



Enterprise Risk Management Report 2018



Introduction

Setting and embedding an organisation's risk appetite is a critical function of the board.

Some level of risk is inherent within all organisational activities: there are commercial and competitive risks around return on investment; internal and operational risks such as health and safety, cybersecurity, culture, ethics and reputational risk; as well as external risks such as megatrends in the environment, the economy, society and politics.

An appropriate risk appetite is one that is aligned with the organisation's purpose and strategy to meet the expectations of its owners, shareholders or stakeholders. A business that is scaling up may employ a high-growth, high-capital expense strategy, while a more established organisation may pursue more stable and moderate growth. All boards should consider the strategic risks posed to their organisation and have plans in place for both short-term crisis management and long-term mitigation.

The board plays an ongoing role in the successful implementation of a risk framework by monitoring the activities of management. Risk reporting is an important component of this but it must go further than 'tick the box' compliance. Education and culture are key to ensuring employees in all parts of the organisation understand and are equipped to operate within acceptable risk tolerances.

As part of a joining initiative with BDO Australia, the Australian Institute of Company Directors (AICD) conducted a survey of a range of senior organisational leaders, including directors and executives, on their organisations' risk appetite. Participants came from all sectors, including listed companies, not-for-profit, private businesses and government organisations.

The results showed a consistent acknowledgement of the importance of risk management. At the same time, it revealed significant gaps for many organisations in their risk management compared to what may be considered 'good practice'. The gap between principle and practice can leave risks unmitigated, or on the other hand mean that an organisation is fearful of taking risk because of a lack of clarity around what is acceptable. This can have a significant negative impact on organisational performance.

DATA AND ANALYSIS IN THIS REPORT

All findings of this report are based on a survey of 356 AICD members, of whom 156 provided demographics and industry data to aid analysis. All analysis of this sample was completed by BDO.

Risk is traditionally seen as negative, something businesses must do their best to avoid. However, in an age where disruptive forces—particularly technology—can no longer be ignored, organisations need to have the capacity to change and experiment, and that means they have to consider some risk.

CULTURE AND UNDERSTANDING

This survey shows that culture and understanding are the two key challenges of coming to grips with risk appetite. However, organisations get a much better handle on their risk when a top-down approach is taken in which all the layers of an organisation are included.

For boards, this means it is essential to take the time to understand their organisation's culture in creating successful risk appetite approaches. Improving reporting to the board to give it a better grasp of the disruptive forces and the risks the business is willing to take to meet that disruption will also be important.

Ultimately, risk appetite is an essential part of dealing with disruption, and directors need to ensure their organisations are able to understand the risks they're

willing to take relative to return on investment as soon as possible. Only then will their businesses be able to survive and thrive in the long term.

UNDERSTANDING THIS REPORT

Now more than ever it is important for organisations and their leaders to understand the risks their organisations face, define them, set thresholds for acceptable risk, and establish escalation protocols when these are not met.

The purpose of this report is to provide directors with an understanding of, and a potential benchmark for, components that make up an effective board's risk appetite position.

In comprehending this report there are a few key concepts that are outlined below to assist readers.

Maturity

Risk appetite maturity relates to the degree to which an organisation has defined, established and implemented their risk appetite. For mature organisations, this means establishing a risk appetite statement, putting in place adequate thresholds and reporting protocols, and linking

to performance and remuneration at all levels within the organisation.

Mature organisations undertake this approach by making sure there is business-wide understanding and education of risk appetite, and developing a culture that encourages ownership from top-down and bottom-up. This implies that all levels in the organisation should be involved in implementation.

Risk Appetite Statements

A risk appetite statement details the amount and type of risk that an organisation is willing to take in order to meet its strategic objectives—this includes reference to both the organisation's risk appetite as well as its risk tolerance.

Top-down and Bottom-up

The effectiveness of risk appetite statements depend on who is involved in its establishment. Where all layers of the organisation play a part, the risk appetite statement is more likely to be effective than those established by only one or two layers of the organisation. Effectiveness requires a top-down and bottom-up approach.

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Executive summary

This Report summarises findings and insights from analysis performed from the results of the Enterprise Risk Management (Risk Appetite) survey conducted as a joint initiative of the AICD and BDO.

The report is divided into the following sections:

- Establishment—outlining an organisation’s risk appetite maturity, and establishing risk appetite statements
- Threshold and reporting—covering maturity and responsibility for risk escalation thresholds and reporting protocols, and the link to performance and remuneration
- Implementation, challenges and advantages—providing insights into challenges and advantages of taking a top-down/bottom-up alignment for implementation of risk appetite.

OVERALL KEY FINDINGS

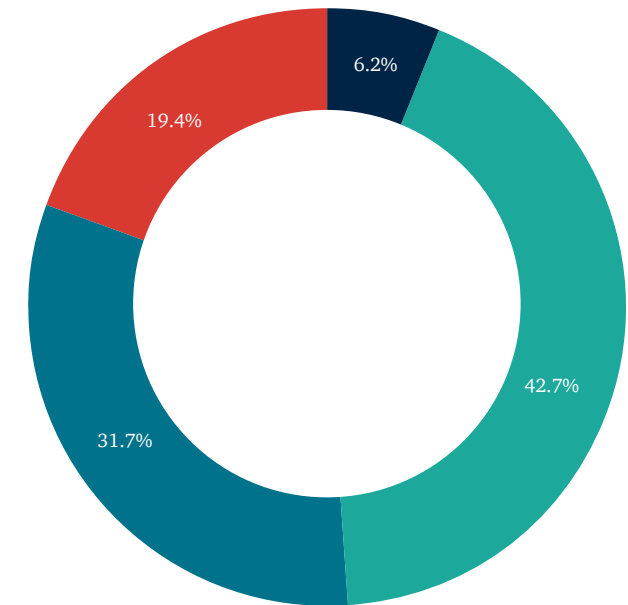
Few organisations have formalised their risk appetite approach

Only 6.2% of organisations identified as having formalised risk appetite statements that were documented in policies and procedures, supported by limits and thresholds that established parameters for specific risks.

Public companies and not-for-profits identified as having higher maturity than their counterparts, with the risk appetite maturity for these organisations strengthening with age of implementation.

Organisations in the manufacturing; education and training; and agriculture, forestry and fishing industries were identified as holding the highest level of maturity.

Overall maturity



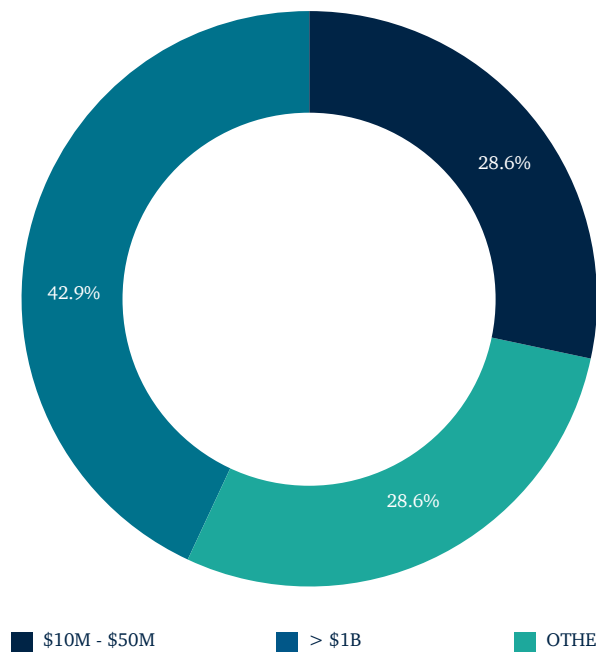
- COMPLETE (R/A STATEMENTS & THRESHOLDS)
- PARTIAL (DOCUMENTED R/A STATEMENT)
- PARTIAL (THRESHOLDS FOR SPECIFIC RISKS)
- NO R/A STATEMENT ESTABLISHED



When assessing maturity by turnover, organisations that fell between \$10m to \$50m, and \$1b or above, had the highest level of risk appetite maturity, making up 57.2% of all mature organisations.

Overall analysis identified that, with time, risk appetite maturity becomes more effective and supports organisational decision making. In addition, although implementation and integration of risk appetite into organisational strategy and business practices is challenging, the advantages derived support better organisational performance.

Maturity by turnover



Risk appetite reporting is in its infancy

Risk reporting, including escalation thresholds and reporting protocols are in their infancy, with 57% of all organisations having no such practices established.

Organisations that established their risk appetite with shared input and responsibility from all layers are more likely to understand the risk they are seeking and willing to accept.

Balancing reporting responsibilities supports useful risk information being communicated to the appropriate levels of the organisation.

Culture and understanding are the greatest challenges

The greatest challenges that organisations unanimously face with regards to risk appetite are:

- Understanding and education (33.5%)
- Culture and ownership (23.5%)

The ability to have strategic risk conversations is seen as the greatest benefit from effectively implementing risk appetite statements.

