk management and internal control; and
- Evaluate the possibility of emerging risks likely to happen in the future and the need to put in place the appropriate controls.

Annual Assessment

37. The annual assessment should consider issues dealt with in reports reviewed by the board during the year together with any additional information necessary to ensure that it has taken into account all significant aspects of risks and internal control of the company for the year under review and up to the date of approval of the statement for inclusion in the annual report.

38. The board’s annual assessment should, in particular, consider:

- Any changes since the last assessment in the nature and extent of significant risks, and the company’s ability to respond to changes in its business and the external environment;
- The effectiveness of the company’s risk management and internal control system;
- The work of its internal audit and risk management (where applicable) units and other assurance providers;
- The extent and frequency of the communication of the results of the monitoring to the board (or board committee(s));
- The incidence of significant control failings or weaknesses that were identified at any time during the period and their impact on the company’s performance or condition (financial or otherwise);
- Any events that impacted the achievement of objectives that were not anticipated by management; and
- The adequacy and effectiveness of the risk management and internal control policies as a whole.

39. Neither risk management nor internal control processes provide absolute assurance. Rather, the board should assess whether management’s processes provide reasonable assurance that significant risks which impact the company’s strategies and objectives are within levels appropriate to the company’s business and approved by the board.

Note: Some questions which the board may wish to consider and discuss with management when reviewing reports on risk management and internal control and when carrying out its annual assessment are set out in Appendix 2.
40. The statement pursuant to 15.26(b) of the LR should include sufficient and meaningful information needed by shareholders to make an informed assessment of the main features and adequacy of the company’s risk management and internal control system.

41. In its narrative statement, the board should disclose the following:

- The main features of the company’s risk management and internal control system;
- The ongoing process for identifying, evaluating and managing the significant risks faced by the company in its achievement of objectives and strategies;
- That such process has been in place for the year under review and up to the date of approval of this statement for inclusion in the annual report;
- The process it (or where applicable, through its committees) has applied in reviewing the risk management and internal control system and confirming that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from that review;
- That a review on the adequacy and effectiveness of the risk management and internal control system has been undertaken;
- Commentary on the adequacy and effectiveness of the risk management and internal control system;
- The process it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report and financial statements; and
- Where material joint ventures and associates have not been dealt with as part of the group for the purposes of applying these guidelines, this should be disclosed.

42. In its narrative statement, the board should also include whether it has received assurance from the CEO and CFO on whether the company’s risk management and internal control system is operating adequately and effectively, in all material aspects, based on the risk management and internal control system of the company.
APPENDIX 1

Risk Appetite

1. Risk appetite is defined as the amount of risk that a company is willing to seek or accept in the pursuit of its value. Each company pursues various objectives to add value and should broadly understand the risk it is willing to undertake in doing so.

2. Risk appetite is not a single, fixed concept. There will be a range of appetites for different risks which needs to be aligned and this appetite may well vary over time.

3. Risk appetite needs to be measurable and integrated within the control culture of the company.

Considerations Affecting Risk Appetite

4. Risk appetite is not developed in isolation from other factors. A company should consider its capacity to take on extra risk in achieving its objectives. It should also consider its existing risk profile, not as a determinant of risk appetite but as an indication of the risks it currently addresses.

5. There may be other factors to consider as well. Some companies may gauge how quickly their competitive environment is changing. A telecommunications company, for example, must anticipate how technology and user preferences will affect product development, making a relevant time frame important.

6. The point is that risk and strategy are intertwined. One does not exist without the other, and they must be considered together. That consideration takes place throughout the execution of the strategy, and it is most important when strategy is being formulated with due regard for risk appetite.


Questions

The board may want to consider the following questions in respect of risk appetite:

1. Is the board clear about the nature and extent of the significant risk it is willing to take in achieving its strategic objectives?
2. What are the significant risks the board is willing to take and not willing to take?
3. How mature is risk management in the company?
4. Has the company followed a robust approach in developing its risk appetite?
5. Who are the key external stakeholders and have their views been obtained when developing the risk appetite?
6. Is the risk appetite tailored and proportionate to the company?
7. What is the evidence that the company has implemented the risk appetite effectively?
APPENDIX 2

Assessing the Effectiveness of the Company’s Risk and Internal Control Processes

Some questions which the board may wish to consider and discuss with management when regularly reviewing reports on risk management and internal control and when carrying out its annual assessment are set out below. The questions are not intended to be exhaustive and will need to be tailored to the particular circumstances of the company.

This Appendix should be read in conjunction with the guidelines set out in this document.

