



THE ANNUAL INTERNAL AUDIT, RISK & FORENSIC CONFERENCE

SESSION : *Risk Appetite Framework & key Risk Indicators*

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Presentation Agenda



Introduction

Understanding Risk appetite Concept

Discussion –Factors ; Risk Appetite formulation

Risk Appetite Framework - elements & roles

Key Risk indicators & formulation thereof

Conclusion

Introduction- appetite?



Appetite – Introduction



- ❑ **Individual**- Appetite is a desire, a psychological need that demands to be met. How is it measured- proxy- e.g. hunger
- ❑ Risk appetite reflects **our desire to take risk-answers**

Q: How much risk do we feel that we can take on in each situation?

- ❑ RA - Tendency of an individual/group to take risk - situation

Understanding Risk appetite Concept



□ ISO 31000: 2018: Risk Criteria

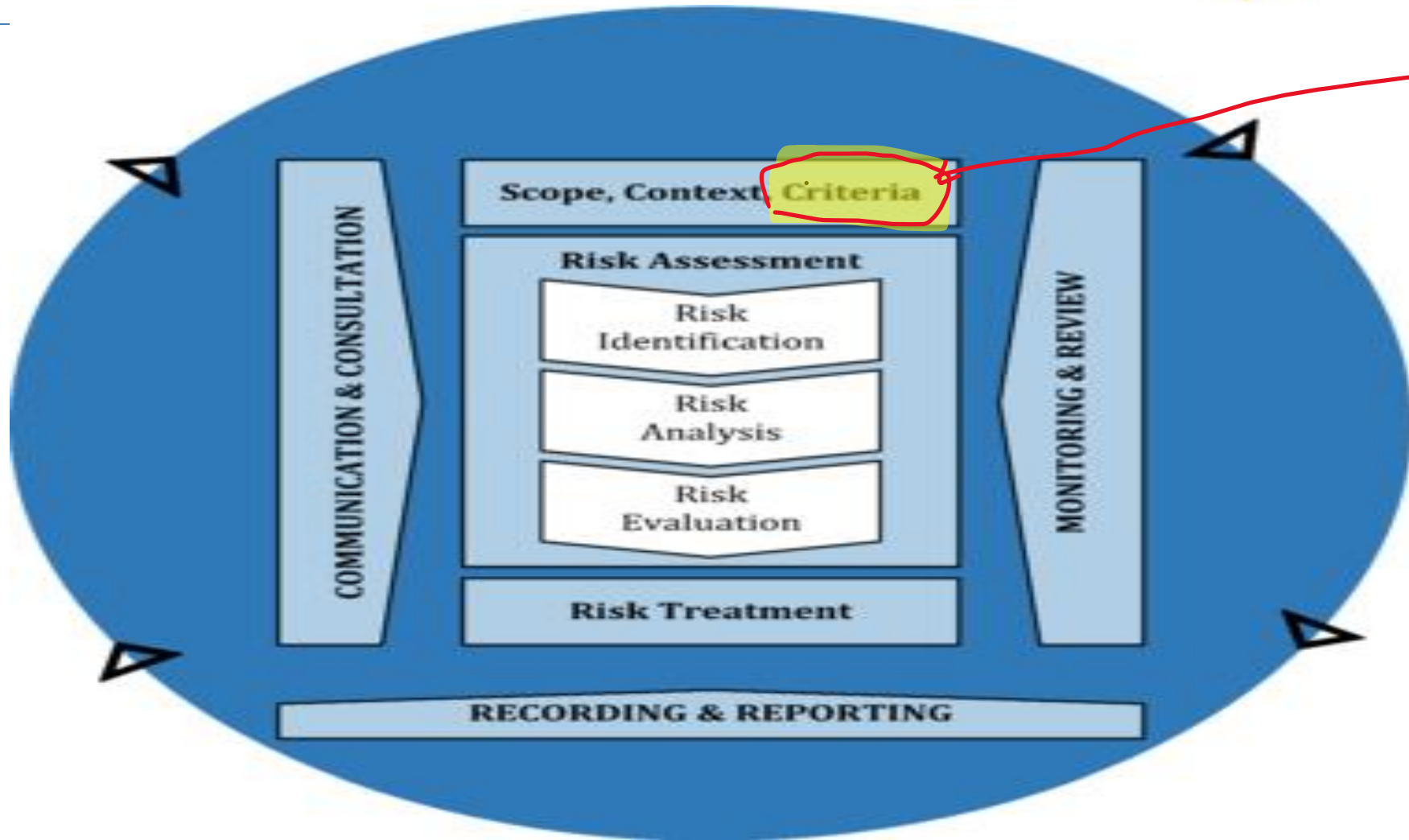
The amount and type of risk that the organization may or may not take, relative to objectives.