Establishment

ORGANISATIONS AND RISK APPETITE MATURITY

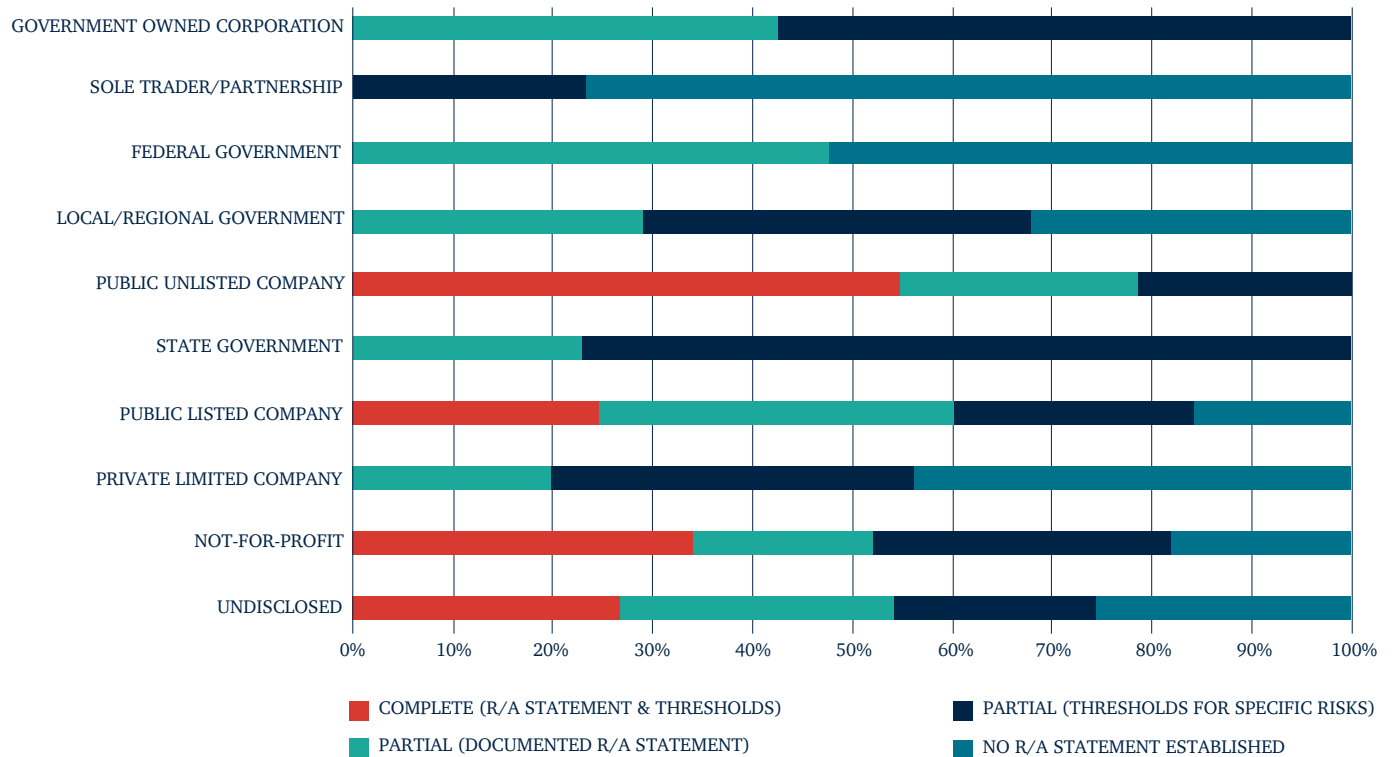
Purpose

To provide insight into the level of risk appetite maturity by organisation type.

Key findings

- Publicly listed and unlisted, and not-for-profit organisations have the highest level of maturity
- Federal, state, and local governments and private organisations have a lower overall maturity level
- 13.3% of public-sector organisations have no risk appetite statement or defined thresholds for specific risks.

Organisation types and incorporation of risk appetite statements





Summary

Publicly listed and unlisted, and not-for-profit organisations, identified as having higher risk appetite maturity that benchmarked above other organisations and the overall average. They identified as having a better grasp of the levels of risk they are prepared to seek or accept.

Federal, state and local governments, as well as private organisations, identified as having lower risk appetite maturity, typically having either 1) formally documented risk appetite statements, or 2) policies, procedures, limits or thresholds for specific risks, but not both.



“Public sector organisations are less mature in understanding and managing the levels of risk they are prepared to seek or accept.”

MATURITY AND DEPTH OF ORGANISATIONAL RISK APPETITE STATEMENTS

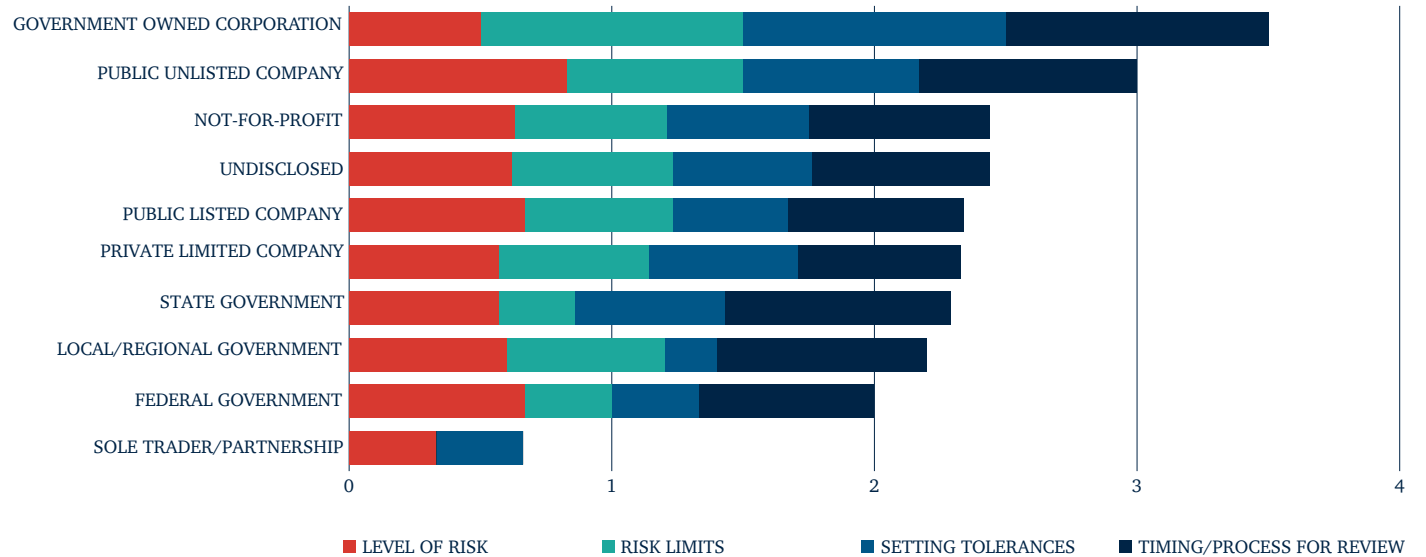
Purpose

To provide insight into the maturity of risk appetite statements by identifying the components considered in their development.

Key findings

- Overall, *risk limits and setting tolerances* are the most challenging components to incorporate into an organisation’s risk appetite statement
- Public-sector organisations are finding it more challenging than other types of organisations to define *risk limits and setting tolerances*
- Government owned corporations (GOCs) and public unlisted companies have more holistic risk appetite statements.

Organisation types and level of risk appetite maturity



Summary

GOCs and public unlisted companies identified as having more holistic risk appetite statements, incorporating at least three of the four components. Similar to other organisations, public unlisted companies found that *risk limits and setting tolerances* were the most frequent components excluded from their risk appetite statements.

Not-for-profits were slightly above overall averages, finding that *risk limits and setting tolerance*, similar to most other organisations, were the components that were more frequently excluded from risk appetite statements.

The public-sector, led by federal government organisations, was found to have the lowest risk appetite maturity and depth, incorporating the fewest components into their risk appetite statements (outside of sole traders and partnerships).



“The public sector, led by federal government organisations, was found to have the lowest risk appetite maturity and depth, incorporating the fewest components into their risk appetite statements...”

