



Board guidance on risk appetite

Good Governance Institute (GGI)

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Board guidance on risk appetite

Risk appetite, defined as ‘the amount and type of risk that an organisation is prepared to pursue, retain or take’¹ in pursuit of its strategic objectives, is key to achieving effective risk management. It represents a balance between the potential benefits of innovation and the threats that change inevitably brings, and therefore should be at the heart of an organisation’s risk management strategy – and indeed its overarching strategy.

It is important that boards understand and apply risk appetite because:

- If they do not know what their organisation’s collective appetite for risk is and the reasons for it, this may lead to erratic or inopportune risk-taking, exposing the organisation to a risk it cannot tolerate; or an overly cautious approach which may stifle growth and development
- If they do not know the levels of risk that are legitimate for them to take, or do not take important opportunities when they arise, then service improvements may be compromised and patient and user outcomes affected
- It can serve as the basis for consistent and explicit communication at different levels, and to different stakeholders. Risk appetite will be influenced by a number of factors including personal experience, political factors and external events among others.

Risk can generate significant opportunities and therefore should be considered in terms of both opportunities and threats:

- When considering threats, the concept of risk appetite embraces the level of exposure which is considered tolerable and justifiable should it be realised
- When considering opportunities, the concept embraces consideration of how much one is prepared to actively put at risk in order to obtain the benefits of the opportunity
- It is important that boards understand that in order to achieve their strategic objectives they may have to adopt a more assertive risk appetite, recognising that risk appetite should be forward-looking.

Risk tolerance is subtly different to risk appetite in that it reflects the boundaries within which the executive management are willing to allow the true day-to-day risk profile of the organisation to fluctuate while they are executing strategic objectives in accordance with the board’s strategy and risk appetite. It is the level of residual risk within which the board expects sub-committees to operate and management to manage. Breaching the tolerance requires escalation to the board for consideration of the impact on other objectives, competing resources, and timescales.

At least once a year, the board should set specific limits for the levels of risk the organisation is able to tolerate in the pursuit of its strategic objectives. The board should also review these limits during periods of increased uncertainty or adverse changes in the business environment.

In setting these risk appetite and tolerance levels, the board should consider risk factors in both the external and internal business environments. These levels could be measured quantitatively, qualitatively, or both, and should be specific to each of the relevant core activities and outcomes.

The board may also set limits regarding the enterprise’s risk appetite, i.e. the risk limits that the board desires, or is willing to take.

The board should monitor and audit the management of significant risk undertaken by managers and clinical staff and satisfy itself that decisions balance performance within the defined appetite and tolerance limits. The board should ensure that it understands the implications of risks taken by management in pursuit of better outcomes, as well as the potential impact of risk-taking by, and on, local communities, partner organisations, strategic providers and other stakeholders.

This process is dynamic; risk probability and impact as well as risk appetite can change through circumstances and experience. The perception of the public to risk and confidence in the organisation’s ability to identify and mitigate risk successfully can shift quickly in the light of publicity and risk failures often outside the direct control of the organisation. As such, risk awareness and communication play an important part in protecting the reputation of the organisation from such instances of outrage.

1. ISO 31000



GGI believes that it helps to identify different types of risk (including, but not limited to, finance, regulation, quality, reputation, and people) but it is important to always assess these in the round. To support this, we have developed the risk appetite matrix.

The matrix sets five levels of risk appetite for each of the risk types. There are no right answers, but the matrix allows board members to articulate their appetite and tolerances and arrive at a corporate view, considering the risk appetite of others and the capacity for management to communicate and deliver.

Boards should consider each strategic objective against the matrix and agree its level of risk appetite, what it can delegate, and what additional assurance it requires. The matrix can also be used for individual initiatives and emerging problems and should help the board to better manage its agenda and the level of routine reporting required.

Breaches of agreed appetite must be escalated with agility.

