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New HKEX requirements on risk management and internal control:

How companies are responding to the code requirements

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In December 2014, Hong Kong Exchanges and Clearing Limited (HKEX) published its new corporate governance requirements - the *Consultation Conclusions on Risk Management and Internal Control: Review of the Corporate Governance Code and Corporate Governance Report* ('the Consultation Conclusions'). These requirements have affected all Hong Kong listed companies and come into effect for accounting periods beginning on or after 1 January 2016.

Recap - New requirements from the corporate governance code

What do the new requirements mean for listed companies?

The new code emphasises that internal control is an integrated part of risk management and stipulates that:

- **the board** is responsible for determining and evaluating risks the business is willing to take in achieving its objectives,
- **management** should design, implement and monitor the effectiveness of risk management and internal control systems,
- An **internal audit ("IA") function** should be established to carry out an independent appraisal of the systems developed by management.

	Top challenges facing Hong Kong executives*	Key lessons from early adopters of the code	How companies are responding successfully
Senior sponsorship	Senior sponsorship is often lacking as only *43% had risk and control as a standing boardroom agenda item.*	Senior management sponsorship, buy-in and oversight is critical to success as this sets the tone for considering risk.	Establishing risk as a boardroom agenda item and providing directors with insight into the major risks affecting the business.
Risk appetite	Only *36% have developed a formal risk appetite statement.* Without doing so, companies find it difficult to calibrate the risks of pursuing a given strategy.	Risk appetite becomes academic when it is developed as a one-off exercise without the input of the board or when it isn't linked back to decision making.	Developing a risk appetite statement that illustrates the thresholds for tolerating risks for key risk areas and defining indicators to regularly monitor risk.
Enterprise risk	*57% of executives struggle with understanding the risk exposure across the enterprise.*	Culture change in a big bang approach can be overwhelming. Incremental steps focused on identifying major risks first often fare better.	Identifying top risks that could impede the business from achieving its objectives, identifying their root causes and developing action plans to mitigate against them.
Accountability	Nearly *50% of management thought that risk awareness was low* when making decisions.	Risk management becomes a tick-box exercise when accountability for risk, particularly on the front line, is either unclear or lacking.	Assigning clear levels of accountability across the three lines of defence and developing oversight through the board or audit/risk committee.
Internal audit	Only *43% adopt a risk based approach to internal audit, in* which IA activities can be clearly linked back to the top risks. *15% do not even have an IA function.*	Internal audit often fails to provide sufficient oversight over risk when it functions separately to the risk management division.	Using techniques such as assurance mapping to identify areas of focus for internal audit.

**Source: KPMG & HKICS survey on the new normal for risk management in Hong Kong (2015)*

Checklist: 10 questions to ask yourself

- ❑ Are the new requirements understood and are there adequately skilled resources in place to deal with them?
- ❑ Is the oversight of risk on the board agenda?
- ❑ Has the business defined the levels and types of risk it is willing to take in pursuing its objectives?
- ❑ Has there been an assessment of the risks facing the business and is there alignment between prioritising and managing them?
- ❑ Is risk information explicitly considered in the strategic and operational decision making processes of the business?
- ❑ Is there a risk aware culture and do staff and management proactively seek to identify emerging risks facing the business?
- ❑ Are the responsibilities of management in identifying risks clearly defined and are they accountable for the decisions they make?
- ❑ Is there an internal control framework in place that allows the business to effectively manage the top risks it faces?
- ❑ Has an internal audit function been established?
- ❑ Does internal audit provide assurance over how the business is managing its risks?

Clearing up a few misconceptions about Enterprise Risk Management ("ERM")

- **It is about operational and financial risks:** ERM considers the wider risk environment including internal and external risks arising from a changing business environment.
- **It focuses on processes and controls:** while it is important to ensure risk is being adequately controlled in a process, ERM programmes also consider broader risks to strategy execution.
- **It is an annual process:** ERM is an ongoing process and should be reviewed on a regular basis.
- **It is expensive and only works for large companies:** ERM is scalable and has been successfully applied at companies of all sizes.
- **It is the job of a risk or audit function:** risk management delivers best results when risks are owned and managed by front line management.

How can KPMG China help?

KPMG China assistance in complying with the new corporate governance code

Potential business issue:	*No structured system to provide clear oversight, governance and taxonomy for the assessment of risk*	*Limited risk awareness or alignment on how top risks facing the business are being managed*	*Internal control (operational and financial) framework hasn't kept pace with business growth*	*Lack of a control conscious culture in the business means that risks are not effectively managed*	*An internal audit function is not in place or does not have the capacity to increase audit coverage*	*An internal audit plan does not focus on the top risks at the boardroom level*	*Internal audit does not provide value for money or deliver meaningful outcomes for the business*
KPMG China services:	Establishing an enterprise wide risk management system	Assessing top risks affecting company objectives	Developing a business wide internal control framework	Establishing a risk and control self assessment system	Establishing an internal audit function and/or internal audit strategic sourcing	Developing a risk based plan through assurance mapping	Conducting an effectiveness review of internal audit
	Risk management assistance		Internal control assistance		Internal audit assistance		

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