The setting of a charity’s risk appetite

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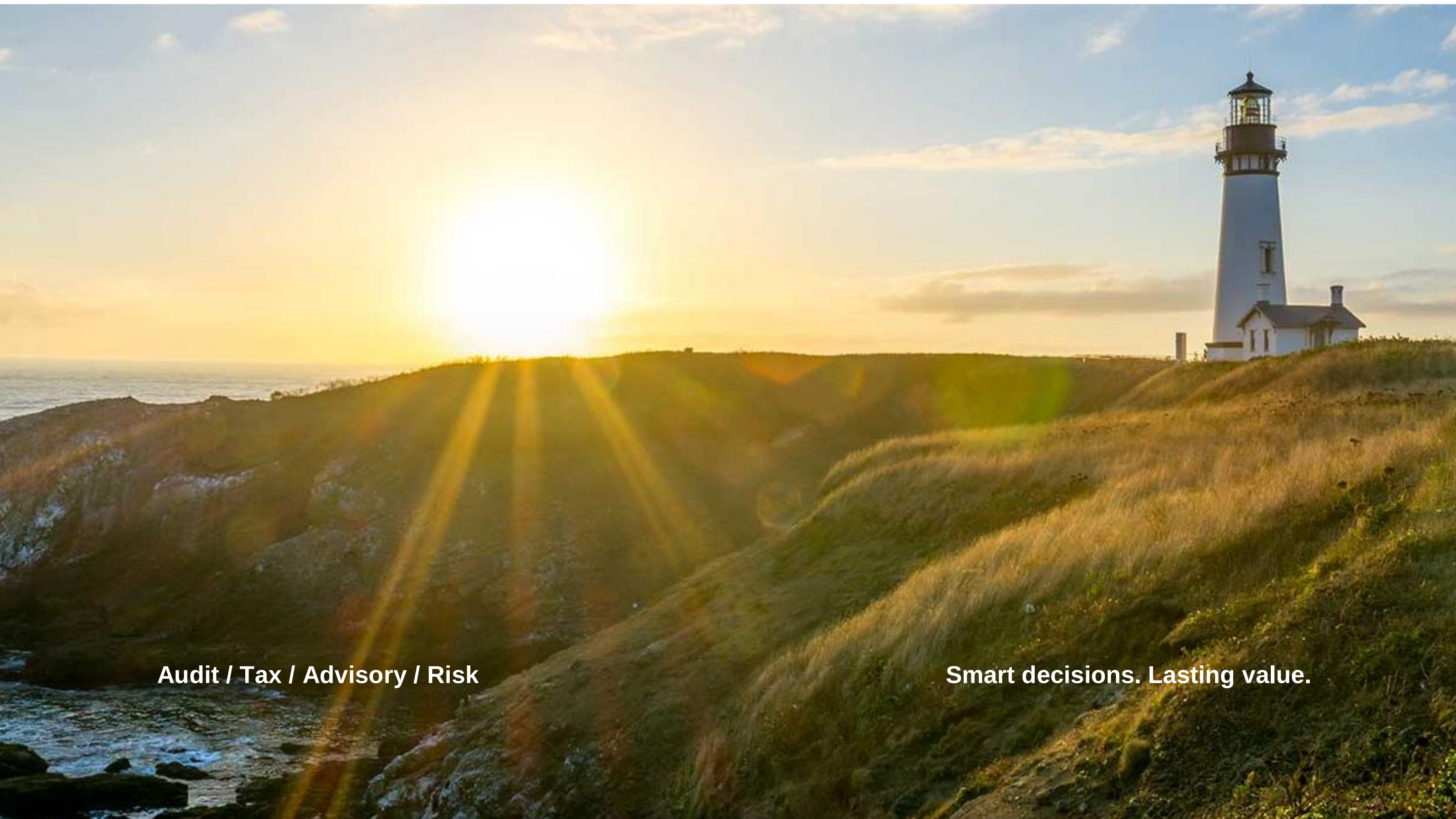

The consideration of risk and how risk is managed is particularly important for charities because their governance structure means that those who are ultimately responsible for the charity, its trustees, are not normally involved in the day to day running of its operations.

Since the publication of the Charity Commission’s Statement of Recommended Practice (SORP) in 2000, trustees of charities have been required to make a statement in their annual Trustees’ Report “confirming that the major risks to which the charity is exposed, as identified by the trustees, have been reviewed and systems or procedures have been established to manage those risks.” This led most charities to put in place a risk management strategy including a risk register. SORP 2015 has taken the disclosure requirements further and requires trustees in their report to provide “a description of the principal risks and uncertainties facing the charity and its subsidiary undertakings, as identified by the charity trustees, together with a summary of their plans and strategies for managing those risks.” For charities, the information on risks and uncertainties will also need to link in with the required disclosures on the amount of the charity’s reserves and why they are held or, if no reserves are held, the reasons for this. In essence a reserves policy is one that cannot and should not be conceived without the consideration of risks. It is derived in part in recognition of the challenges the charity faces in the short and medium term to help the charity be sustainable, whilst meeting the needs of current and future beneficiaries. Interestingly we have seen a lot more discussion of risks and reserves as a result of the requirements of SORP 2015. It has made trustees go back to the drawing board and reconsider the appropriate level of reserves and satisfy themselves that they have understood the basis upon which these have been set and central to that has been discussions around risks and how these are managed.

The complexity of the strategy and the risk register is often dictated by the size, nature and the complexity of the charity and its activities.