Strategic risks and the board assurance framework

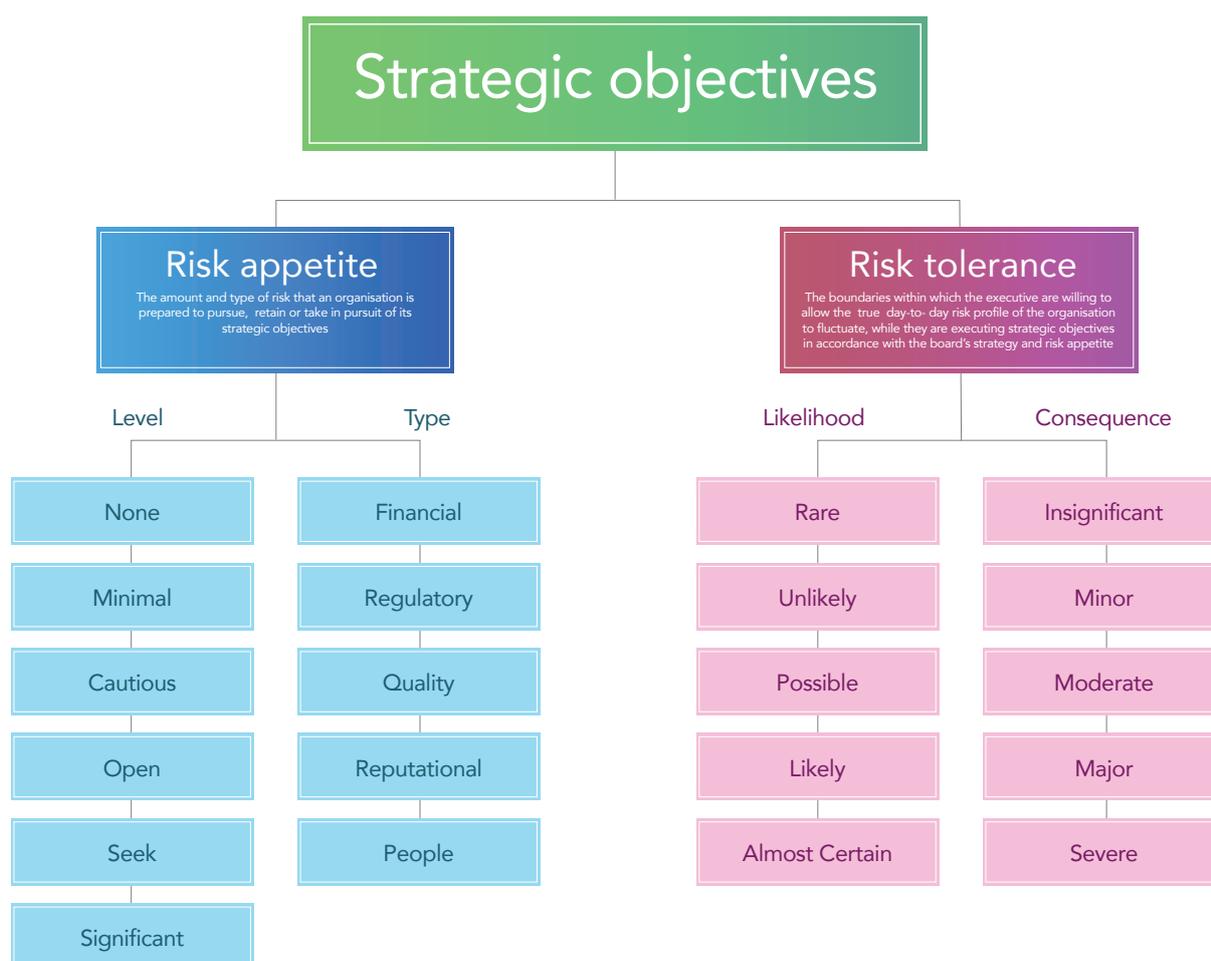
A critical role of any board is to focus on the risks that may compromise the achievement of the organisation’s strategic objectives. In order to be confident that the systems of internal control are robust, a board must be able to provide evidence that it has systematically identified its strategic objectives and managed the principal risks to achieving them.

A good board assurance framework (BAF) is a live tool that helps boards to undertake this duty by providing a simple yet comprehensive means by which to effectively manage the principal risks to meeting the strategic objectives. The Audit Committee Handbook identifies the BAF as ‘the key source of evidence that links strategic objectives to risks and assurances, and the main tool that the board should use in discharging its overall responsibility for internal control’.²

The BAF, therefore, is the key document that should be driving the board and committee agendas. It provides a structure that enables the board to focus on the significant risks, highlights any key controls (management actions to avoid or mitigate risks) that have been put in place to manage the risk, any areas requiring further action, sources of evidence or assurance, and any gaps.

