RISK MANAGEMENT

The board is responsible for risk management, while management is accountable to the board for this process and for reporting on the operation and effectiveness of controls.

The group has adopted an ongoing, systematic and documented risk management process that ensures that all material risks are identified, evaluated, effectively managed and, where this is practical, quantified. This process will ensure sustainable risk awareness and culture at all levels. The assessments are aligned to the strategic objectives of the group.

RISK REGISTER

Risks have been specifically defined and recorded in a risk register, and management evaluated the impact, likelihood and response to these risks. Each risk on the register is assigned an impact and probability rating, which in turn determines the inherent risk rating and its significance to the group. Detailed risk mitigation plans are developed for each risk, which then determines the level of residual (net) risk. Residual risk ratings are then assigned to each risk. Key risks facing the group are detailed on pages 44 to 47.

FINANCIAL RISK

The group is exposed to financial risks through currency and interest rate exposures.

Exposure to foreign currency exchange rate fluctuations arise from the group's direct imports of merchandise into South Africa, mainly from China. It is the group's policy to enter into forward cover contracts for all import orders to cover import commitments. There were no uncovered foreign currency liabilities at the end of the period.

No speculative foreign exchange trading is permitted.

INTERNAL AUDIT

The group does not currently have an independent in-house internal audit department.

This is compensated for by established internal control structures, and specific review and detective processes performed by the finance team, including:

- formal completion of standard audit checklists and reporting on the results thereof;
- daily bank reconciliations and investigations at a store level;
- regular stock counts and investigations;
- regular and detailed review of significant and extraordinary transactions by experienced staff;
- regular store visits by regional operational managers; and
- ad hoc store visits by financial managers and other senior staff.

The finance team reports on various operational key performance indicators (KPIs) on a weekly and monthly basis and investigates any out-of-line measurements.

Furthermore, the group engaged independent specialist firms to conduct a review of certain selected key controls in the IT environment to confirm that the design of the controls is effective and whether the controls operated effectively. Their review did not indicate any significant weaknesses.

Regional managers and financial managers conduct monthly store audits to ensure compliance with operating procedures and policies, using formalised standard audit checklists and scorecards.

The group's stock and cash losses as a percentage of sales are generally low by industry standards, which suggest overall that key operational controls are effective. Furthermore, merchandise margins and profitability is actively measured and reviewed at a granular level, and has been sustained through rigorous cost management and control over merchandise and procurement practices.

INTERNAL CONTROL SYSTEMS

To meet the group's responsibility to provide reliable financial information Holdsport maintains financial and operational systems of internal control. These controls are designed to provide reasonable assurance that transactions are concluded in accordance with management's authority; that the assets are adequately protected against material losses, unauthorised acquisition, use or disposal; and those transactions are properly authorised and recorded.

The systems include a documented organisational structure and division of responsibility; established policies and procedures which are communicated throughout the group; and the careful selection, training and development of people.

The group monitors the operation of the internal control systems in order to determine if there are deficiencies. Corrective actions are taken to address control deficiencies as they are identified. The board of directors, operating through the audit and risk committee, oversees the financial reporting process and internal control systems.

There are inherent limitations on the effectiveness of any system of internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, an effective internal control system can provide only reasonable assurance with respect to financial statement preparation and the safeguarding of assets.

CULTURE

The group has clear organisational structures that ensure segregation of duties and encourage accountability with appropriate oversight and support.

The business model and processes are mature and management has developed a disciplined business with internal control frameworks that consist of various codes of conduct and ethics, and detailed policy and procedure manuals which are reviewed regularly and updated as systems are improved and processes evolve to meet new demands or mitigate new risks.

CONTROL ENVIRONMENT

The group has various preventative and detective controls which interact to ensure the efficiency of the internal control systems. The business is fundamentally split into three areas, being merchandise, operations and finance. Accounting and merchandise functions are centralised at head office, and transaction steps are appropriately segregated and supervised.

Except for insignificant petty cash expenses, stores cannot make any payments for stock purchases, other expenses or to staff. Various levels of authorisation are in place at head office to monitor and approve transactions.

The group has a whistle-blowing hotline, which is monitored by the finance function.

REPORTING AND MEASUREMENT

Specific risk management frameworks have been determined per area and are supported with various reports and KPIs to enable measurement of the effectiveness of controls. Accounting and reporting processes are robust and enable accurate and regular analysis of information compared to predetermined performance measures and historical trends.

Key measurements and reports include:

- daily bank reconciliations per store;
- weekly sectional counts of selected stock and biannual full stock counts in stores;
- weekly high-risk store review reports;
- results of audit checklists completed by store managers and regional managers;
- various merchandise reports on performance per category and across various matrices;
- monthly Exco meetings and comprehensive month-end packs which cover financial, merchandise and operational performance; and
- monthly measurement of outsource partners' performance in terms of their service level agreements.