To be truly effective, risk management should not be an isolated process but part and parcel of the strategic thinking for the charity. A well-defined strategy will balance opportunities and expected rewards against related risks. All too often risk registers focus on the risks that a charity should avoid or mitigate and not on the risk of missed opportunities.

Good risk management will lead trustees to consider the various options open to the charity in pursuit of its charitable objectives.

For example:

- a charity with a fall in its committed giving may consider new income generation options including targeting high net worth individuals
- a charity involved in research activities may consider entering into a joint venture with a commercial enterprise in pursuit of a new drug or treatment
- an advocacy charity with substantial government funding may choose to run a campaign highlighting weaknesses in government policy.

In all these examples, the risk is arguably high but may be worth taking when balanced against a potentially high reward. In order for the charity to understand how much risk it is willing to take, or where the balance is in the risk/reward equation. It must have an understanding of its risk appetite.

What is risk appetite?

In 2011 the Institute of Risk Management (IRM) published its Guidance Paper on Risk Appetite and Risk Tolerance, defining risk appetite as "the amount of risk an organisation is willing to seek or accept in the pursuit of its long-term objectives".

In setting their risk appetite trustees should consider that there is 'no one size fits all' approach and there is no one magic calculation, and that risk appetite may not be always quantifiable.

Setting of risk appetite:

- depends on understanding the importance of different objectives and actions and the risks that have to be taken to achieve those objectives
- needs to be considered for individual programmes and projects, and also across operating areas, geographies, activities, functions
- needs to consider the overall portfolio of risks to ensure that an organisation's risks and response are appropriate, balanced and sustainable.

Defining risk appetite will include both:

- quantitative measures – financial measures
- qualitative measures – reputational impact, management effort, regulatory compliance.

In some situations or for some issues, the trustees may adopt a policy of zero tolerance to some risks such as regulatory infringements. So for example a charity running shops or a care home will not tolerate infringement of health and safety regulations.

The interaction of risk and control

In determining risk appetite, boards should also consider the interaction between risk and control. At an operational level the focus is more likely to be on control than at the strategic level where the focus is on risk taking. Moreover consideration of controls when setting risk appetite will ensure that the risk response is appropriate and that the cost and benefits of the various control measures are properly considered. Over responding can lead to extra costs or inhibited activity and this is of particular significance in the current challenging economic environment

Setting risk appetite

Like performance management, the setting of risk appetite is a top down process, set by the trustees and communicated broadly throughout the organisation ensuring that all the charity's activities are then carried out in line with this risk appetite. Management then apply this risk appetite across the various risks, activities and operations of the charity.

Much has been written on setting of risk appetite by boards for both profit and not for profit organisations. Some advocate the view that boards should articulate a definitive risk appetite statement for their organisations. Indeed some organisations have done this but in our experience this proves hard for non-profit organisations often with a range of diverse activities and operations and various income generating streams. For example, a charity running shops will not tolerate any infringement of health and safety regulations but the same charity may be operating in a war zone in which case it will have some risk appetite for working in such areas. It may therefore be difficult to find one statement encapsulating such a range in risk appetite. Critically, setting one risk appetite statement also will not allow trustees and the management to consider the interaction between risk and controls and whether some risks are over or under controlled. However it is possible for trustees to set a risk appetite framework.

As with all discussions around risk it is important to agree who the initial contributors and participants to the discussions will be and to choose the right forum for such discussions.

In our experience consideration of risk appetite is an iterative process which requires an understanding of the basics by the participants. All participants should be familiar with the strategic plan, direction and objectives of the charity. The participants should also be familiar with the charity’s organisational risk register understanding the critical risks the charity is faced with. This includes understanding the gross or inherent risks as well as the control framework reducing the risk to its net or residual amount. It may be useful to categorise the risk register under the various headings of strategic, financial, reputational, operations and knowledge, or similar group headings if this has not been done before.

An essential feature of setting risk appetite is establishing a time horizon for a risk. Our tolerance of risks is different depending on the time horizon over which we are evaluating that risk.

To avoid confusion and misunderstanding the time horizon should be established at the outset. Generally speaking, trustees and boards are focused more on the longer term strategic planning periods whereas management may be more focused on the shorter annual targets.

Taking each critical risk or category of risk in turn participants should discuss not just their risk appetite but also their risk tolerance – ‘the boundaries of risk taking outside of which the organisation is not prepared to venture in the pursuit of its long term objectives’.

It may be useful for participants to rate their risk appetite using a simple scaling system of willingness to accept risk – low to medium to high.

Risk contagion

All too often discussions around risk consider each risk in isolation and do not consider the exposure to a portfolio of risks or risk contagion. A well prepared organisation should be prepared to face the interaction of separate events. The same principle applies to consideration of risk appetite. For example a charity venturing into new fundraising campaigns may consider its risk appetite to be high for a new high risk/high reward campaign but be unwilling to consider two such campaigns at the same time.
Or a care home charity with a high growth strategy may have a lower appetite for taking on a new specialist dementia care service.

The time needed to determine the charity's risk appetite will vary depending on the maturity and understanding of the risk management process at the charity. Once discussions have been completed then the views of major internal and external stakeholders should be obtained. Trustees should at the same time ensure that they have put in place adequate arrangements to ensure that they receive sufficient, relevant and timely information pertaining to risk management and that the process continues to be developed, monitored and improved.

Notes

Start the conversation

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