

Risk Appetite

A digestible guide on risk appetite for first time board members



Risk Appetite: Introduction and Glossary

We would like to extend a warm welcome to you and thank you for taking a seat at the boardroom table.

This guide requires you to use your imagination where **restaurant dining and the concept of your appetite**, both literal and theoretical, merge with risk appetite in the boardroom. We have curated fun menus and a hunger scale as tools to help your understanding.



Board decision-making is informed by an understanding of risk and how it is managed. One of the key responsibilities of board directors is setting the organisations **risk appetite**.

We have prepared for you a curated glossary of risk terms that we think would be helpful for you to know before reading using the risk appetite tools on the pages ahead.

Risk	Refers to the effect of uncertainty on objectives (AS/NZS ISO 3100 Risk management)
Risk management	The way that organisations take uncertainty into account when they make decisions. It is the culture, processes and structures directed towards taking advantage of potential opportunities while managing potential adverse effects
Risk appetite	The mutual understanding, between management and board, of the drivers of and parameters around opportunity-seeking behaviour. Risk appetite is defined by the board, who is then responsible for ensuring the organisation has a framework for identifying and managing risk on an ongoing basis.
Risk treatment	Refers to any process to modify risk.
Risk tolerance	The organisation's or stakeholder's readiness to bear the risk after risk treatment in order to achieve its objectives.
Risk register	A tool for documenting risks, and actions to manage each risk.

Table of Contents

Risk Appetite: Introduction and Glossary	1
Risk Appetite: A Menu of Risk Types	3
Risk Appetite: An Analogy	4
Risk Appetite: The Challenges.....	5
Risk Appetite: Woven into an Organisation’s Purpose, Strategy and Performance.....	6
Risk Appetite: Risk Leadership Roles	7
Role of the CEO	7
Role of the Board.....	7
Role of the Risk Committee	7
Risk Appetite: A Three Course Menu of Risk Appetite Focussed Questions.....	8
Risk Appetite: The Hunger Scale	9
Risk Appetite: A closing message from the 2020 Emerging Leaders in Governance Risk Team	10
Meet the Authors	11

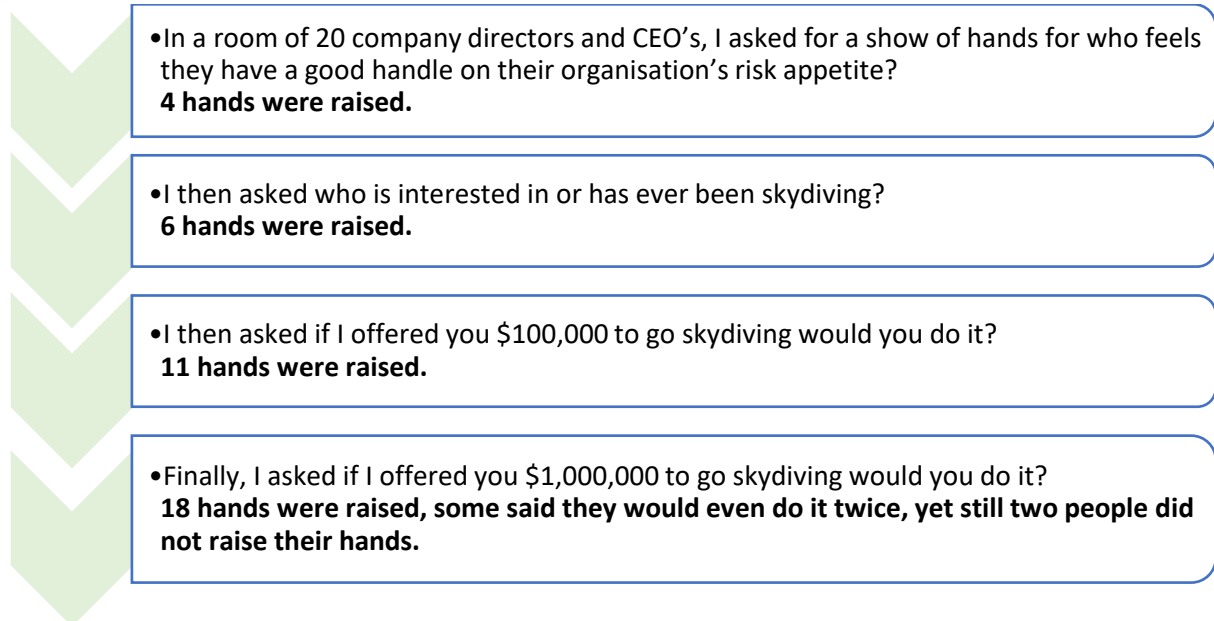
Risk Appetite: A Menu of Risk Types

The types of risks presented and discussed at the Boardroom table can differ greatly depending on the organisation and the industry.