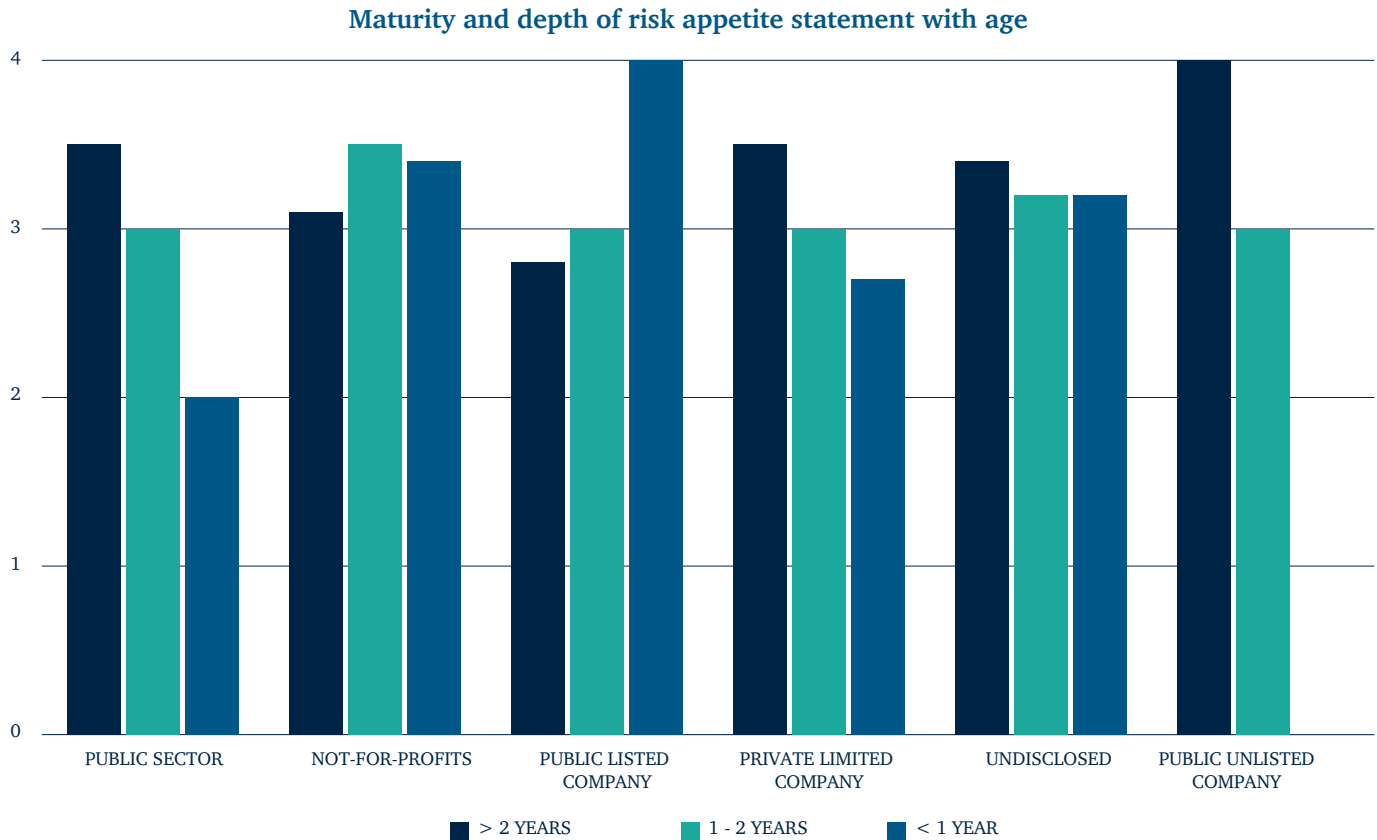
CHANGE IN DEPTH OF ORGANISATIONAL RISK APPETITE STATEMENTS WITH MATURITY

Purpose

To provide insight into the depth of risk appetite statements as they mature with age.

Key findings

- Organisations that implement and maintain their risk appetite statements experience improved maturity and depth over time
- Public sector organisations experience substantial improvement in maturity and depth of risk appetite, as do private limited companies and public unlisted companies
- Public listed companies and not-for-profit organisations tend to peak at high levels, then experience a decline in maturity and depth after initial implementation and with age.



Summary

The overall level of risk appetite maturity increases for most organisations the longer the risk appetite statement has been implemented. Depending upon the type of organisation, improvements from 5.8% to 75% from <1 year to >2 years are experienced.

Public sector organisations experience substantial improvement in maturity and depth in the years after developing and implementing their risk appetite statements. On average, an improvement of 75% from <1 year to >2 years is experience for these types of organisations.

“Organisations that implement and maintain their risk appetite statement experience improved maturity and depth over time.”



EFFECTIVENESS OF RISK APPETITE STATEMENTS BY ESTABLISHMENT TEAMS

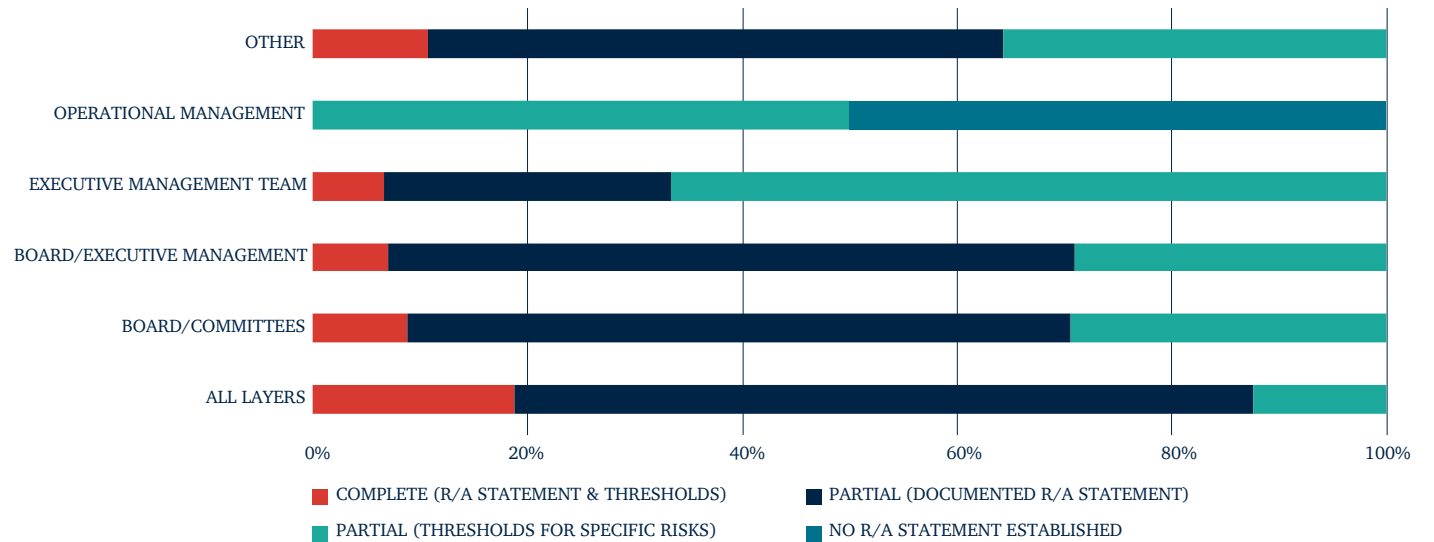
Purpose

To provide insight into the effectiveness of organisational risk appetite statements based on the personnel that were involved in establishment.

Key findings

- Where all layers of the organisation had involvement, or were considered in the establishment of risk appetite statements, achieving effectiveness was more than twice as likely as those that did not engage broadly
- Risk appetite statements established by executive management teams had an increased focus on defining thresholds for specific organisational risks, with 53.3% of these being important risks.

Effectiveness of risk appetite statement by development team

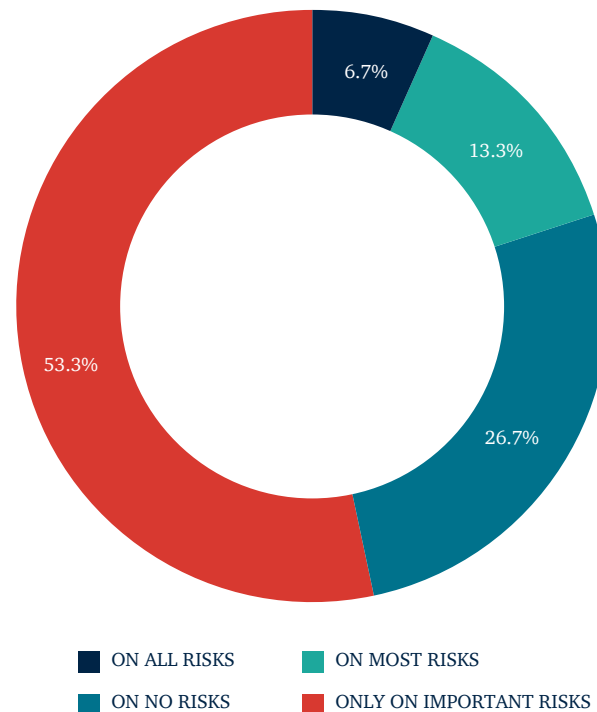


Summary

Where all layers of the organisation were involved in the establishment of the risk appetite statements, it was more than twice as likely to be more effective than risk appetite statements established by only one or two layers of the organisation.

Risk appetite statements that were established by an organisation’s executive management team were found to consider thresholds and limits for specific risks more than any other group. Further, it was identified that in 53.3% of these instances, executive management teams focused their attention on important risks.

Establishment of risk appetite statements



“Organisations that established their risk appetite statements with input from all layers were twice as likely to have effective risk appetite statements.”