□ COSO (2017) Risk Appetite

as the types and amount of risk, on a broad level, an organization is willing to accept in pursuit of value.



Risk Appetite /Criteria within ERM -ISO



Risk Appetite within ERM -COSO



Figure 3—COSO Enterprise Risk Management, Components and Principles

ENTERPRISE RISK MANAGEMENT



Governance and Culture

1. Exercises Board Risk Oversight
2. Establishes Operating Structures
3. Defines Desired Culture
4. Demonstrates Commitment to Core Values
5. Attracts, Develops, and Retains Capable Individuals

Strategy and Objective Setting

6. Analyzes Business Context
- 7. Defines Risk Appetite**
8. Evaluates Alternative Strategies
9. Formulates Business Objectives

Performance

10. Identifies Risk
11. Assesses Severity of Risk
12. Prioritizes Risk
13. Implements Risk Responses
14. Develops Portfolio View

Review and Revision

15. Assesses Substantial Change
16. Reviews Risk and Performance
17. Pursues Improvement in Enterprise Risk Management

Information, Communication, and Reporting

18. Leverages Information and Technology
19. Communicates Risk Information
20. Reports on Risk, Culture, and Performance

Discussion: key terms



- ❑ **Risk Appetite Statement:** articulation / expression of risk appetite in a **written form**. Qualities ;
 - i. Clear, precise & use relevant risk appetite language*
 - ii. Ease of understanding*
 - iii. Daily application*
- ❑ *Risk appetite : trade off between return and risk*
- ❑ **Risk Tolerance/Performance Tolerance** - The extent of **variation** relative to the achievement of an **objective** that the entity is prepared to accept.

Discussion: key terms cont...



- ❖ **Risk capacity**: Maximum amount of risk that the entity can take and remain viable. Capacity : varies across risk types, business units and strategic scenarios.
- ❖ **Risk Appetite**; within the risk capacity; achieve its strategic objectives and business plan.
- ❖ **Risk Tolerance/Buffer** = Risk capacity- Risk Appetite



