

GGI Board Briefing: Defining Risk Appetite and Managing Risk by Clinical Commissioning Groups and NHS Trusts, January 2012

“You must be prepared to lose a fly to catch a trout”

A year of change

During 2012, the reform of the NHS will move forward with a transitional re-alignment of commissioning as we move from the former Primary Care Trust-based (PCT) commissioning system to one where Clinical Commissioning Groups (CCGs) and the National Commissioning Board (NCB) take over this responsibility. All NHS providers must reach NHS FT status, and the NHS will come under Competition law. This process is planned to be largely complete by 2013.

Various new responsibilities, such as the duty of candour and the new NHS equalities requirements, are being hard-wired into the new system. In parallel, there is a significant acceleration of the provider development programme within the reforms. A stepped change in the role of Monitor, a new provider development authority and clarification over competition with non-NHS care providers are all intended to promote efficiency and effectiveness, better choice for patients, value for money and quality. All of this generates additional risk in the health system and we suspect very different attitudes to risk by new commissioners. The Good Governance Institute (GGI) believes it is time to revisit risk management systems.

The board of any enterprise is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives and should maintain sound risk management and internal control systems. (The UK Corporate Governance Code, May 2010). GGI encourages all boards to take a planned risk-based approach to their business, and to think through and agree what value the board will deliver over the coming year.

This resource

Working with colleagues in the Southwark CCG and Business Support Unit (BSU), Paul Moore, Chief Risk Officer at University Hospital of South Manchester NHS Foundation Trust and colleagues elsewhere this

resource has been produced by Dr John Bullivant and Andrew-Corbett-Nolan to identify:

- A high-level outline of risk and risk appetite
- A matrix, by which boards can develop their own generic risk appetite and which can also be applied to specific risk
- The means by which existing risk management systems including risk registers and Board Assurance Frameworks (BAF) can be refreshed and made relevant to board agendas and decision taking
- A case study scenario to help boards work through the risk appetite issue.

Introduction – risk and risk appetite

This GGI board briefing is directed at board members and those supporting boards such as Board Secretaries, risk leads, internal and external auditors, audit committees, professional advisors engaged in developing boards and regulators. We are particularly grateful to colleagues in Southwark (both the Business Support Unit and CCG) for helping us to develop this briefing, and in testing out some of the concepts in practice. We believe this work has important significance for all NHS boards and encourage them to focus on this issue in the coming year.

Organisations exist for a purpose – perhaps to deliver a service, or to achieve particular outcomes. In the private sector the primary purpose of an organisation is generally concerned with the enhancement of shareholder value; in the public sector the purpose is more concerned with the delivery of service and/or of a beneficial outcome in the public interest. Whatever the purpose of the organisation may be, the delivery of its objectives is surrounded by uncertainty that both poses threats but can also offer opportunities for success.

Risk is defined as this uncertainty of outcome, whether positive opportunity or negative threat, of actions and events. The risk has to be

‘Clinical Commissioning Groups will need to take difficult decisions on very complex issues going forward while also taking advantage of opportunities that arise to ensure continual improvement. This requires a fresh look at risk and a sound understanding of the organisations ‘risk appetite’. Southwark Clinical Commissioning Leads worked with the GGI to develop a risk appetite maturity matrix. This proved to be a very useful tool in aiding our thinking on risk, our risk tolerance and our corporate decision making.’

Dr Amr Zeineldine

Chair Southwark Clinical Commissioning Group*

‘We used the tool with real time/live issues to assess risk appetite, both from the individual perspective of clinical leads and agreeing consensus as a corporate team. The tool can aid CCGs very effectively in addressing/negotiations on complex issues going forward to ensure wise decision making’

Maggie Aiken

Associate Director for Governance & Quality, Southwark BSU

**Southwark is a London pathfinder working towards authorisation*

assessed in respect of the combination of the likelihood of something happening, and the impact that arises if it does actually happen. Risk management includes identifying and assessing risks (the “**inherent risks**”) and then responding to them.

