

By: The Head of Audit & Risk

To: Governance and Audit Committee – 02 December 2008

Subject: ADVISING MEMBERS ABOUT FURTHER STEPS  
BEING UNDERTAKEN TO STRENGTHEN THE  
COUNCIL'S OVERALL RISK MANAGEMENT

Classification: Unrestricted

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**Summary:** This report presents the concept of risk appetite and sets this in the context of the Council's overall risk management framework.

## **FOR INFORMATION AND DECISION**

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### **INTRODUCTION**

1. The issue of risk appetite was raised by internal audit in the 2008/09 Risk Management report (Recommendation 5 on aggregate risk). There was a need for the Council to understand the aggregate risk for different activities and business units, comparing the results with the Council's overall risk appetite.
2. The concept of risk appetite is explained below. It is widely used in the private sector (oil and gas exploration) and in the public sector by Government departments such as DfID to evaluate the returns on capital associated with long term contracts. The Council would benefit from understanding its aggregate risk exposure. By assessing risks individually, the Council may inadvertently be either more risk averse or risk exposed than intended. If too risk averse innovation will be stifled, if too risk exposed there is a threat to key objectives.
3. An understanding of aggregate risk assessment would enable the Council to balance high risk high return initiatives and activities with lower risk lower return activities. Adopting this approach should improve the return on capital and operating budgets.
4. Reports on the Council's aggregate risk would in time be provided to the Council's Chief Officer Group, Cabinet and Governance and Audit Committee.

### **Definition of risk appetite**

5. *Risk appetite is the amount and type of risk an organisation is prepared to seek, accept or tolerate.* (Source – British Standard 31100:2008)
6. Risk appetite reflects an organisations approach to both opportunities and threats within appropriate levels of authority. The organisation's risk appetite should be established and/or approved by the Board (or equivalent) and effectively communicated throughout the organisation. Risk appetite should be formerly

reviewed by the Board (or equivalent) as part of the organisation's strategy and planning process.

7. *Risk appetite will best be expressed as a series of boundaries, appropriately authorised by management, which give each level of the organisation clear guidance on the limits of risk which they can take, whether their consideration is of a threat and the cost of control, or of an opportunity and the costs of trying to exploit it. This means that risk appetite will be expressed in the same terms as those used in assessing risk. An organisation's risk appetite is not necessarily static; in particular the Board will have freedom to vary the amount of risk which it is prepared to take depending on the circumstances at the time. (Source – HM Treasury, The Orange Book 2004)*

## **Considerations**

8. The challenge to setting risk appetite across all of an organisation's activities, particularly in the local authority context, is the need to balance a number of qualitative and quantitative boundaries at all levels and across unrelated disciplines.
  - The qualitative boundaries set out what should not be done. For example, in the areas of health and safety standards risk of deviation from compliance standards will not be accepted, in areas of regulated activity adherence to professional standards is required and behaviour of staff must be within the organisation's code of conduct.
  - The quantitative boundaries set the threshold for risk within a certain area or level of management responsibility before higher authorisation is required. For example, this may be financial spend delegations or variances within delivery targets. The range of non-financial drivers in the public sector make setting quantitative boundaries more difficult.
9. The benefit of establishing a risk appetite is to help lock in risk management to the organisation's decision making and planning processes, empowering staff and raising morale. Having a clearly defined and well communicated risk appetite will:
  - help reinforce an understanding and engagement with the opportunities provided by delegations in the Standing Orders/Standing Financial Instructions, and
  - encourage innovation and the taking of responsibility by teams in the planning process where they can provide more options, balanced within their overall resource constraints.
10. The risk appetite will support management in articulating where and by whom they expect decisions to be taken, supporting delegation and empowering staff within reasonable boundaries. Only those actions, be they for an opportunity or threat, which are risk assessed above a certain level will require escalation for a decision. At the same time this application of the risk appetite to decision making will strengthen management's engagement with the risk management process as they will need to challenge their team's risk assessments to be sure nothing is being 'hidden' and the right matters are escalated for decision.

11. Common to both the challenge and benefit of setting a risk appetite for the organisation is the importance of its communication across the organisation, both in the first instance and over time to reinforce how it is applied

**Supporting detail**

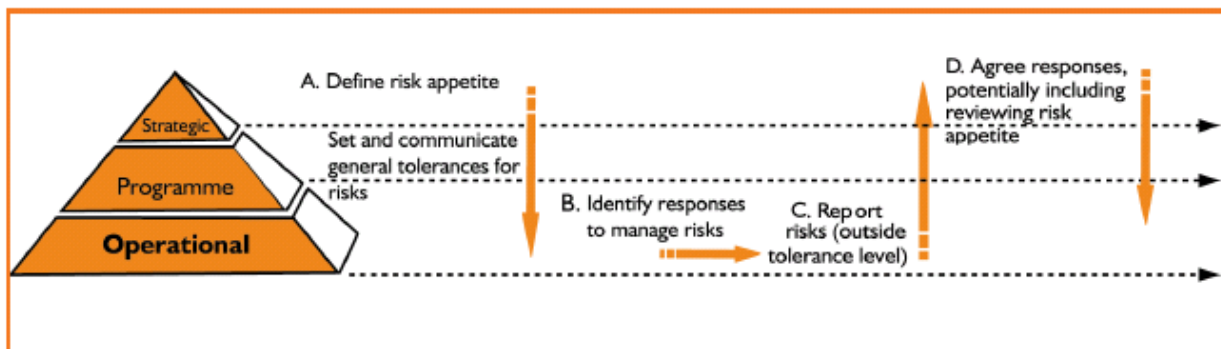
Content of a risk appetite statement

12. The organisation should prepare a risk appetite statement, which may:

- Provide direction and boundaries on the risk that can be accepted at various levels of the organisation, how the risk and any associated reward is to be balanced, and the likely response
- Consider the context and the organisation’s understanding of value, cost-effectiveness of management, rigour of controls and assurance process
- Recognise that the organisation might be prepared to accept higher than usual proportion of risk in one area if the overall balance of risk is acceptable
- Define the control, permissions and sanctions environment, including the delegation of authority in relation to approving the organisation’s risk acceptance, highlighting of escalation points, and identifying the escalation process for risk outside acceptance criteria, capability or capacity
- Be reflected in the organisation’s risk management policy and reported upon as part of the organisation’s internal risk reporting system
- Include qualitative statements outlining specific risks the organisation is or is not prepared to accept
- Include quantitative statements, described as limits, thresholds or key risk indicators, which set out how certain risks and their rewards are to be judged and/or how the aggregate consequences of risks are to be assessed and monitored.

(Source – British Standard 31100:2008)

An overview model of risk appetite



(Source – HM Treasury, The Orange Book 2004)

**Recommendation**

13. Members are asked to note this report

14. The concept of risk appetite is being raised at directorate level as part of the current round of business planning, incorporating risk management and consideration of the 2009/10 Internal Audit Plan.

15. The objective is to ensure that directorates understand the concept of risk appetite and start to reflect elements in their service planning. Updated risk registers are to be brought to a future meeting of the Governance and Audit Committee in 2009 (most likely, March) and this will present further opportunity for discussion and comment.

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