Threshold & reporting

ESTABLISHED RISK APPETITE REPORTING

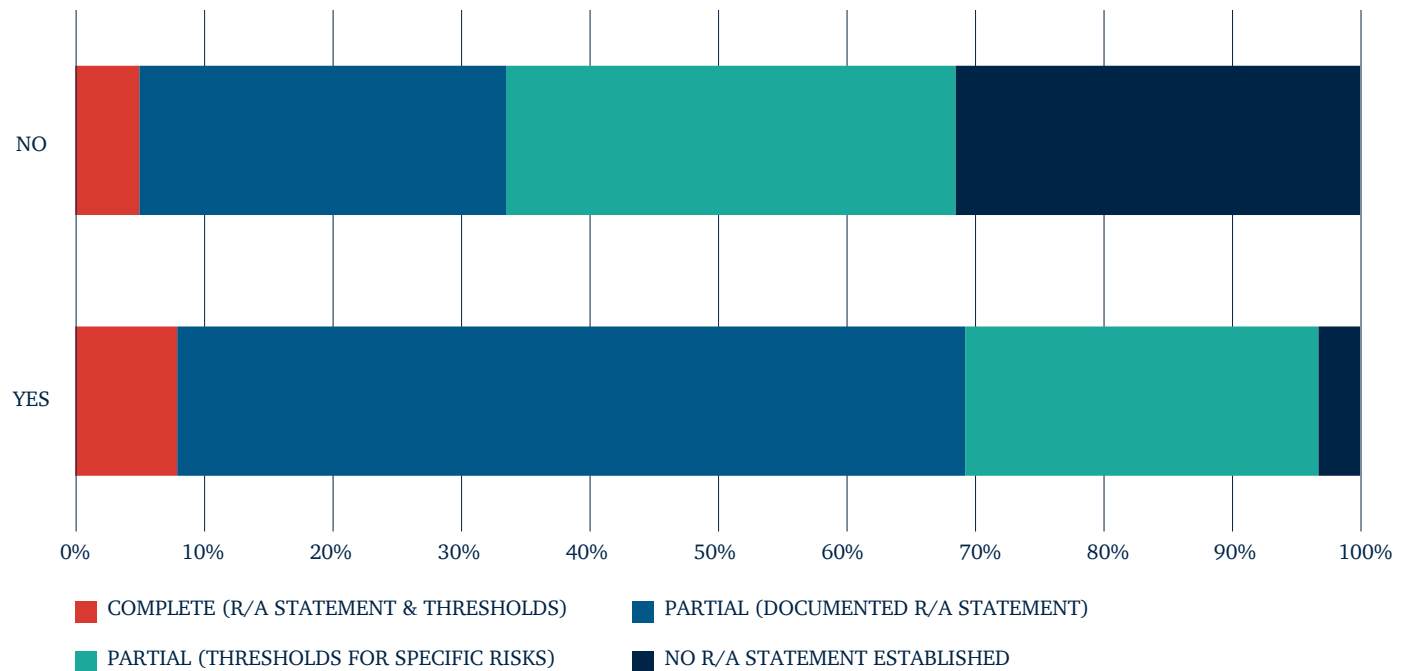
Purpose

To provide insight into the maturity of the establishment of risk escalation thresholds and reporting protocols for actual or near miss breaches of risk appetite.

Key findings

- 57% of organisations have not established risk escalation thresholds and reporting protocols for actual or near miss breaches of risk appetite
- Only 7.8% of organisations that have implemented thresholds for specific risks have completed formal documentation of a risk appetite statement that includes these thresholds and reporting protocols.

Risk escalation thresholds and reporting protocols by maturity





Summary

Of all organisations, irrespective of their risk appetite maturity, only 43% identified as having implemented some form of risk escalation thresholds and reporting protocols for pending, actual or near miss deviation from risk appetite.

Of the 43% only 7.8% are considered to have established documented risk appetite statements that are formally documented with limits and thresholds establishing parameters for specific risks. Of the 57% of organisations with no risk appetite statements established, 3.3% have risk escalation thresholds and reporting protocols in place.



“Risk reporting, including escalation thresholds and reporting protocols, are in their infancy, with 57% of all organisations having no such practices established.”

RESPONSIBILITY FOR ESTABLISHING RISK ESCALATION THRESHOLDS AND REPORTING PROTOCOLS

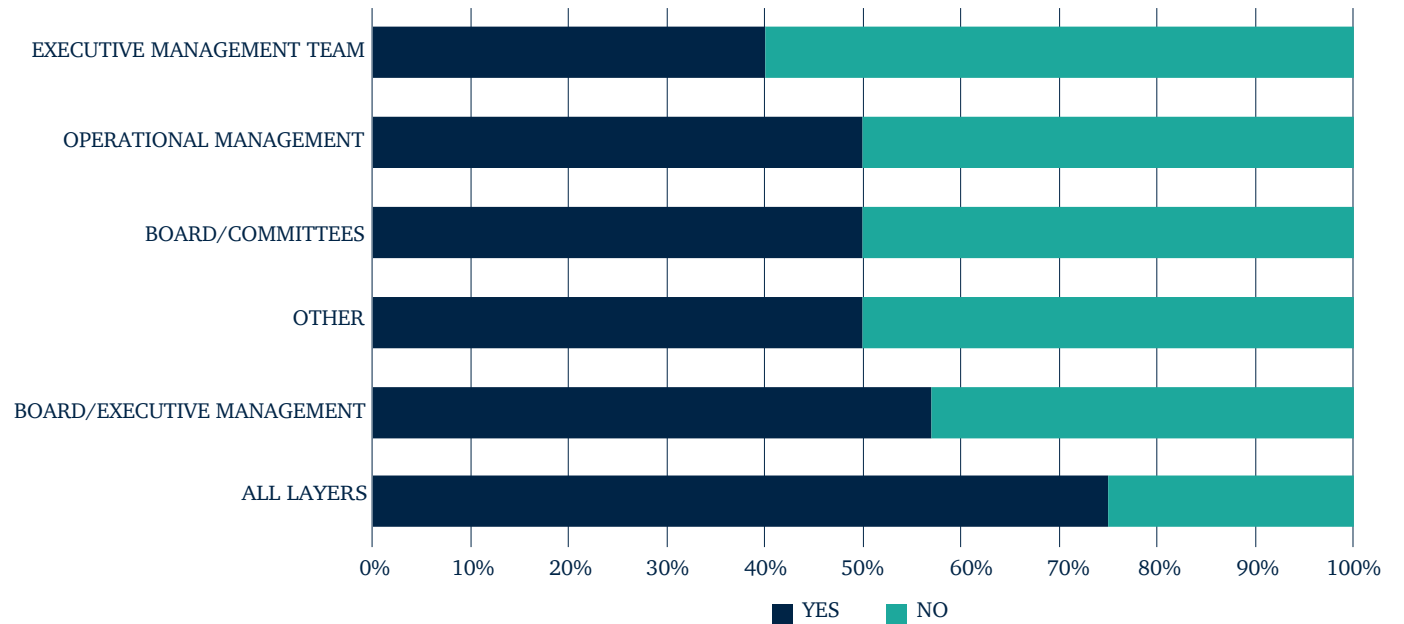
Purpose

To provide insight into the maturity of risk escalation thresholds and reporting protocols by responsibility for implementation.

Key findings

- Organisations that establish risk appetites with input from all layers of the organisation will incorporate escalation thresholds and reporting protocols in 75% of instances
- In 66% of instances, where at least two layers of an organisation have been responsible for establishing the risk appetite, escalation thresholds and reporting protocols are included
- Where one layer of the organisation is responsible for establishing the risk appetite, there is a higher likelihood that escalation thresholds and reporting protocols will not be developed.

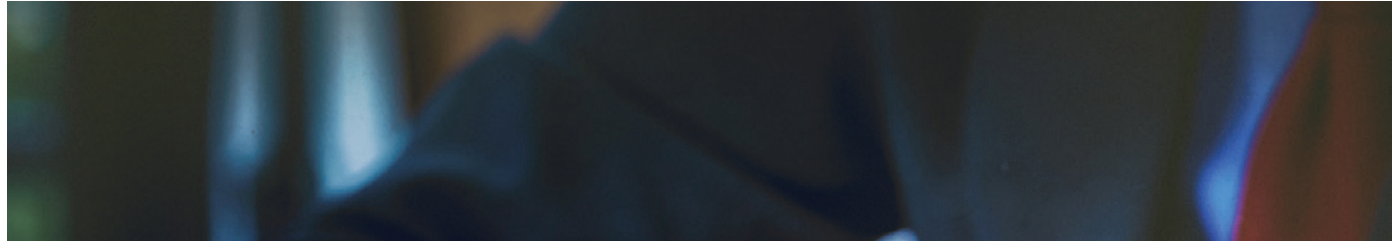
Risk appetite escalation and reporting by maturity and depth



Summary

Organisations that establish their risk appetite statements with a shared responsibility crossing all layers of the organisation also identify as developing escalation thresholds and reporting protocols in 75% of instances. For organisations that have only one layer of input and responsibility for establishing risk appetite statements, escalation thresholds and reporting protocols will typically not be developed 52.5% of the time.

“Organisations that establish their risk appetite with shared input and responsibility from all layers are more likely to understand the risk they are seeking and willing to accept.”