The resources available for managing risk are finite and so the aim is to achieve an optimum response to risk, prioritised in accordance with an evaluation of the risks. Risk is unavoidable, and every organisation needs to take action to manage risk in a way that it can justify to a level which is tolerable. The amount of risk that is judged to be tolerable and justifiable is the “**risk appetite**”.

Risk appetite is therefore ‘**the amount of risk that an organisation is prepared to accept, tolerate, or be exposed to at any point in time.**’ (HMT Orange Book definition 2005) It can be influenced by personal experience, political factors and external events. Risks need to be considered in terms of both opportunities and threats and are not usually confined to money - they will invariably also impact on the capability of our organisation, its performance and its reputation.

We need to know about risk appetite because:

- If we don’t know what our organisation’s collective appetite for risk is and the reasons for it, then this may lead to erratic or inopportune risk taking exposing the organisation to a risk it cannot tolerate; or an overly cautious approach which may stifle growth and development
- If our leaders do not know the levels of risk that are legitimate for them to take, or do not take important opportunities when they arise, then service improvements may be compromised and patient outcomes affected
- It is a window into a tangible understanding of the collective mind of our leadership. Understanding our risk appetite helps us achieve insight into whether we genuinely have an agreed approach to leading the organisation.



Using risk appetite in practice

At least once a year, the board should set specific limits for the levels of risk the enterprise is comfortable to tolerate in the pursuit of its objectives. The board should also review these limits during periods of increased uncertainty or adverse changes in the business environment.

In setting these risk tolerance levels, the board should consider risk factors both internally and externally. These levels could be measured quantitatively, qualitatively, or both, and should be specific to each of the relevant business activities.

These levels should also be used to set the parameters for the development of the overall business strategy.

The board may set limits regarding the enterprise’s risk appetite i.e. the risk limits that the board desires, or is willing, to take. Where the risk appetite exceeds or deviates materially from the limits of the enterprise’s risk tolerance (the enterprise’s ability to tolerate), this should be disclosed in public reports.

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Risk appetite is a series of boundaries, appropriately authorised by the board, which guide staff on the limits of risk that they can take. It can be viewed differently depending on whether the risk (uncertainty) is:

- **a threat** – the level of exposure which is considered tolerable;
- or
- **an opportunity** – what you’re prepared to put ‘at risk’ in order to obtain a benefit.

Risk falls into three components:

- the inherent risk status – i.e. before any controls put in place
- risk mitigation- management actions
- residual risk after actions have been implemented.

Management should implement specific limits or tolerance levels that are aligned with those overall limits set by the board at departmental or functional, activity and operational risk levels.

The board should continually monitor management of significant risk and satisfy itself that management decisions balance performance within the defined tolerance limits. The board should ensure that it understands the implications of risks taken by management in pursuit of better outcomes, as well as the potential impact of risk-taking by and on local communities, partner organisations, strategic providers and other stakeholders.

This process is dynamic. Risk probability and impact as well as risk appetite can change through circumstances and experience. The perception of the public to risk and confidence in the organisation’s ability to identify and mitigate risk successfully can shift quickly in the light of publicity and risk failures often outside the direct control of the organisation. So risk awareness and communications play an important part in protecting the reputation of the organisation.

Risk cannot usually be fully mitigated. If we have defined the original risk and established our mitigating controls we can be clear of the residual risk that we are prepared to carry. If residual risk is too great more action is needed: if too little it suggests we are expending too much energy.

Failure to define a risk appetite will confuse those who carry out the intentions of the board and may result in too aggressive or timid a handling of the issue.

Risk appetite and the wider context

In 2006 HM Treasury issued guidance for private and public organisations stating that it is essential that the board’s attitude to risk is communicated to the whole organisation and applied in decision making regarding the prioritisation of policies, work streams, programmes, projects, operational service delivery and the funding that goes with them.

Risk is complex and may operate at both strategic and operational levels.

The Financial Reporting Council (FRC) (Boards and Risk: A Summary of Discussions with Companies, Investors and Advisers, FRC, Sept 2011) recognises that the board has particular responsibility for **identifying** risks linked to the strategy, or resulting from external developments such as political and regulatory change. These are characterised as, top down risks, and may be contrasted with bottom up operational risks which are the responsibility of management to identify and, where appropriate, bring to the attention of the board.