Below is a list of some of the most common types of risks that may be considered by board directors.

Operational	Risks that may occur in the day to day operations of the organisation, i.e. employee behaviour.
Reputational	Any risk that may negatively affect an organisation's reputation, i.e. a security incident where confidential information is shared publicly.
Environmental	Risks related to the physical environment such as natural disasters, i.e. COVID-19.
Financial	Any risk associated with finance, i.e. changes in interest rates or foreign exchange.
Market	Risk related to being competitive in the industry, i.e. competition for funding or change in funding key performance indicators.
Strategic	Risks related to the strategic plan, i.e. a failed business decision.
Health and Safety	Related to State and Federal legislation about the health and safety of those in the workplace, i.e. not sufficiently managing workplace hazards.
Legal and Regulation	Risk associated with legal and regulatory compliance, i.e. breach of contract.

Risk Appetite: An Analogy



This analogy highlights our personal risks versus organisational risk and how our personal preferences and appetite for risk is likely to play a part in organisational and boardroom decisions.

Risk Appetite: The Challenges

The risk appetite challenges for Boards include:

Getting consensus around how much risk is appropriate for the organisation

Not having a shared view of how much risk is appropriate for the organisation

Having trouble articulating and implementing an organisational risk appetite

Amazon spent 6 years to make profit, a risk their board were able to take. Not for Profit boards don't have the time to take those kinds of risks.

Board members are not compensated; will this mean they take more risk or less risk? Does their accountability or investment hinder their appetite?

Funders or grant givers want to see where their money goes therefore risk tolerance may be low or agreed to prior.

Risk Appetite: Woven into an Organisation's Purpose, Strategy and Performance



The organisation's DNA is set by its purpose, strategy and performance and the most successful Boards reflect a common understanding of risk appetite into each one of these interrelated elements when they are set and evaluated.

Risk appetite is important when charting the course of an organisation, setting strategies and at a decision-making and performance review level. Risk appetite conversations should start when establishing or revising an organisation's purpose, vision and values. If these elements of the organisation are founded in the organisation's risk appetite, then all risk-based decisions can easily be viewed through the lens of the organisation. An organisation's purpose, vision and values drive strategy formation and execution, day-to-day performance and ultimately create value for the organisation.

When deciding on the organisation's strategy this should be framed with conversations around risk appetite and the Board should carefully decide which strategies are within an acceptable range of risk tolerance based on the risk appetite set by the Board.

We can also focus the conversation on risk appetite when we evaluate organisational performance. The Board often undertakes evaluative conversations after decisions are made to evaluate whether the board directors are still confident in the level of risk that the organisation is pursuing and to consider whether the Board needs to change its course or reset the strategy.

The whole point is that directors and the CEO need a meeting of the minds as to the boundaries within which to operate over time. In my experience board-management risk appetite dialogue is the important thing. The statement itself can be very simple so long as it reflects the dialogue. — Norman Marks, Author of Risk Management in Plain English: A Guide for Executives: Enabling Success through Intelligent and Informed Risk-Taking (2018)

Risk Appetite: Risk Leadership Roles

Role of the CEO

The CEO is responsible for designing and implementing the framework for managing the risk culture of the organisation. The CEO must ensure the use appropriate risk management frameworks, internal controls, crisis management and business continuity plans are developed, implemented and monitored throughout the organisation.

Role of the Board

The role of the board is to make decisions about the appropriate risk framework and ensure that effective controls are in place including the setting of risk appetite. The board is responsible for ensuring that the CEO is effectively implementing risk frameworks.

Role of the Risk Committee

A risk committee is established by the board to assist in the effective discharge of its control, compliance and risk responsibilities, as the governing body of the organisation, under the relevant organisational constitution, Acts and legislation.

The Committee is responsible for:

- Reviewing and monitoring internal control systems.
- Reviewing and monitoring risk and opportunity management systems.
- Reviewing and monitoring corporate reporting systems.
- Reviewing and monitoring compliance systems.
- Ensuring the delivery of an effective governance, risk and compliance framework.



Risk Appetite: A Three Course Menu of Risk Appetite Focussed Questions

For Starters

1. What is our risk appetite?
2. How close is the organisation to its overall capacity for risk? How do we know this?
3. Do we have different appetites for different types of risk?

Entrée

4. Are we risk averse? Is this just for some specific risks? Or for all risks?
5. Which risks would seriously impact on the organisation's strategy? Are we operating within our appetite for these risks?
6. How well are those risks being managed and which areas require further improvement?
7. How do we measure the performance of the organisation to determine whether it is operating within the risk appetite set by the board?
8. How could we be presenting risk data in a way that improves our understanding of the risk exposures that we are running?