INSURANCE

The group accepts a certain level of self-insurance risk to reduce overall insurance cost. Individual claims of up to R100 000 are self-insured, but limited to a total aggregate of R1 million for motor claims and R300 000 for all other risks per annum. The self-insurance risk stimulates the understanding and importance of asset protection controls in the group.

Management uses independent insurance broker AON as a specialist consultant to assist in annually reviewing the scope and appropriateness of the short-term insurance programme. Various factors are considered when setting and reviewing insurance covers, including the expanding business operations and resulting growth in sales, profits, assets and employees, as well as changes in business practices and legislation.

Other matters covered in the review are: uninsured and uninsurable risks, the appropriateness of policy deductibles, exclusions and indemnity limits. Management also considers the credit ratings and stability of underwriters and their ability to service the group's needs. Management reports to the audit and risk committee on the insurance renewal process and on material incidents during the year.

RISK MANAGEMENT (continued)

SIGNIFICANT RISKS

Risk	Response
Expansion through new store openings	
The group is considering a number of locations for the opening of new stores, but its ability to successfully do so is dependent on a number of factors, including the availability of site locations suitable to house the large-format premises that the group generally operates from and the group's ability to successfully negotiate acceptable lease conditions. The group plans to open at least two new stores per year, but there is no guarantee that such plans will be successful. New stores may be unproductive or dilute existing stores' profits.	• Engage property developers to identify and secure new space where possible, or extend existing stores • Viability analysis to consider proposed new sites • Store performance is reviewed continuously and, should it become necessary, stores may be closed or relocated • Review opportunities for smaller new sites.
Impairment of store locations and other adverse effects on trading density	
Changes to the demographic profile of the area in which stores are located may result in a decline in customer traffic and sales volume in respect of such stores. Furthermore, specialist, independent retailers focused on the sales of a narrow range of categories, which open in close proximity to the group's stores, may impact on sales volume and customer traffic. Other extraneous factors like weather and holidays, as well as the success of national and/or regional sports teams, also affect the group's sales.	• Engage property developers to identify and secure new space where possible, or extend existing stores • Viability analysis to consider proposed new sites • Expanding the store base into different locations like malls and new geographic locations • Ongoing maintenance and refurbishment of store fixtures and fittings • Closely monitor the market, both locally and internationally • Store performance is reviewed continuously and, should it become necessary, stores may be closed or relocated • Undertake research to properly understand local demographics.
Retail lease risks	
The group generally has limited bargaining power in negotiating the terms of leases and is usually bound to the owners' standard terms and conditions of lease. The group can give no assurances that it will be able to renew leases on acceptable terms. Furthermore, where the lease agreements limit the right of the group to terminate on notice, the group's ability to readily adapt to changes in the industry, the demographic profile of the area, or prevailing business is reduced. Continued high increases in property rates and electricity may threaten the viability of certain stores.	• The majority of leases are for initial terms of five years with options to renew, which provides a measure of flexibility • Engage property developers early to negotiate lease agreements • Store performance is reviewed continuously and, should it become necessary, stores may be closed or relocated • Concerted focus on reducing electricity usage and costs.

Risk	Response
Expansion of product offering/categories	
The growth of the group depends partly on the introduction of new products and new categories across stores. If the group is unsuccessful in forecasting developing trends or misjudges the introduction of new products and categories, new products may not be available when customers request them or, alternatively, the group may be overstocked with products for which there is low demand. Similarly, failure to accurately forecast customer demand may lead to excess inventory possibly requiring large-scale clearance sales and inventory write-offs, or a shortage of stock. Such outcomes could harm the perception of the group as a market leader and preferred shopping destination, and damage customer loyalty, leading to adverse effects on sales and profits.	• Regular interaction with suppliers to identify new products and developments • Visits to international trade shows • Experienced buying teams • Sophisticated merchandise processes, which include detailed forecasting of demand and stock levels.
Loss of or inability to retain or recruit, senior management and key personnel and expertise	
The group operates in an environment where there is a scarcity of retail-specific skills. The success of the group is based, in part, on the operational and strategic contributions of its key personnel, who have extensive experience in the retail industry. In the event that the group is unable to retain the services of such individuals, its prospects and financial condition may suffer material adverse effects. Failure to internally develop and train, or otherwise recruit, adequately experienced and skilled personnel to ensure long-term competitiveness will adversely affect the prospects of the group.	• Ensuring that processes are in place to attract, retain and develop high-quality staff • Development programmes to enhance the pool of leadership skills • Merchant trainee programme to develop graduates for roles in merchandise functions • Competitive remuneration and incentive schemes to enhance retention • Succession plans.
Disruptions to distribution processes	
The group imports approximately 30% of the products sold through its stores directly and handles this through a dedicated distribution centre. The success of the distribution function impacts directly on stock availability and, therefore, on sales and profitability. Potential disruptions to the distribution process include labour issues, electricity shortages, destruction or damage.	• Risk reviews to consider events and factors that can cause a disruption in the supply chain • Maintain appropriate insurance cover • Quality assurance and quality control processes • Sourcing from different suppliers and countries to expand procurement opportunities, including considering local manufacturers as substitutes and/or assuming distribution on behalf of local suppliers • Consulting with logistical specialists • Viability analysis to consider proposed new sites.