The BAF is, in GGI’s view, the original invest-to-save scheme for boards. Time spent on getting the various elements of the BAF right will help boards streamline assurance, locate where and how assurance is tested and develop proportionality in board reporting.

Key to this will be boards taking responsibility for identifying their risk appetite and risk tolerance for each strategic objective and agreeing what is sufficient in terms of controls and the assurances that the controls are operating effectively. The greater the risk appetite, the more controls should be put in place by management to avoid or mitigate the risk.



Applying risk appetite matrix

RISK APPETITE LEVEL	0 NONE	1 MINIMAL	2 CAUTIOUS	3 OPEN	4 SEEK	5 SIGNIFICANT
RISK TYPES						
FINANCIAL How will we use our resources?	We have no appetite for decisions or actions that may result in financial loss.	We are only willing to accept the possibility of very limited financial risk.	We are prepared to accept the possibility of limited financial risk. However, VFM is our primary concern.	We are prepared to accept some financial risk as long as appropriate controls are in place. We have a holistic understanding of VFM with price not the overriding factor.	We will invest for the best possible return and accept the possibility of increased financial risk.	We will consistently invest for the best possible return for stakeholders, recognising that the potential for substantial gain outweighs inherent risks.
REGULATORY How will we be perceived by our regulator?	We have no appetite for decisions that may compromise compliance with statutory, regulatory of policy requirements.	We will avoid any decisions that may result in heightened regulatory challenge unless absolutely essential.	We are prepared to accept the possibility of limited regulatory challenge. We would seek to understand where similar actions had been successful elsewhere before taking any decision.	We are prepared to accept the possibility of some regulatory challenge as long as we can be reasonably confident we would be able to challenge this successfully.	We are willing to take decisions that will likely result in regulatory intervention if we can justify these and where the potential benefits outweigh the risks.	We are comfortable challenging regulatory practice. We have a significant appetite for challenging the status quo in order to improve outcomes for stakeholders.
QUALITY How will we deliver safe services?	We have no appetite for decisions that may have an uncertain impact on quality outcomes.	We will avoid anything that may impact on quality outcomes unless absolutely essential. We will avoid innovation unless established and proven to be effective in a variety of settings.	Our preference is for risk avoidance. However, if necessary we will take decisions on quality where there is a low degree of inherent risk and the possibility of improved outcomes, and appropriate controls are in place.	We are prepared to accept the possibility of a short-term impact on quality outcomes with potential for longer-term rewards. We support innovation.	We will pursue innovation wherever appropriate. We are willing to take decisions on quality where there may be higher inherent risks but the potential for significant longer-term gains.	We seek to lead the way and will prioritize new innovations, even in emerging fields. We consistently challenge current working practices in order to drive quality improvement.
REPUTATIONAL How will we be perceived by the public and our partners?	We have no appetite for decisions that could lead to additional scrutiny or attention on the organisation.	Our appetite for risk taking is limited to those events where there is no chance of significant repercussions.	We are prepared to accept the possibility of limited reputational risk if appropriate controls are in place to limit any fallout.	We are prepared to accept the possibility of some reputational risk as long as there is the potential for improved outcomes for our stakeholders.	We are willing to take decisions that are likely to bring scrutiny of the organisation. We outwardly promote new ideas and innovations where potential benefits outweigh the risks.	We are comfortable to take decisions that may expose the organisation to significant scrutiny or criticism as long as there is a commensurate opportunity for improved outcomes for our stakeholders.
PEOPLE How will we be perceived by the public and our partners?	We have no appetite for decisions that could have a negative impact on our workforce development, recruitment and retention. Sustainability is our primary interest.	We will avoid all risks relating to our workforce unless absolutely essential. Innovative approaches to workforce recruitment and retention are not a priority and will only be adopted if established and proven to be effective elsewhere.	We are prepared to take limited risks with regards to our workforce. Where attempting to innovate, we would seek to understand where similar actions had been successful elsewhere before taking any decision.	We are prepared to accept the possibility of some workforce risk, as a direct result from innovation as long as there is the potential for improved recruitment and retention, and developmental opportunities for staff.	We will pursue workforce innovation. We are willing to take risks which may have implications for our workforce but could improve the skills and capabilities of our staff. We recognize that innovation is likely to be disruptive in the short term but with the possibility of long term gains.	We seek to lead the way in terms of workforce innovation. We accept that innovation can be disruptive and are happy to use it as a catalyst to drive a positive chan.