RISK REPORTING BY IMPORTANCE AND POSITION

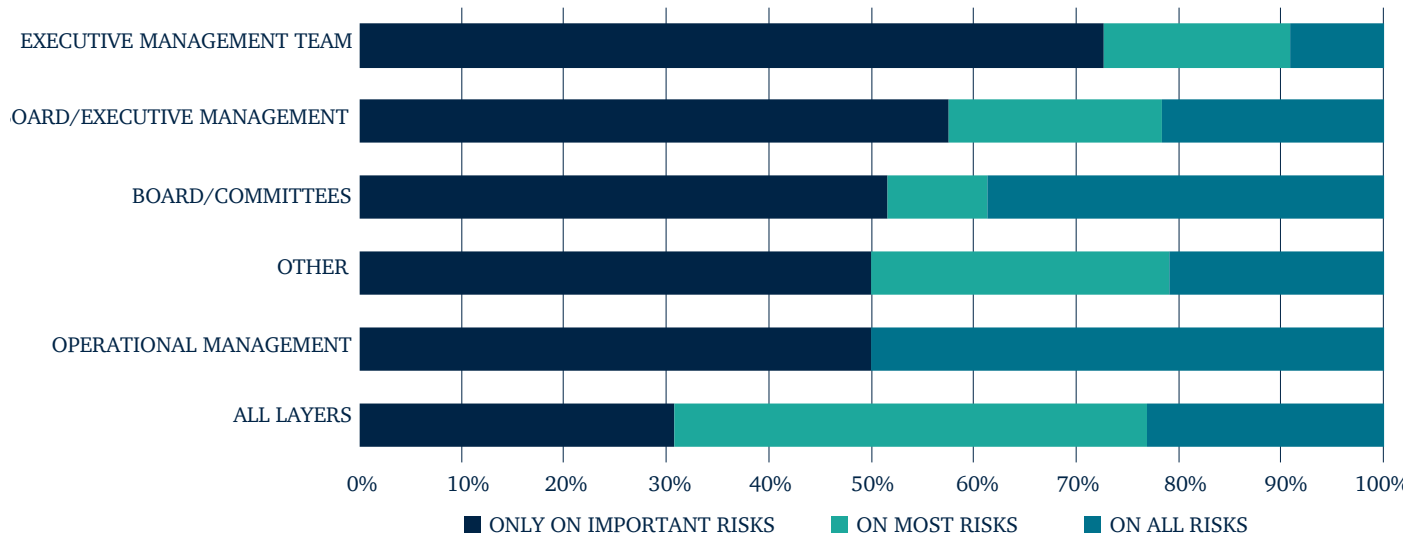
Purpose

To provide insight into risk reporting protocols by responsibility for reporting and types of risks being reported.

Key findings

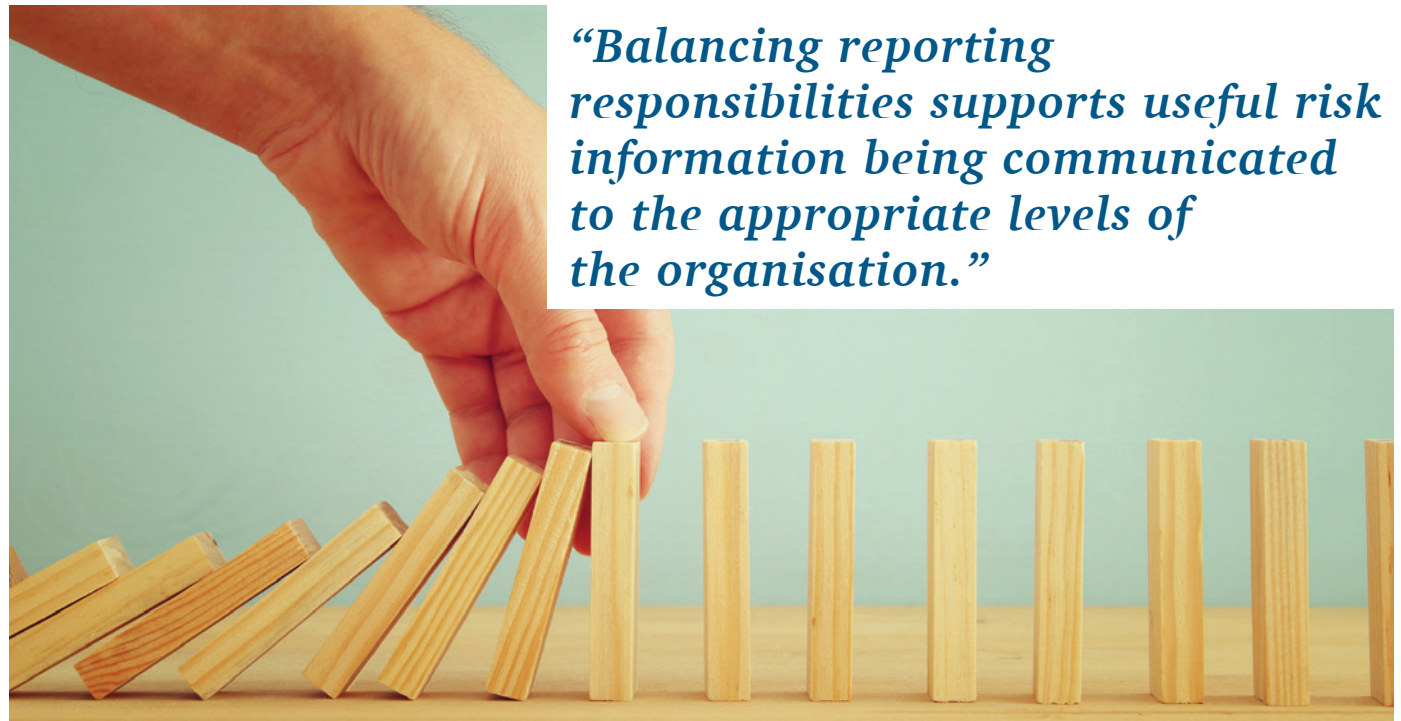
- Board/Committees and executive management teams are more inclined to target risk reporting focusing on important risks
- Operational layers responsible for risk reporting find it challenging to understand user needs in higher layers of the organisation, typically reporting on all organisational risks.

Risk appetite reporting by responsibility for reporting



Summary

Each layer of an organisation requires useful risk information to make appropriate decisions based on their level of responsibility and accountability. Where organisations bestowed risk reporting responsibilities on executive management teams or the board and executive management, 65.1% of respondents said important risks were being surfaced. On the other hand, where operational layers were responsible, a higher proportion of respondents said their organisation reported on all risks. In cases where responsibility is left to operational management, it may be necessary to educate managers on the risks that need to be escalated.



“Balancing reporting responsibilities supports useful risk information being communicated to the appropriate levels of the organisation.”

RISK REPORTING AND LINK TO PERFORMANCE AND REMUNERATION

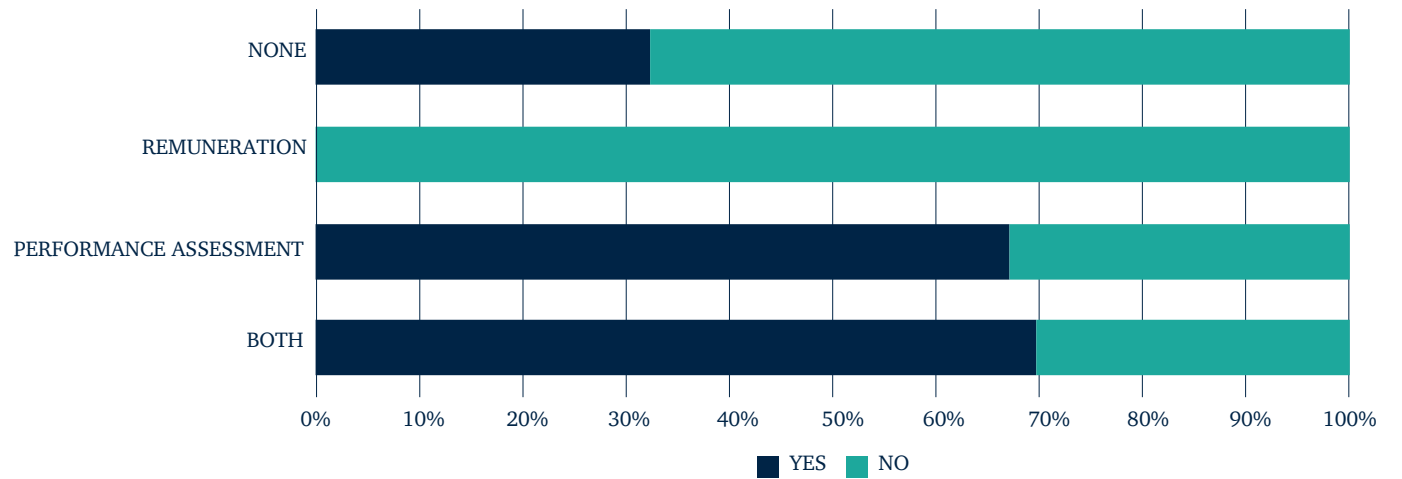
Purpose

To provide insight into the breakdown of organisations that have established risk reporting protocols but have not linked this information to performance and remuneration.

