



Beyond Governance
Creating clarity, improving business

Risk Appetite Statement

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Risk Appetite Statement

What is a risk appetite statement?

The Institute of Risk Management defines risk appetite as ‘the amount and type of risk that an organisation is willing to take in order to meet their strategic objectives’. An organisation’s sector often determines the extent of their risk appetite for different risks. For example, in financial services an organisation is likely to have a lower risk appetite to fraud and security risk.

A risk appetite statement helps organisations keep their risk profile within acceptable levels to pursue their objectives or other strategic goals before taking action deemed necessary to reduce the risk. It is a mechanism for balancing risk and should consider both upside and downside risks and how downside risks can be controlled and/or mitigated.

The board of directors is responsible for determining the nature and extent of significant risks an organisation is willing to take and its risk appetite statement.

Risk appetite statements can cover areas including safety, compliance, operational risk, cyber security, and reputation.

How do you design a risk appetite statement?

The risk appetite statement needs to be linked to the strategic objectives of the organisation and the board need to be clear about the risks the organisation is willing to take to achieve its objective; the tone from the top.

In designing an organisation’s risk appetite an organisation first needs to define the risks, what risks is the organisation actually concerned about? An organisation will need to consult with internal stakeholders and executive management to determine these risks.

For each of the risks identified, consider the impact, likelihood, and severity of the outcome of each risk which then enables the organisation to gauge the risk exposure against the risk appetite when making strategic decisions. Internal and external factors should be considered when creating the risk appetite statement. Each risk should be categorised to determine the level of controls needed.

Risk appetite needs to be measurable to enable the board to monitor risk and ascertain if operations are under control, and also to provide guidance for decision making. For example, if employee turnover/attrition is a major concern, how many vacancies can an organisation sustain before services are seriously affected?

In order to support the above, an organisation should use key risk indicators, a traffic light system where green is acceptable, amber is marginal, and red is unacceptable. This should include actions the organisation needs to take to close the gaps.



Why is a risk appetite statement needed?

A risk appetite statement helps maintain appropriate corporate governance by expressing, setting and monitoring an organisations appetite for risk. By setting out what the board of directors believes to be excessive risk, management are clear on what approach to take. It is common to set limits in an organisation as to the level of exposure for specific categories of risk. When an organisation's board is required to make a decision, they should consider whether:

- The benefits justify the outcomes;
- The outcomes are within risk appetite;
- Resources are available to realise the benefits; and
- The consequences of taking a decision outside of risk appetite.

The consequence of not having a risk appetite statement is either an organisation that is too risk averse i.e., organisations avoid risk so decisions are only taken with no inherent risk, or an organisation takes too many high risks which can put the organisations resources at risk, or worse, failure.

Organisations should have a risk culture that balances risk awareness and risk taking whilst not stagnating innovation.