Main

9. Where is our risk profile changing most quickly?
10. What are the significant changes to the business, competition or control environments?
11. Have we properly understood how to map our organisations strategic objectives to our risk objectives?
12. If there were to be a breach of our risk appetite limits, what would be the management actions that would bring the measure back within our appetite range?
13. Have the limits and triggers been calibrated well enough so that those actions would have enough time to take effect?

Dessert

14. Can the board or CEO give an example of the last time that risk appetite informed a business decision?
15. Do staff use risk appetite concepts in their day to day employment? Do you think most operational staff can answer questions about how these concepts relate to them?

Risk Appetite: The Hunger Scale

Hunger Rating	Philosophy	Objective / negative impact relationship	Tolerance for Uncertainty
Painfully Hungry 	Will take justified risks	Willing to accept a large negative impact in order to pursue a strategic objective	Fully anticipated
Open, Risk Seeking Hungry, but not starving 	Will take strongly justified risks	Willing to accept some negative impact in order to pursue a strategic objective	Expect some
Flexible, Risk Tolerant Neutral – not hungry or full 	Preference for safe delivery	Potential negative impact and strategic objective completion given equal consideration	Limited
Cautious, Risk Neutral Comfortably satisfied 	Extremely conservative	Only willing to accept a small negative impact in order to pursue a strategic objective	Low
Minimalist, Moderately Risk Averse Painfully full 	Scared, avoidance of risk is a core objective	Not willing to accept any negative impact in order to pursue a strategic objective	Extremely Low
Averse, Risk Averse			

Risk Appetite: A closing message from the 2020 Emerging Leaders in Governance Risk Team

What does a Lawyer, a HR Professional, an Engineer, a Psychologist and an Entrepreneur know about risk? Only the the nuts and bolts of risk appetite, which is why this guide is only the tip of the iceberg for risk theory and risk concepts relevant to boards. When risk is on the menu at your board, make sure you take the time to look beyond this guide and assess.

We hope you have enjoyed getting to know the concept of risk appetite and how it applies to Boards.

We would love your feedback so please feel free to reach out to us on LinkedIn.

Fun fact: This risk appetite guide for new board members was developed at a time when most organisations were 'painfully full' – scared and avoidance of risk is a core objective due to the COVID-19 pandemic.

We hope you get to experience the full spectrum of risk appetite in your Board career.

So, keep learning and stay healthy.

2020 ELGP Risk Team 😊

Meet the Authors



Henry Burke

Henry is a legal professional with a passion for social justice. Until 2018, Henry practiced law mainly in the areas of Family & De Facto and Wills & Estates law. Looking to combine his interest in humane areas of the law, in particular Elder Law, and care for others he began work with Hall & Prior in 2019 as Governance & Administration Officer. He greatly enjoys working with a diverse group of people in the area of Aged Care, who share compassion for others.



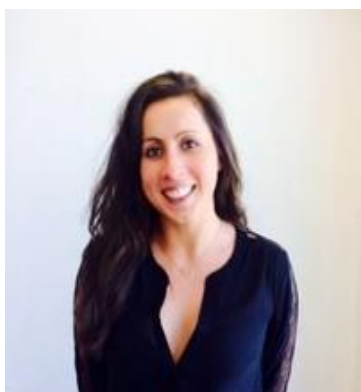
Kassia Ralston

Kassia is an Engineer and former Australian Water Polo athlete. She leads the planning and project management of major public infrastructure projects and influences the design to enable more inclusive and accessible Australian communities. Kassia is a Committee Member for the Western Australian Division of Engineers Australia, a not-for-profit organisation, to advance the science and practice of engineering for the benefit of the community. She volunteers as a Surf Patrol Member for Swanbourne Nedlands Surf Life Saving Club. Kassia looks forward to further leadership opportunities for for-purpose community organisations, projects and initiatives.



Dr Sarah Parkin

Dr Sarah Parkin is a Clinical Psychologist who has focused her career on understanding how to support individuals with their mental health needs across the lifespan. After working in various positions across the public and private sector Sarah made the decision to seek employment in a not-for-profit organisation as she considered this more aligned with her values and aspirations to positively support local communities. Sarah is currently employed as a Clinical Psychologist by Youth Futures WA where she provides psychological support to young people with mental health issues who have experienced barriers to engaging in mainstream education.



Lisa King

An accredited HR Professional with a legal background Lisa has a diverse background that includes private, in-house Legal, recruitment, OHS and HR. This has been gained through private legal practice, global financial services, not for profit member based and agency service providers. Additionally, Lisa has achieved an impressive academic record that only supplements that capability including her AHRI accreditation and ER/IR Masters. Lisa emigrated alone and has worked and volunteered in Kenya and Philippines. Lisa's point of difference is she is able to use her whole brain when problem solving and has a passion for future proofing businesses.