Key findings

- 69.8% of organisations that have linked performance assessments and remuneration to risk management were found to have effective risk reporting protocols

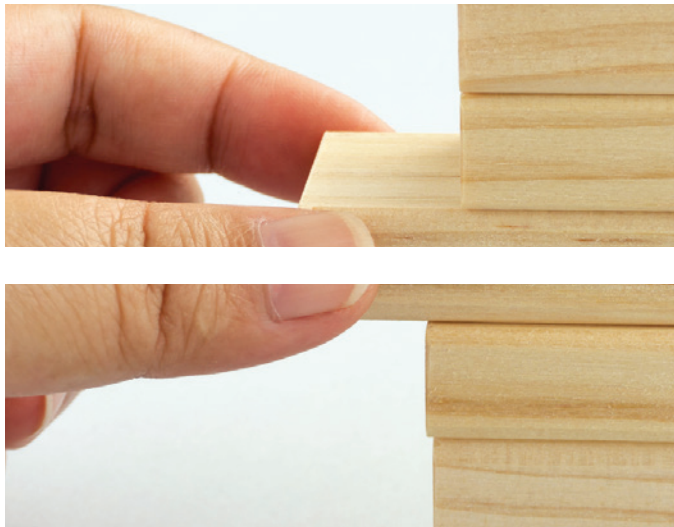
Performance and remuneration linked with risk appetite reporting



Summary

In answering the question whether risk appetite is linked to performance assessment and remuneration, organisations that linked employee performance and remuneration (i.e. both) were more likely to have established escalation thresholds and risk reporting protocols. Only 30.2% of organisations that had established escalation thresholds and risk reporting protocols identified as not having these linked to employee performance assessments and remuneration.

Organisations that had only linked remuneration to their risk management were found to have a lower maturity than organisations who only linked their risk management to performance assessments.



“Respondents from organisations that had established escalation thresholds and risk reporting protocols were more likely to identify their organisation as linking risk appetite reporting to both employee performance assessment and remuneration.”

Implementation, challenges & advantages

CHALLENGES FOR ORGANISATIONS WITH OR WITHOUT TOP-DOWN/BOTTOM-UP ALIGNMENT

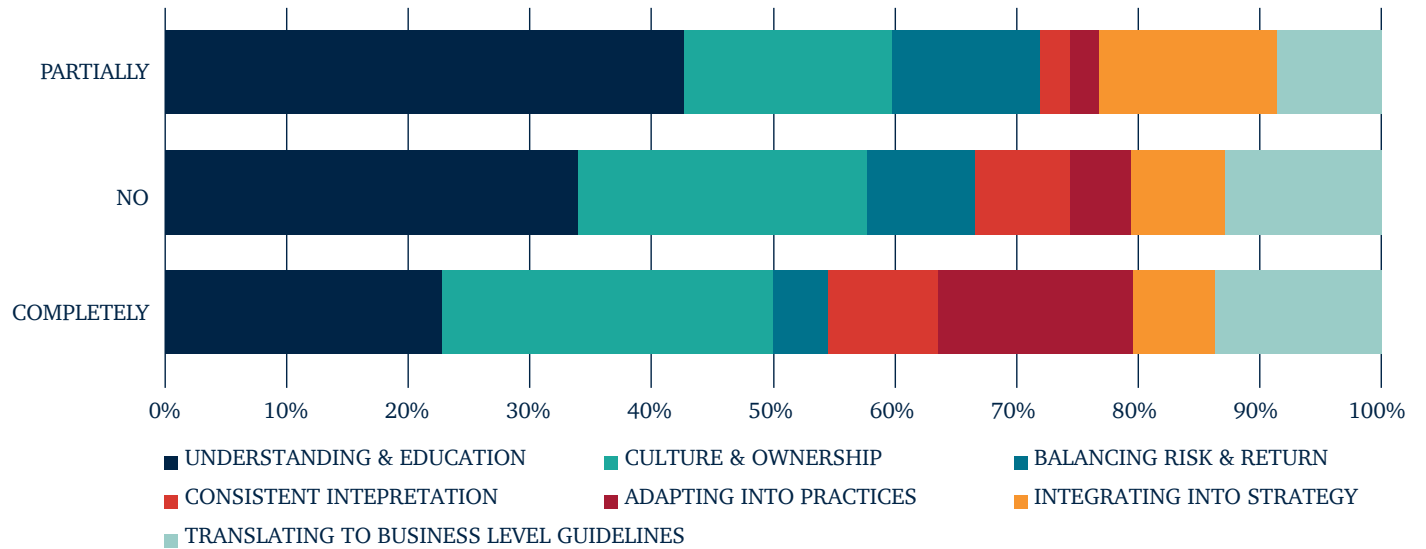
Purpose

To provide insight into the challenges that organisations are faced with when they have and have not aligned top-down risk appetites and bottom-up risk limits.

Key findings

- Organisations with completely aligned top-down risk appetites and bottom-up risk limits identified the following to be less challenging:
 - Understanding and education
 - Balancing risk and return
 - Integration with strategy
- More mature organisations recognise culture and ownership, and adapting risk appetites into practices as their biggest challenges.

Alignment of top-down risk appetite and bottom-up risk limit, and risk management challenges





Summary

Organisations with aligned top-down risk appetites and bottom-up risk limits have significantly less difficulty balancing risk and return, integrating risk with strategy and promoting the understanding and education of risk. This correlation is consistent with the overall most identified perceived risk management challenge: understanding and education. This suggests that alignment between top-down risk appetites and bottom-up risk limits assists organisations in overcoming the biggest challenges facing risk appetite implementation.

“Alignment of top-down risk appetites and bottom-up risk limits supports more effective strategic direction and balances risk and return.”



CHALLENGES BY ORGANISATIONAL POSITION

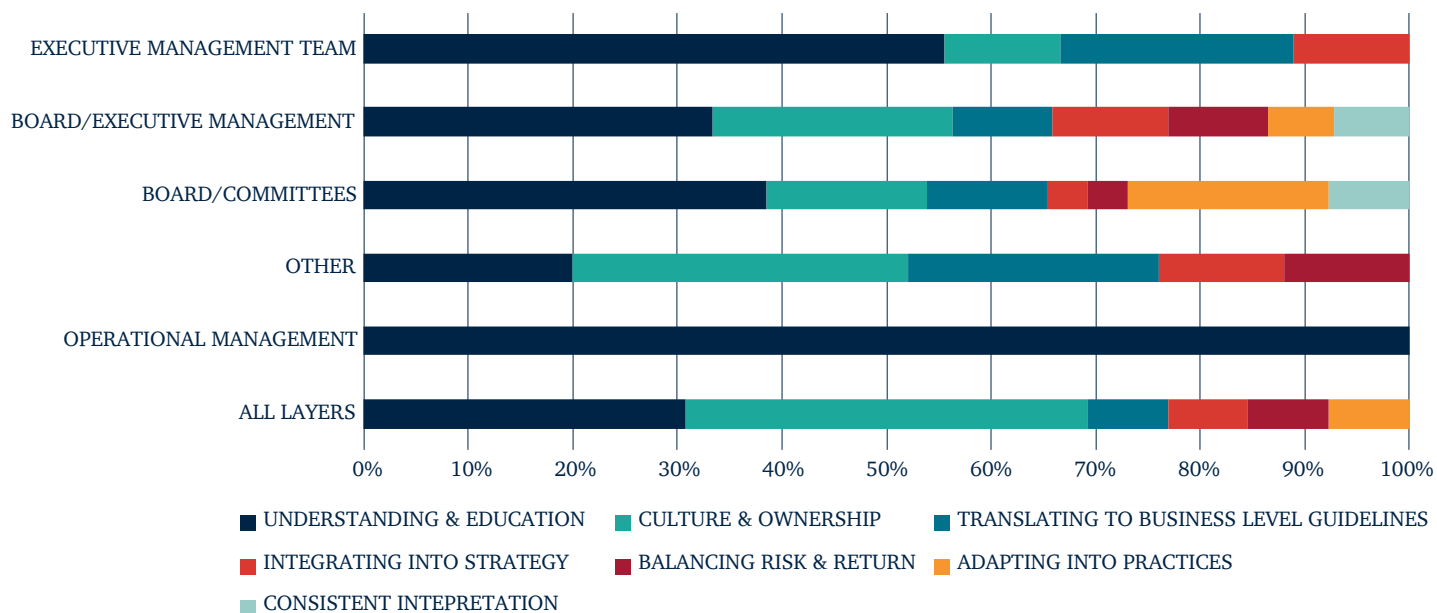
Purpose

To provide insight into the challenges in implementing risk appetite statements, as experienced by organisational position.

Key findings

- The greatest challenges that organisations, irrespective of position, unanimously face are:
 - Understanding and education (33.5%)
 - Culture and ownership (23.5%)
- Executive management teams identify understanding and education as their greatest challenge, followed by translating risk appetites to business level guidelines
- Board/Committees see balancing risk and return and integrating risk appetites into strategy as their lowest two challenges, whereas these are seen as the third and fourth greatest challenge by other positions.