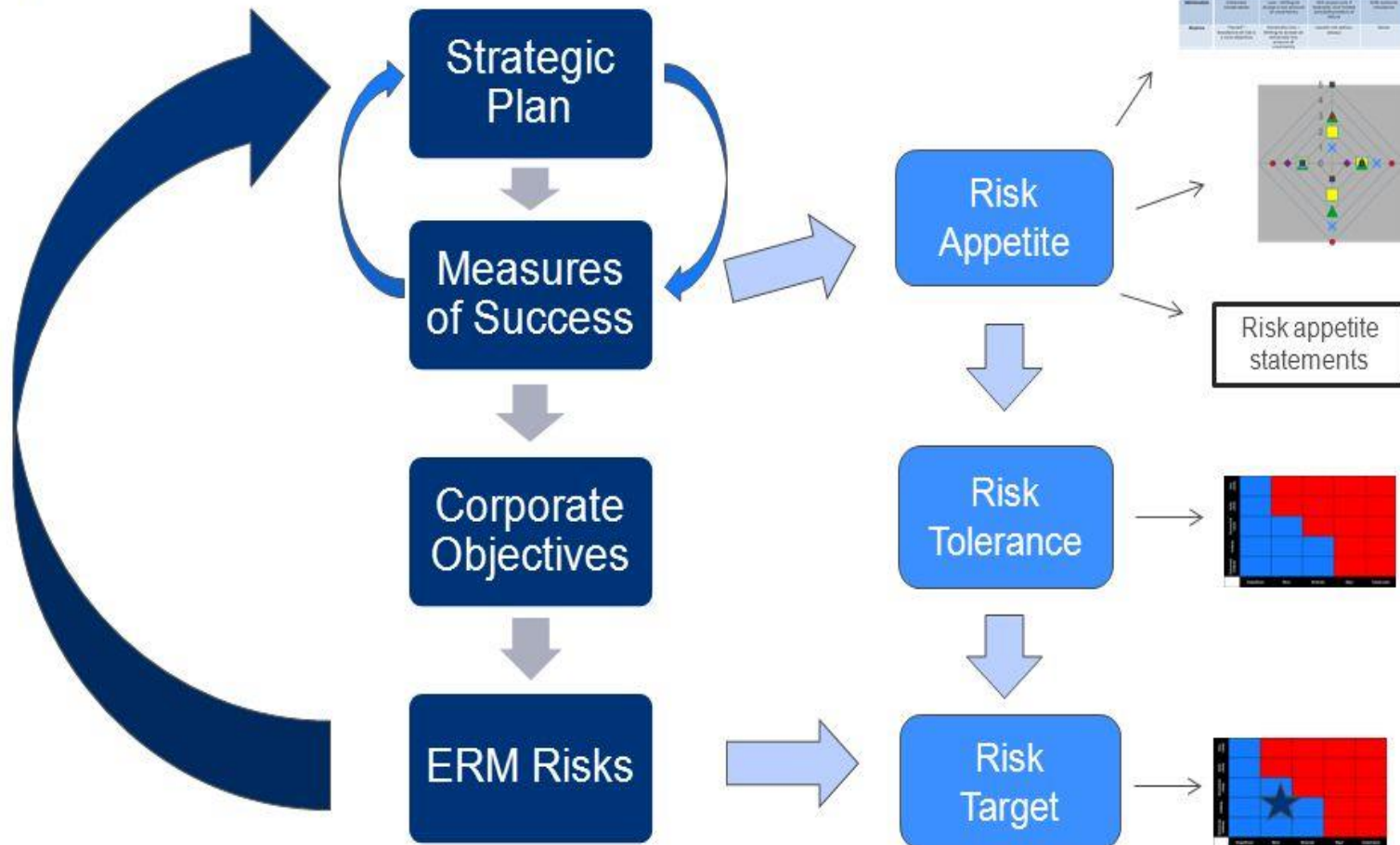
Factors – Setting Risk Appetites/Criteria



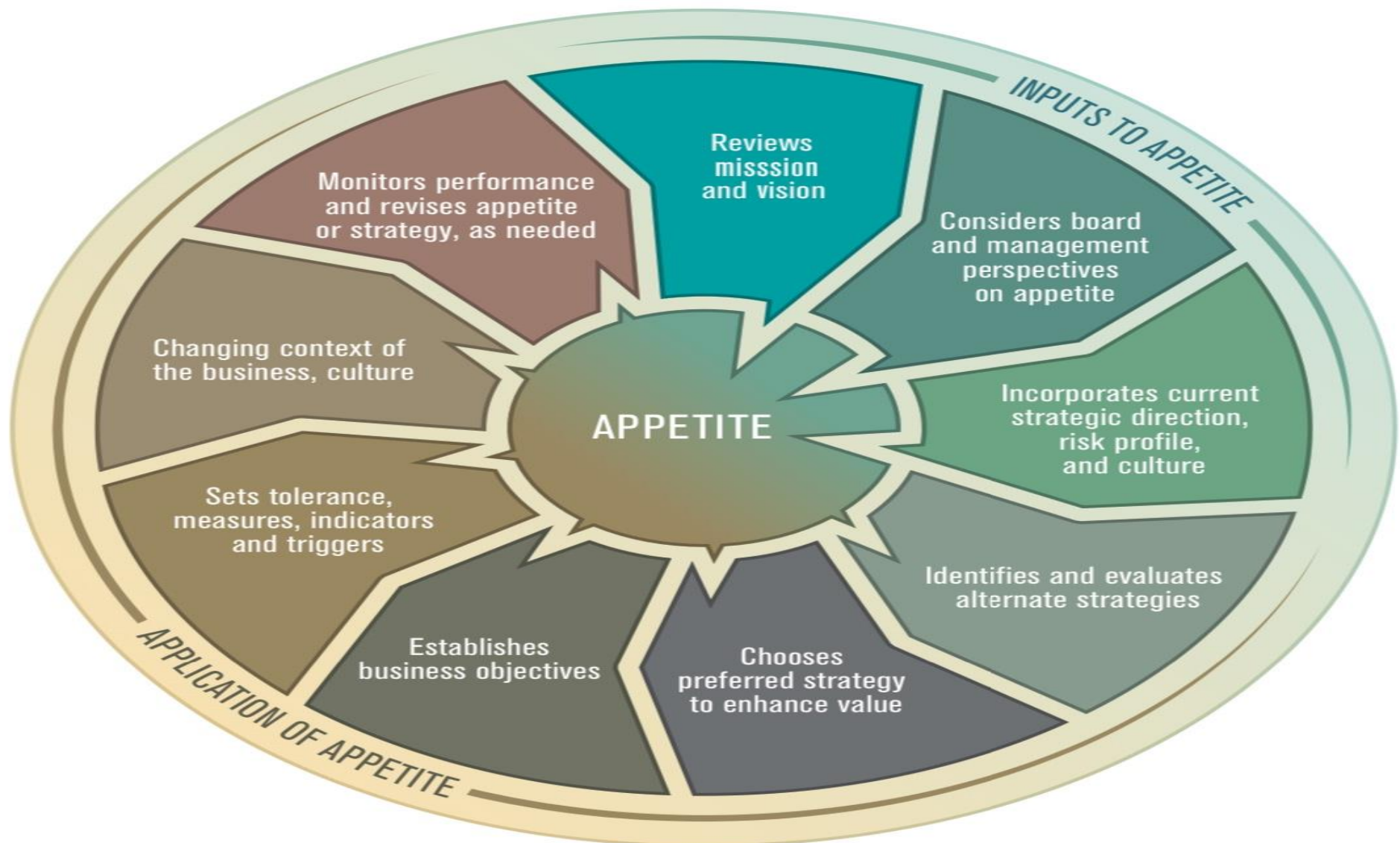
- ❑ Nature and type of uncertainties: that affect outcomes and objectives
- ❑ how consequences (+ve & -ve) and likelihood will be defined and measured;
- ❑ time-related factors.
- ❑ consistency in the use of measurements.
- ❑ how the level of risk is to be determined.
- ❑ Organization's capacity.



