

AUDIT OUTCOMES

Risk identification to **kick-start audits**

The identification of risks is an important starting point in operational audits and can contribute significantly to the success of audit processes and outcomes.

Risk is pervasive and exists in both private and public organisations; it is universal and can have either a positive or negative effect on business. In addition, risk can impose costs on business and society that are not warranted or, more importantly, not adequately provided for. Risk is also often confused with uncertainty. "It needs to be remembered that an uncertain situation involves a complete lack of information on possible outcomes, whereas risk at times involves definite certainties or outcomes," says Angela Mhlanga, managing director at Compass Insurance.

Given its dynamic and diverse nature, risk is afforded different meanings, depending on the context and the discipline that it forms part of. These meanings need to be identified and aligned to different businesses prior to any form of audit process being undertaken, in order to ensure that the correct measurements and risk mitigation techniques are in place.



"AN UNCERTAIN SITUATION INVOLVES A COMPLETE LACK OF INFORMATION ON POSSIBLE OUTCOMES" ANGELA MHLANGA, MANAGING DIRECTOR AT COMPASS INSURANCE

TYPES OF RISKS

Fundamental risks: These are impersonal in nature and affect society at large; examples include war, earthquakes and drought. Some are insurable, although most are not, and so need to be analysed and taken into careful consideration. Mitigating or precautionary strategies may be plausible and need to be incorporated into the business planning process accordingly.

Pure and particular risks: These are personal risks that affect individuals or small groups of people, such as fraud, sabotage, contamination, negligence, pollution and strikes. The identification and analysis of these risks requires specialist input and can be rather complex.

Speculative risk: This is also known as two-way risk, and the materialisation of such a risk could lead to either a profit or a loss. Speculative risks are more commercial in nature; they include marketing risks, brand risks and strategic risks, and are typically addressed by line management and business executives rather than by risk management specialists.

Operational risks: Such risks define the success or failure of a business and, as a result, form the auditor focus when formulating risk assessment and management models. The need to manage these risks is driven by the knowledge that these could be 'bust' areas that have the potential to destroy the business or result in major losses. Risk identification requires a holistic approach that is primarily driven by management and, importantly, is inclusive of relevant stakeholders within the organisation, as each person needs to take responsibility for their relevant focus area.

RISK MATRIX DEVELOPMENT

In order for all parties to follow a stringent risk assessment and identification

model, businesses need to develop a risk matrix.

The procedure generally followed in the establishment of a risk matrix that is utilised as a basis for the audit process is as follows:

- **Identification of risks:** The type of risk is the first point of reference that needs to be understood. Does the business encompass a variety of risks, what types of risks are these and which area is most prominent and in need of the most tactical mitigation action?
- **Identification of controls:** Businesses then need to identify the controls available to them to mitigate these risks, including relevant strategies, staff/stakeholder involvement, resource allocation, etc.
- **Evaluation of controls:** Businesses need to decide whether these controls will be effective in terms of implementation and mitigation techniques, as well as whether sufficient controls are in place in relation to the severity of the risk.
- **Contextualisation of the residual risk:** The next step is to contextualise the residual risk, or risk that measures exposure to the loss remaining after other known risks have been factored in or eliminated. Companies need to identify whether this risk is high, medium or low, and establish controls in accordance with this.

Operational auditors should review the controls identified in the processes continually, as part of their ongoing risk assessment. This analysis will form the basis of continued risk management strategy improvements.

"The above forms the basis for an enhanced understanding of the control environment and should be used to manage and mitigate business risk, regardless of the risk category," concludes Mhlanga. 35