Implementation challenges in risk appetite statements



Summary

The greatest perceived challenges in implementing risk appetite statements vary depending upon position, however, understanding and education; and culture and ownership make up the largest portion of challenges irrespective of the position.

Executive management teams, made up by C-suites, experience understanding and education as their greatest challenge, similar to Board/Committees. However, where executive management teams find it more challenging to translate risk appetite to business level guidelines, Board/Committee members find that adapting risk appetite into practices is a greater challenge.



CHALLENGES OF RISK APPETITE MATURITY OVER TIME

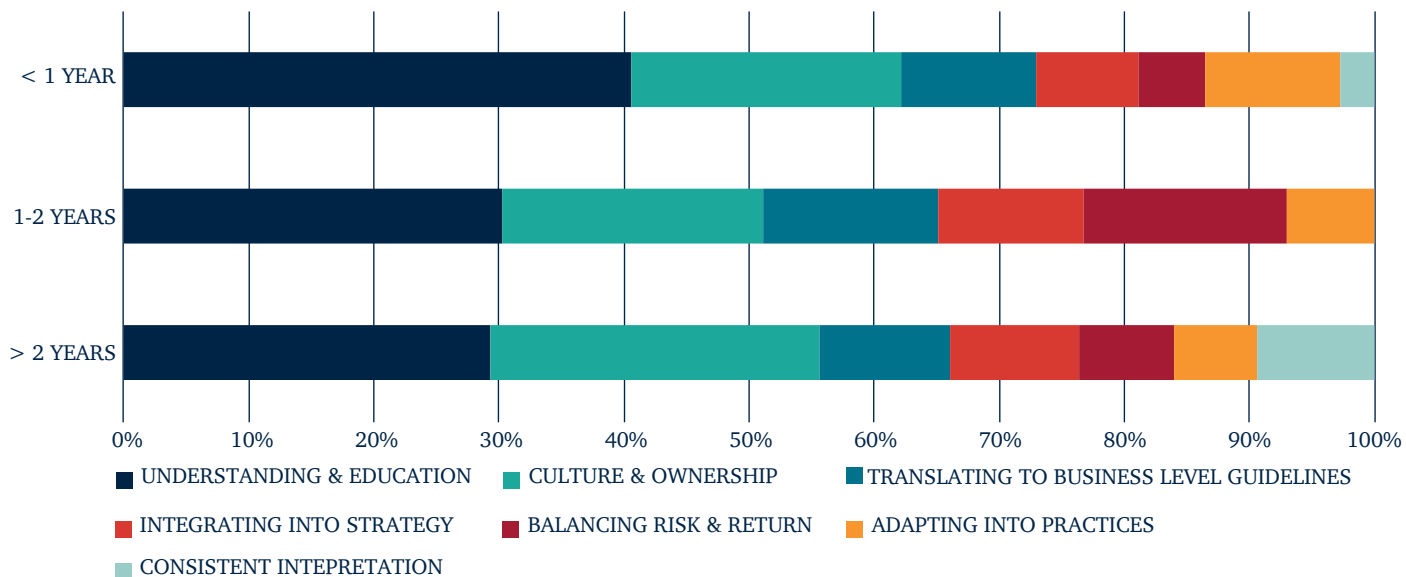
Purpose

To provide insight into the challenges of risk appetite over time and through maturity.

Key findings

- Understanding and education is identified as improving over time yet still remains the greatest challenge
- As risk management matures through establishment to implementation, the challenge of fostering culture and ownership throughout the organisation increases
- Years 1 to 2 are a challenging time for organisations as the integration of risk appetites throughout strategies and practices becomes reality.

Challenges of risk appetite maturity over time



Summary

Understanding and education is the greatest challenge through all stages of risk appetite maturity. In more mature organisations, this is closely followed by culture and ownership. Even though culture and ownership is seen as the second greatest challenge, it is also seen as one of the greatest advantages that an organisation can experience (referred to as ‘fostering a culture throughout the organisation’).

The second year of implementation results in increased integration challenges for many organisations. Significant effort is required by all layers of organisations to effectively integrate risk appetite into strategy while also making it applicable to business-level practices.

“Effectively integrating risk appetite into an organisation’s strategy and business practices is both challenging and rewarding.”



ADVANTAGES FOR ORGANISATIONS WITH OR WITHOUT TOP-DOWN/BOTTOM-UP ALIGNMENT

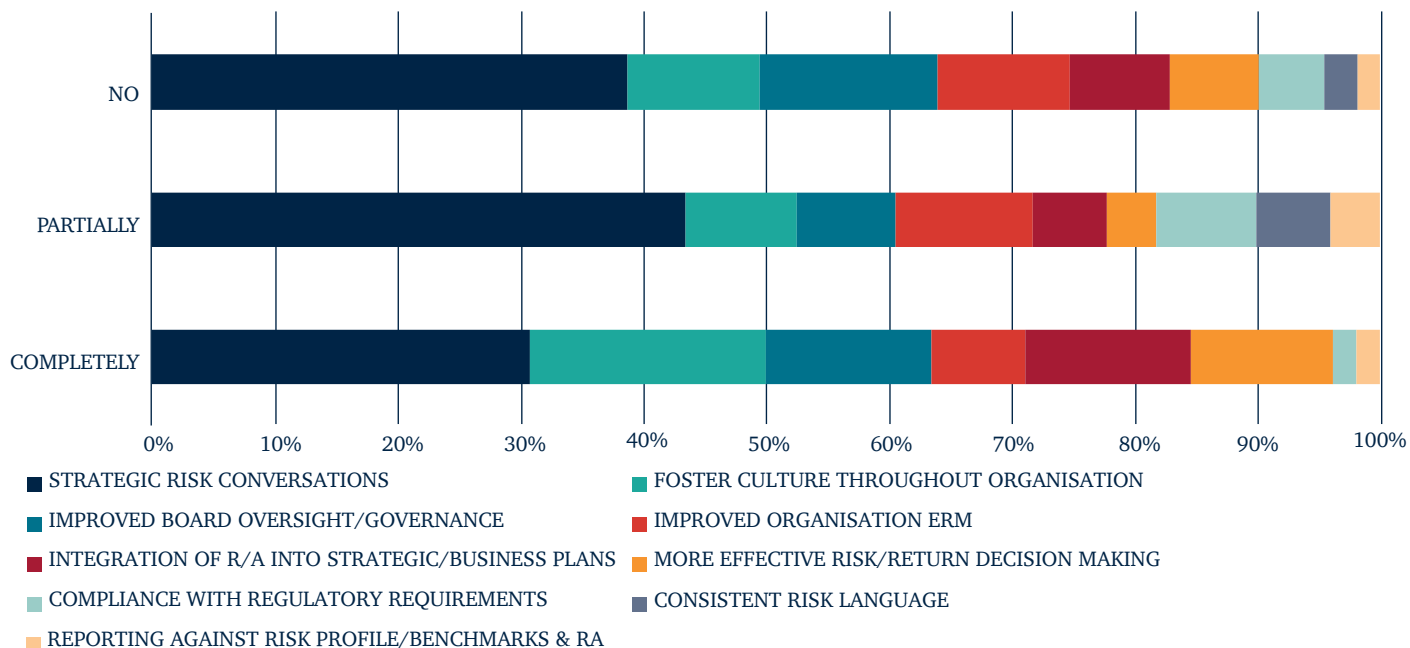
Purpose:

To provide insight into the greatest advantages that organisations experience when they have—and have not—aligned top-down and bottom-up through their risk appetite.

Key findings:

- The greatest advantages that organisations experience through aligning risk in their organisation from top-down risk appetites and bottom-up risk limits are:
 - Strategic risk conversations (30.77%)
 - Fostering culture throughout organisation (19.23%)
- Where organisations have complete alignment in top-down risk appetites and bottom-up risk limits, they experience a greater advantage in fostering culture throughout the organisation than those that are not aligned.

Greatest advantages of having a risk appetite statement



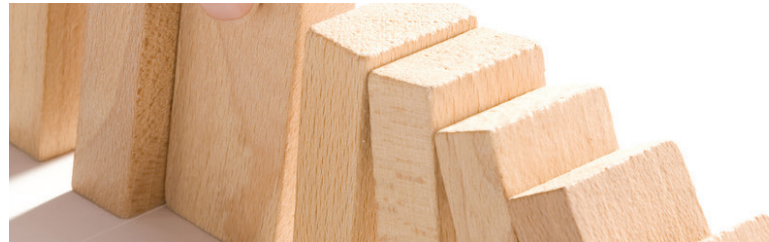


“Aligning top-down risk appetite statements and bottom-up risk limits fosters a stronger risk culture throughout an organisation.”

Summary:

Irrespective of whether organisations have demonstrated alignment between top-down risk appetites and bottom-up risk limits, strategic risk conversations were the greatest advantage of implementing a risk appetite statement.

Organisations that had complete alignment in top-down risk appetites and bottom-up risk limits, found fostering a risk management culture far more meaningful and advantageous than organisations had not aligned these aspects.