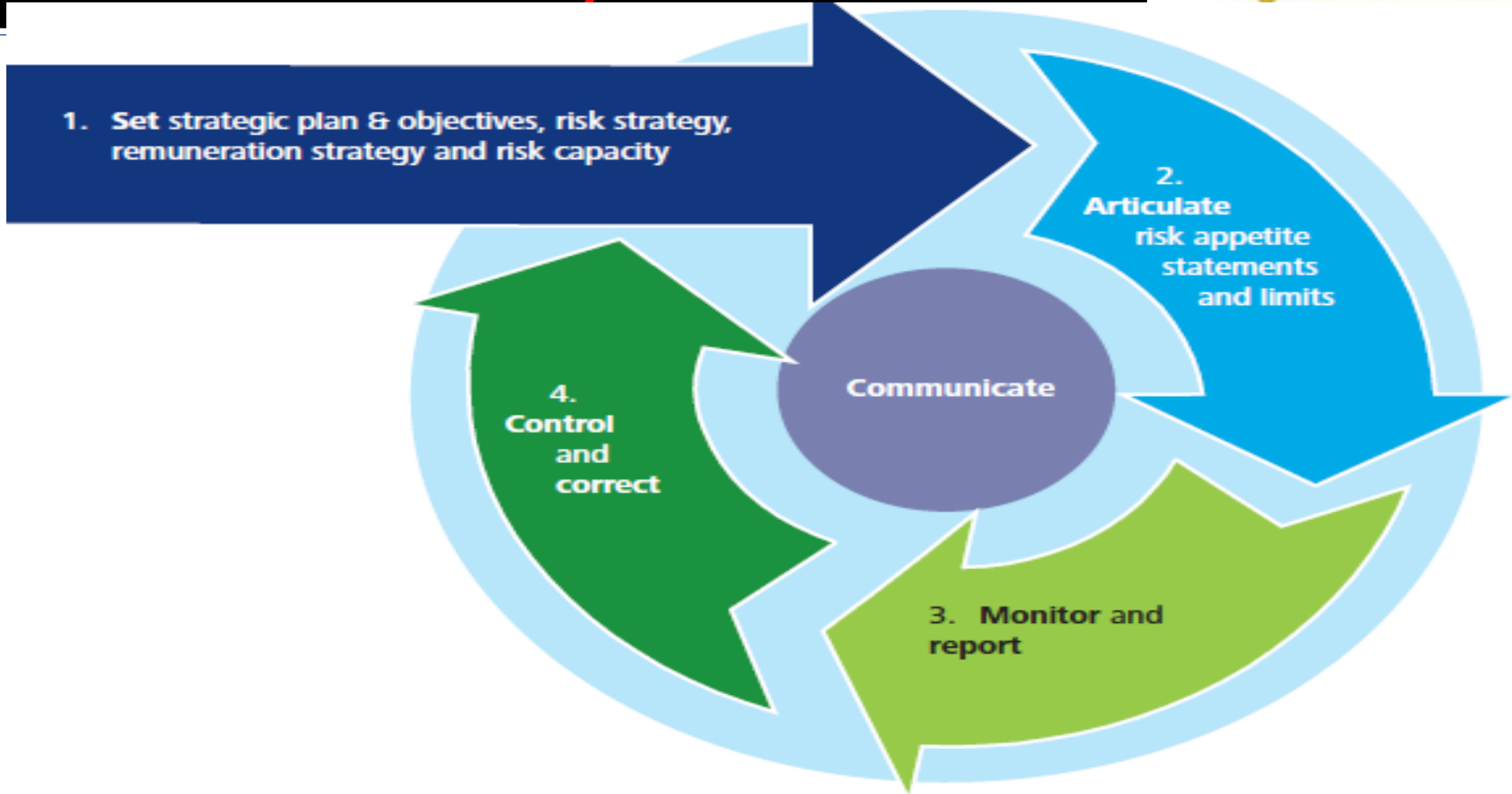
► Risk Appetite Framework



RAF formulation & monitoring- cont..



RAF formulation & monitoring- cont..