RISK MANAGEMENT (continued)

Risk	Response
Supply chain	
The inability to provide our customers with the appropriate merchandise at the right price and time as a result of deficiencies in the supply chain. The group's suppliers are subject to certain operational risks, including labour disputes, economic instability, disruptions or delays in distribution and other factors beyond the control of the group. Where suppliers suffer operational issues which cause delivery delays or increased production costs, such effects may be passed on to the group, negatively impacting inventory levels and decreasing profitability.	• Maintain appropriate insurance cover for loss of profit • Specific supplier terms and conditions • Regular follow-up on order status with suppliers • Risk reviews to consider events and factors that can cause a disruption in our supply chain • Closely monitor the market, both locally and internationally • Quality assurance and quality control processes • Sourcing from different suppliers or importing directly.
Information technology (IT) systems	
The group is highly dependent on reliable, effective and efficient information and technology systems to process sales transactions, control access, and process transactions and information. Should the group's systems be affected by viruses, unauthorised access, system failure, loss of data or similar disruptions, the group may suffer material adverse effects on its operations, business, sales and revenues. The ever-increasing reliance upon computer systems necessitates a stable, secure and uninterrupted computer infrastructure.	• The group's information technology is outsourced to UCS who has significant and relevant industry expertise and experience. UCS's performance is monitored by the group in terms of a detailed service level agreement, which covers, amongst other things, data storage recovery and backup, system implementation, and system resumption • Senior management review and updating of the IT strategic plan • Maintaining a regularly tested disaster recovery plan that should provide seamless computing capacity in the event of a disaster, involving the establishment of secure computer servers in separate locations with adequate capacity to provide backup access to critical systems • Change control procedures for all system enhancements • Ensuring that access controls are implemented and enforced • Standardisation of applications and infrastructure technology • Upgrade and technology "refresh" programme to ensure that our applications and infrastructure are current and supported • Emphasis at all levels on enhancing IT security from all potential threats, both internal and external • Reviews of IT governance.

Risk	Response
Personal liability and legal compliance	
Customers may lodge personal liability claims against the group for harm caused by or suffered in connection with the use of goods sold by the group's subsidiaries. The legislative framework within which we operate has become increasingly complex. Amendments to existing laws, new laws and pending Bills have to be tracked and continuously assessed to ensure compliance. Business processes have to be aligned to ensure compliance.	• Ongoing review of legislation (existing, new and pending) • Compliance report-backs given to executive committees and the risk committee • Workshops and task teams are formed within our business to assess the impact of laws and to agree on implementation of action plans where necessary • Awareness and training sessions for our staff on new laws.
Exchange rate, interest rate and inflation fluctuations	
Sudden changes in the exchange rate may affect the costs of goods imported, directly and indirectly. Significant and sudden increases in local interest rates may curb consumer expenditure, in addition to increasing the cost of borrowing and corporate funding. Such changes may adversely affect the group's profitability and growth. Furthermore, higher inflation rates may curb the group's profitability where such increased inflation rates are not associated with increased productivity and/or impacts on consumer spending habits.	• All import orders are covered by forward exchange contracts • The group is generally able to adjust ranges to fit key price points • The group is generally able to pass price increases on to customers, although the volume of sales across price points may change.
Crime	
Prevailing high levels of crime in South Africa pose a risk to the group, which may suffer losses from fraud and theft.	• Continually reviewing security at stores • Staff training on how to deal with armed robberies • Anonymous whistle-blowing number to report criminal acts • Tight controls over the handling of cash and control over stock.
Business continuity	
The loss of a major head office facility or distribution centre could impact upon critical business functions. Continuous electricity shortages impacts on ability to distribute merchandise and to trade.	• Separate head office building and distribution facility • Providing backup facilities for critical functions • Install generators, UPSs and other battery solutions to enable stores to trade seamlessly despite intermittent electrical supply • Splitting the computing capacity over different server rooms in separate locations • Business continuity plans and disaster recovery plans • Comprehensive physical protection measures • Appropriate insurance cover.