ADVANTAGES BY ORGANISATIONAL POSITION

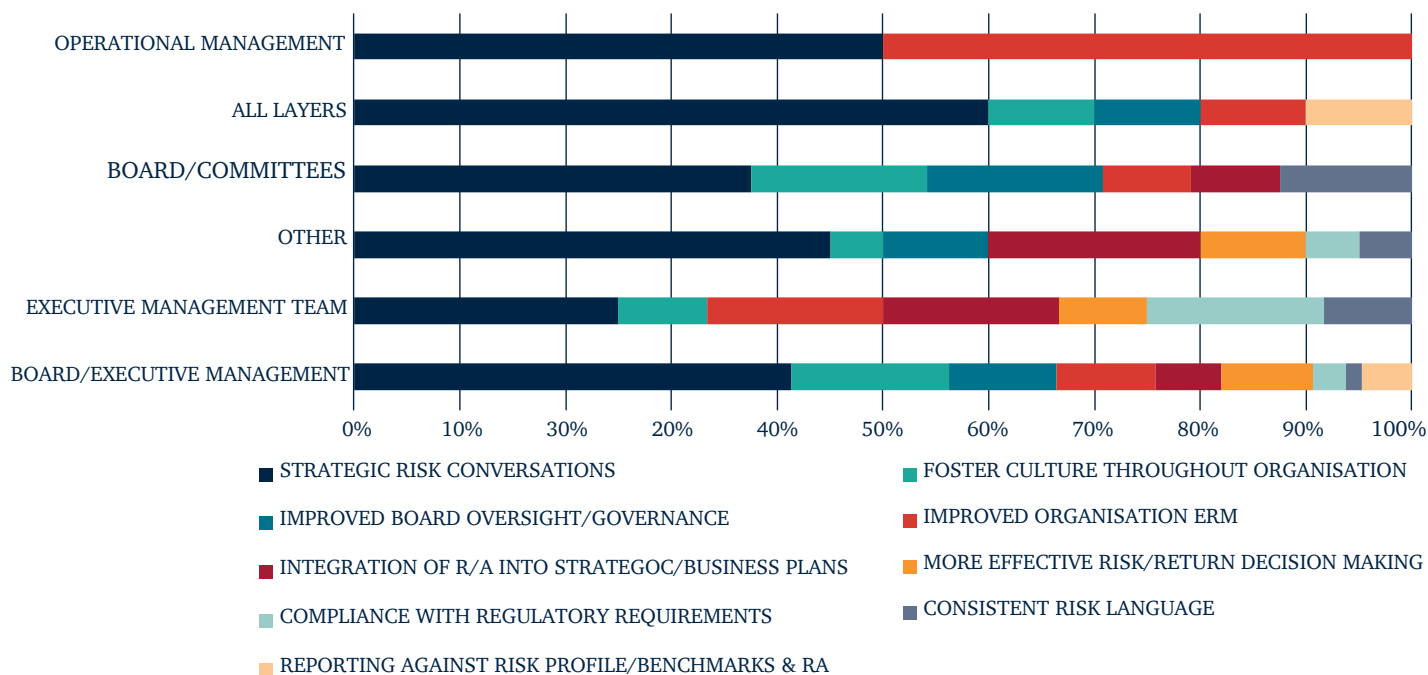
Purpose

To provide insight into the advantages that exist in implementing risk appetite statements, by organisational position.

Key findings

- Strategic risk conversations are by far the greatest advantage experienced when implementing risk appetite statements, followed by:
 - Foster culture throughout organisation
 - Improved board oversight/governance
- Executive and operational management do not recognise improved board oversight as one of the greatest advantages of implementing risk appetite statements, where all other positions do.

Advantages of having a risk appetite statement



Summary

Although strategic risk conversations are seen as the greatest overall benefit to arise from implementing risk appetite statements, other benefits vary depending on the position's organisational layer (i.e. operational, tactical/oversight, strategic).

Outside of strategic risk conversations, executive management believe that integration of risk appetite into strategic/business plans, compliance with regulatory requirements, and improvement organisational enterprise risk management, are all equally ranked in second place. They also consider that fostering culture throughout the organisation, more effective risk/return decision making, and consistent risk language, are equally ranked as the third greatest advantage.



“The ability to have strategic risk conversations is seen as the greatest benefit from effectively implementing risk appetite statements.”

ADVANTAGES OF RISK APPETITE MATURITY OVER TIME

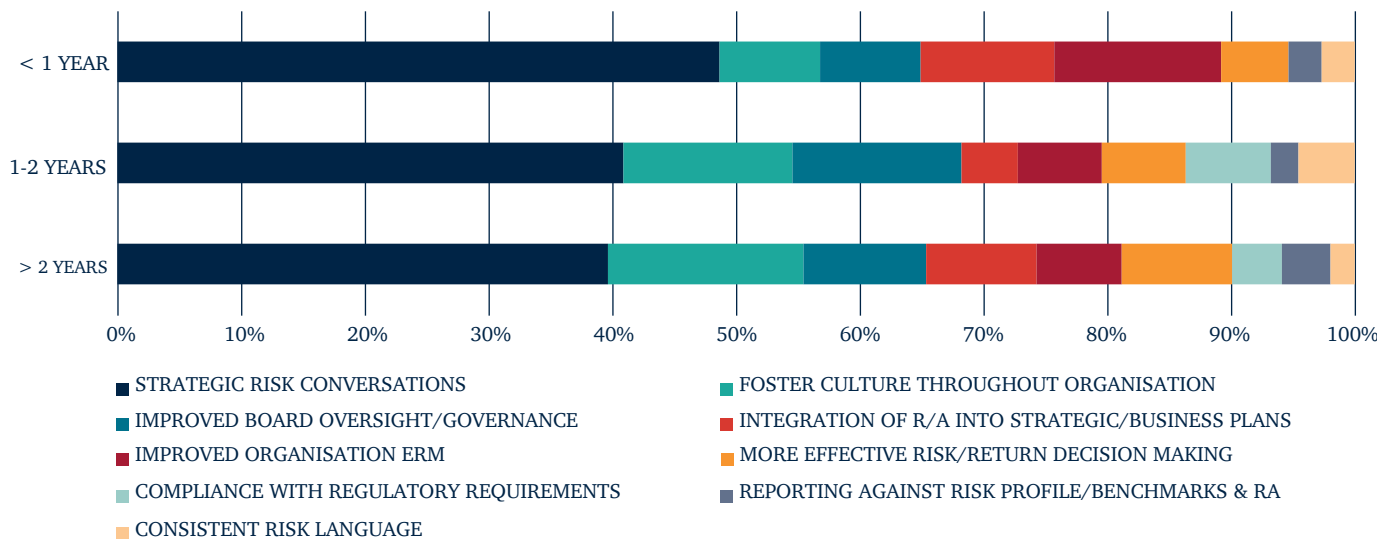
Purpose

To provide insight into the advantages of risk appetite over time and through maturity.

Key findings

- Organisations find that as culture is fostered throughout the organisation, their risk appetite matures over time
- Overall effectiveness of risk/return decision making has a positive correlation to risk appetite maturity.

Risk appetite maturity over time



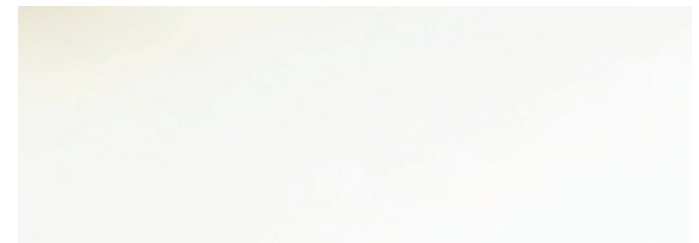
Summary

As organisational risk appetites mature, the advantages and importance of being able to have strategic risk conversations is still perceived as the greatest advantage, although the incremental benefit experienced year on year decreases over time. Attention and benefits then turn to an increase in fostering organisational culture, and supporting the overall risk appetite journey.

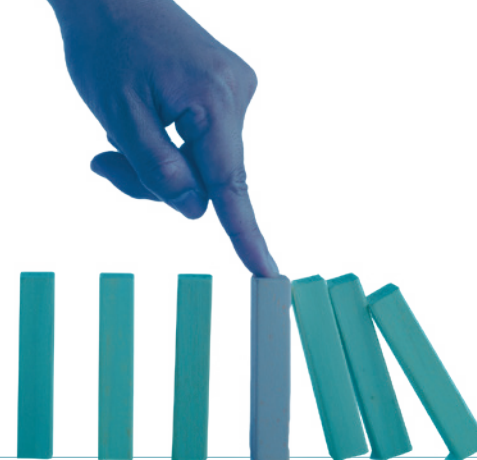
The benefits derived from fostering culture throughout the organisation also paves the way for other advantages to be experienced such as improvements in the effectiveness of risk/return decision making, and reporting against risk profile/benchmarks and risk appetite.



“As risk appetites mature, organisations become more effective in their decision making.”



About BDO



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BDO IN AUSTRALIA

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BDO INTERNATIONAL

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About AICD



The Australian Institute of Company Directors is committed to excellence in governance.

We make a positive impact on society and the economy through governance education, director development and advocacy.

Our membership of more than 43,000 includes directors and senior leaders from business, government and the not-for-profit sectors.



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