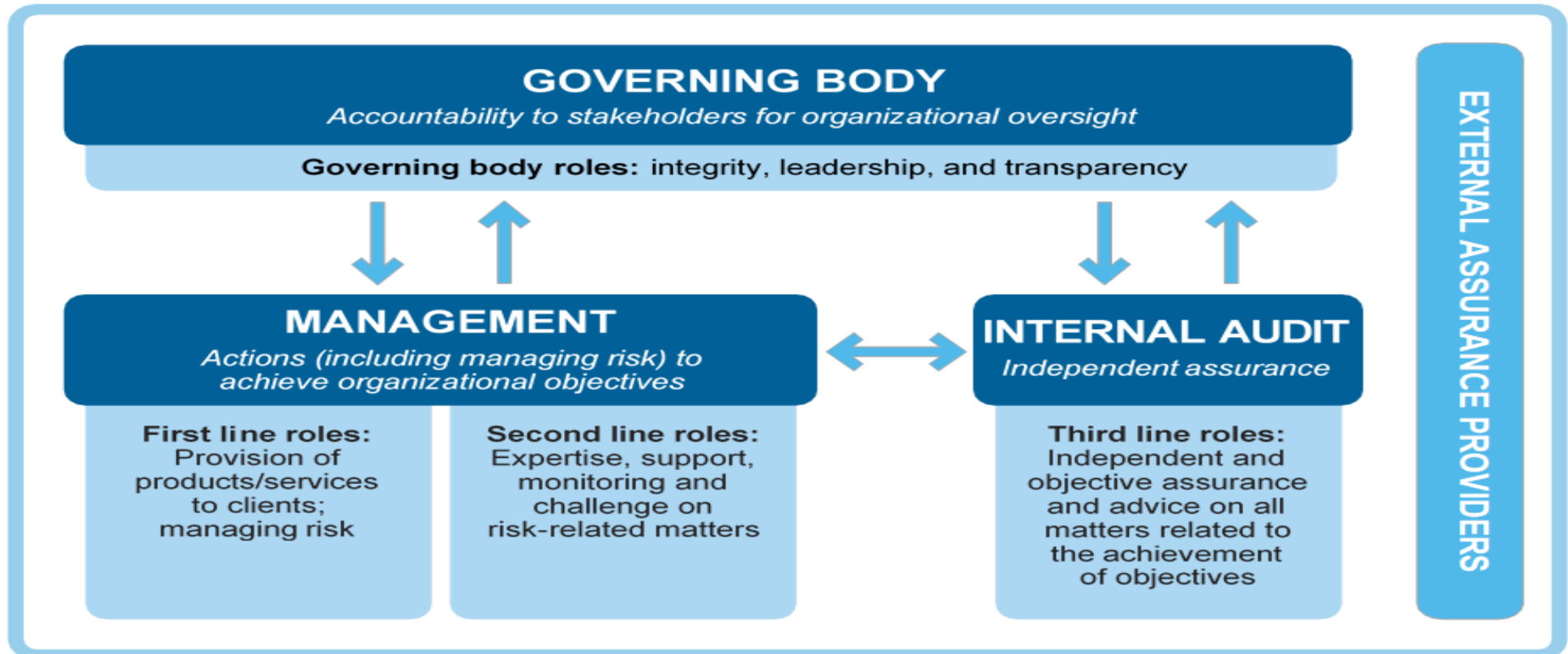


Implementation of Strategy: : Role of Risk Appetite (RA)



- ❑ RA should be known by both **Board & Mgt** when **selecting** and **implementing** strategies for each objectives.
- ❑ Taking risks requires a sense of what amount of **risk is acceptable** in pursuing *strategies and objectives*– **RA sets the tone for RM**
- ❑ **Changes** in the environment - **understand & react/optimize** – align Risk Appetite
- ❑ Choosing the **status quo** constitutes a risk that the entity must also assess.

Risk Appetite : 3-lines model



KEY: ↑ Accountability, reporting ↓ Delegation, direction, resources, oversight ↔ Alignment, communication coordination, collaboration

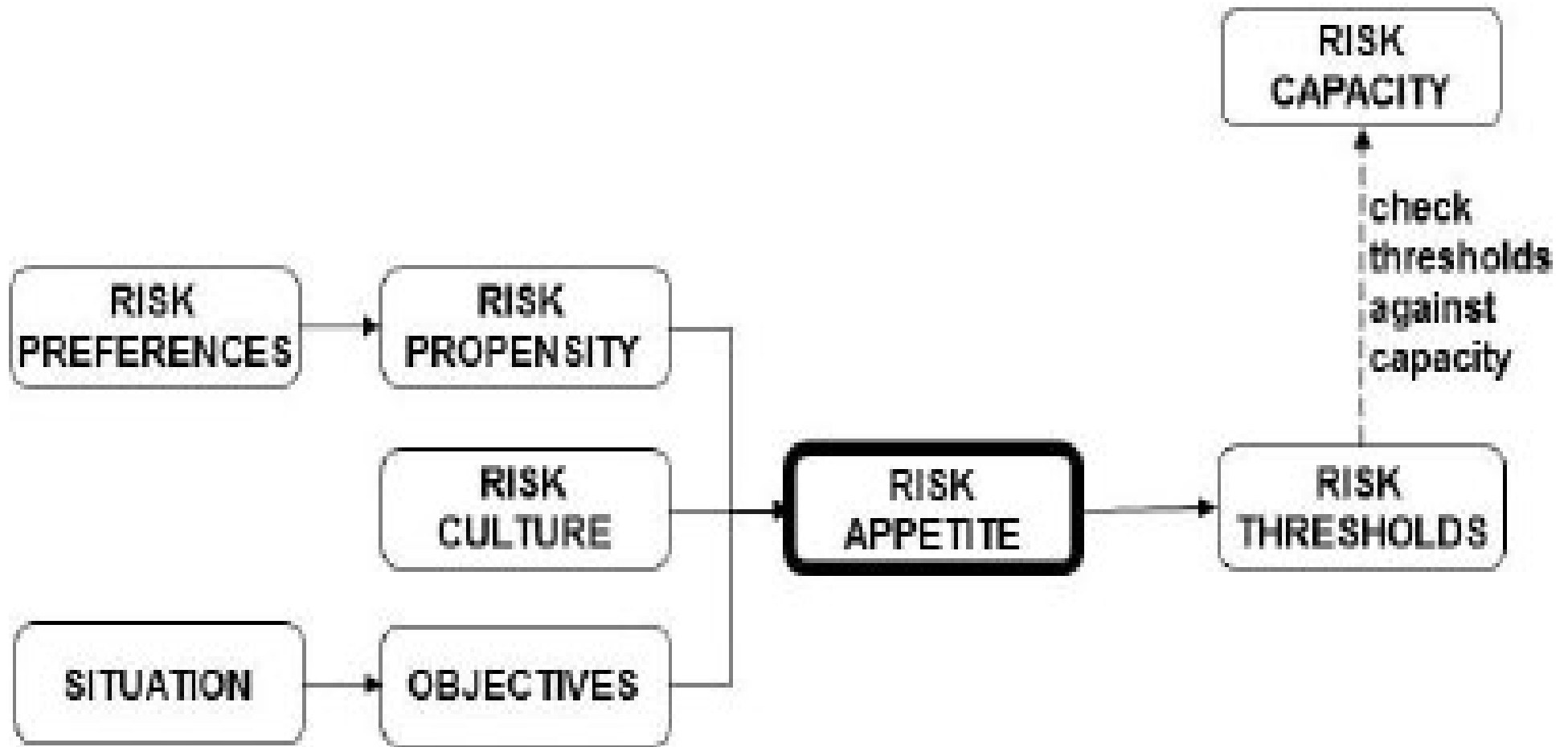
Risk Appetite : Roles & Responsibilities