Assessing the Risk Management Framework

1. Has the company established a risk management framework?
2. Does the board of directors and senior management perceive risk management as an integral part of objective setting and optimisation of performance?
3. Has risk management ownership been clearly defined and accepted by the employees concerned? Is it clear that the management of risk is an integral part of business management, owned by every manager, with the support and facilitation of the risk management staff?
4. Is there a Risk Management Committee (RMC) at board level chaired by an independent director?
5. Have risk management policies been approved by the RMC?
6. Has the company’s acceptable risk appetite (risk tolerance) or risk criteria been defined, by the RMC, where appropriate, and disseminated?
7. Is there a Management Committee on risk management, chaired by the CEO (or equivalent)?
8. Have procedures for managing significant risks been defined, approved by executive management and implemented in the company?
9. Are the board and executive management aware of high risk areas in the operations and strategies of the company and have these been properly documented and tracked?
10. Have the risk profiles for the company been established?
11. Has the company identified its legal and regulatory obligations with regard to risk disclosure?
12. Does the system for identifying and assessing risks have the following characteristics:
   • Systematic – formalised with sufficient level of appropriate detail
   • Comprehensive – encompassing all key areas of the company and reviewed on a regular basis
   • Integrated – linked to the core business process (e.g. business/strategic planning, contracting, mergers and acquisitions) within the company
   • Dynamic and iterative – repeated as necessary to ensure the assessment remains current in the midst of changing business conditions
13. Has a system been established to identify significant risks affecting the preparation of the financial statements?
14. Are risks that exceed the acceptable limits or criteria defined by the company dealt with first? Has a residual risk level been defined and reported to the board?
15. Do major risks give rise to specific actions? Has the responsibility for such actions been defined? Where appropriate, is implementation of these actions monitored?

16. Is there a mechanism that makes it possible, when necessary in the light of changing business conditions and risks, for the company to make changes to the company’s objectives and business strategies?

17. Does the company have early warning key risk indicators (KRIs) in place to alert management (and the board as necessary) of significant changes in risk levels (e.g. political and economic upheavals, technological innovations resulting in the obsolescence of the company’s products or services, system failure, project delays, fraud, new product from competitors)?

18. Is the board meeting periodically with key management to discuss the key risk profiles of the company, the changing risk levels, changes to risk processes and the adequacy of internal control?

19. Are the results of risk assessment activities shared across the company for appropriate actions to be taken?

20. Has appropriate risk information, including risk appetite or criteria and risk levels, been cascaded to all the operating units?

21. To what extent are the mandate and scope of multiple governance functions in the company aligned to avoid overlap and ensure that there are no coverage gaps?

Control Environment and Control Activities

22. Do the company’s culture, code of conduct, human resource policies and performance reward systems support the business objectives and the risk management and internal control system?

23. Does senior management demonstrate, through its actions as well as its policies, the necessary commitment to competence, integrity and fostering a climate of trust within the company?

24. Are authorities, responsibilities and accountabilities defined clearly so that decisions are made and actions taken by the appropriate people after due consideration of the risks involved and the approved risk appetite or criteria?

25. Are the decisions and actions of different parts of the company appropriately co-ordinated?

26. Does the company communicate to its employees what is expected of them and the scope of their freedom to act? This may apply to areas such as customer relations; service levels for both internal and outsourced activities; health, safety and environmental protection; security of tangible and intangible assets; business continuity issues; expenditure matters; accounting; financial and other reporting.

27. Do people in the company (and in its providers of outsourced services) have the knowledge, skills and tools to support the achievement of the company’s objectives and to effectively manage risks that may affect the achievement of these objectives?

28. How are processes/controls adjusted to reflect new or changing risks?

29. Are business continuity management processes in place? Have these processes been periodically tested and communicated to relevant employees?

30. Are succession planning activities in place and operating effectively?
Information and Communication

31. Do the board and management receive timely, relevant and reliable reports on progress against business objectives and the related risks to enable them to make appropriate decisions? This could include reports with key performance indicators (KPIs) and indicators of changes in risk levels (KRIs), together with qualitative information such as customer satisfaction, conversion rates etc.

32. Are information needs and related information systems reassessed as objectives and related risks change or as reporting deficiencies are identified?

33. Are periodic reporting procedures, including quarterly and annual reporting, effective in communicating a clear account of the company’s performance and the achievement of company’s objectives?

34. Are there established channels of communication for individuals to report suspected breaches of law or regulations or other improprieties?

35. Is the whistleblowing mechanism independent of management and clearly communicated to all the stakeholders and employees?

Monitoring

36. Are ongoing processes embedded within the company’s overall business operations to monitor the effective application of the policies, processes and activities related to risk management and internal control? (Such processes may include control self-assessment, confirmation by personnel of compliance with policies and codes of conduct, or internal audit or other management reviews).

37. Do risk owners have an obligation and a process to provide assurance to the board that they are adhering to the risk management and internal control framework?

38. Do these processes monitor the company’s ability to re-evaluate risks and adjust controls effectively in response to changes in its objectives, its business, and its external environment?

39. Are there effective follow-up procedures to ensure that appropriate change or action occurs in response to changes in risk and control assessments?

40. Is there appropriate communication to the board (or board committees such as RMC and AC) on the effectiveness of the ongoing monitoring processes on risk and control matters? This should include reporting any significant failings or weaknesses on a timely basis.

41. Are there specific arrangements for management monitoring and reporting to the board on risk and control matters of particular importance? These could include, for example, actual or suspected fraud and other illegal or irregular acts, or matters that could adversely affect the company’s reputation or financial position.

42. Does the CEO/CFO (or their equivalent) provide assurance that the risk management and internal control framework is in place and operating effectively?