| Level | Responsibility |
|-------------------------------------|--|
| Board of Directors | <ol style="list-style-type: none">a. Review, challenge, and approve the RA Statementsb. Provide risk governance and independent oversightc. Accountable for overseeing the effectiveness of the RA. |
| Executive/ Senior Management | <ol style="list-style-type: none">1. Establish corporate strategy, RA and reporting2. Monitor aggregate risk exposures against risk tolerances3. Accountable for communicating the RA, reinforcing the risk culture and optimizing |

Risk Appetite : Roles & Responsibilities cont..

| Level | Responsibility |
|--|--|
| Management: (1st line & 2nd line) | <ul style="list-style-type: none">i. Establish <i>business strategies, metrics, and risk tolerances</i>ii. Propose RA and engage staff to <i>ensure alignment of activities with RA</i> and within Risk Tolerance levelsiii. Accountable for managing operations within -RAiv. Provide <i>expertise, support, monitoring and challenge on RA & related risk activities</i> . |
| Internal Audit | <ul style="list-style-type: none">1. Assurance risks management within established RA levels.2. Discuss & communicate acceptance of risks beyond established levels (fraud, reputation, compliance): Std 2600 |

Risk Appetite – factors



Review of RAF



A. Are the **entity RA** inline with the **prevailing external & Internal environment**?

- what changes need to be incorporated to sustain success?
- Do new guidance exists
- Are there **specific risks** that need to be considered in reviewing RA? Which ones & why?

B. Any entity strategies/activities being implemented **above the relevant risk appetite** ; effect on execution of strategy?

Key Risk Indicators (KRIs)



- ❖ **Defn:** *Metrics that predict potential risks that can negatively impact businesses; weaknesses within risk and control environment.*

Why KRIs

1. Identifying any **risk exposure** relating to current or emerging risk trends.
2. Assessing and quantifying each risk and its potential impact.
3. **Timely and ongoing** risk control and monitoring.
4. Leaders- **alerts** of potential risks in advance.
5. Providing time to develop the **appropriate and effective risk responses**.
6. Establishing **objectivity** within the risk management process.

Key Risk Indicators (KRIs)



Factors

1. Based on established **Standards**
2. **Consistent** methodology
3. Facilitate **clear understanding of the risk variables-**
L&I:
4. **Quantifiable** (number, amount or percentages)-
trend analysis
5. **Ease** of application & understanding by the end users
6. **Timely**, provide a **simplified but complete** –risk &
cost effective

Risk Appetite, Tolerance and Indicators – when applicable



Appetite

- *development of strategy*

• *objective-focused*

• *Aids in decision-making*

• *evaluating overall entity performance*

Tolerance

- *Applies in the execution of strategy*

objective-focused

• *Aids in decision-making*

Evaluating performance Vs objectives

Indicators

• *Applies at any level of the business*

• *Considers specific risks (risk-focused)*

• *Ties risks to KPI*

Conclusion



What do other professionals say about Risk appetites:

<https://youtu.be/wZNnRSrDBoM>

Conclusion



Discussion Questions

1. Strategy formulation and Risk Appetite – *areas for improvement in public sector entities*
2. **Challenges** in formulation and monitoring risk appetite statements and KRIs in public & private entities in Kenya
3. Do risk appetites **change**?

Q & A



Thank You



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