However these distinctions did not hold when it came to the board's responsibility for managing risk. Some operational risks are just as capable of damaging the long-term viability or reputation of the enterprise as strategic risks, and in its oversight and monitoring capacity the board need to focus on those risks capable of causing most damage to the enterprise if they materialise, regardless of how they are classified.

It helps to identify different types of risk appetite (money, quality, regulation and reputation) but always to assess these in the round. Again the FRC report that whereas previously each risk had tended to be looked at in isolation, there was increasing awareness that risks were sometimes interconnected and sequential, and of the cumulative impact and disruptive effect of a number of significant risks materialising at the same time.

Previous Secretary of State Andy Burnham commented on the Mid Staffordshire case:

'the main lesson I take from the problems experienced at Mid-Staffs (is) that in future we must never separate quality and financial data. They are always two sides of the same coin.'

Risk appetite involves taking considered risks where the long-term benefits outweigh any short-term losses. It may be appropriate to incur a loss if this paves the way to eventual success

The Public Accounts Committee (PAC) has supported well-managed risk taking, recognising that innovation and opportunities to improve public services requires risk taking, providing that we have the ability, skills, knowledge and training to manage those risks well.

Quality Risk Profiles (QRPs) are an important tool for providers and commissioners of services bringing together a wide range of information about each provider of health and adult social care registered with the Care Quality Commission. The QRP provides an estimate of the risk of potential non-compliance with the essential standards of quality and safety.

Risk Appetite Statement example: Insurance Company – AVIVA

Aviva recognises that its long-term sustainability depends upon the protection of our franchise and our relationship with customers. As such, Aviva will not accept risks that materially impair the reputation of the Group and requires that customers are always treated with integrity.

Commissioning consortiums may find the QRP a useful tool in monitoring the providers that they commission services from, and in improving their commissioning for quality. However, it is important for the commissioner to have set its tolerance of non-compliance by providers in order to influence and focus commissioning decisions. This will also support managing public and political expectations of the commissioner's responsibility for the quality of services it buys from providers. Provider boards should also explore how they can use the QRPs.

King III (the King Code and Report on Governance in South Africa, 2009), which is emerging as the new international corporate governance code, offers advice to organisations large and small, public and private that are adopting a risk appetite approach:

The board should be responsible for the governance of risk and set levels of risk tolerance and risk appetite annually.

The board should appoint a committee responsible for risk. This committee should:

- consider the risk management policy and plan
- monitor the risk management process
- convene at least twice per year
- be evaluated once a year by the board
- have a minimum of 3 members
- have as its members executive and non-executive directors, members or senior management and independent risk management experts to be invited in necessary.

With regards to risk, the board should:

- delegate to management the responsibility to design, implement and monitor the risk management plan
- ensure that risk assessments are performed on a continual basis
- ensure that frameworks and methodologies are implemented to increase the probability of anticipating unpredictable risks
- ensure that management considers and implements appropriate risk responses
- ensure continual risk monitoring by management
- receive assurance regarding the effectiveness of the risk management process
- ensure that there are processes in place enabling complete, timely, relevant, accurate and accessible risk disclosure to stakeholders.

The formal risk appetite statement

If the organisation has not made a formal statement on its risk appetite, it will have a control problem. Without such a statement managers are running their business with insufficient guidance on the levels of risk that they are permitted to take, or not seizing important opportunities due to a perception that taking on additional risk is discouraged.

The importance of having a documented statement is emphasised within the new British Standard: "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 are to be balanced and the likely response.” (BS31100)

Research by Nottingham University suggests that almost all of the organisations that formally express their appetite for risk include one or more qualitative statements such as:

- We have a low appetite for risk
- We have no appetite for fraud / financial crime risk
- We have a zero tolerance for regulatory breaches
- We will at all times attempt to avoid negative press coverage
- We will not take risks that effect the quality of customer service provided
- We are committed to protecting the environment

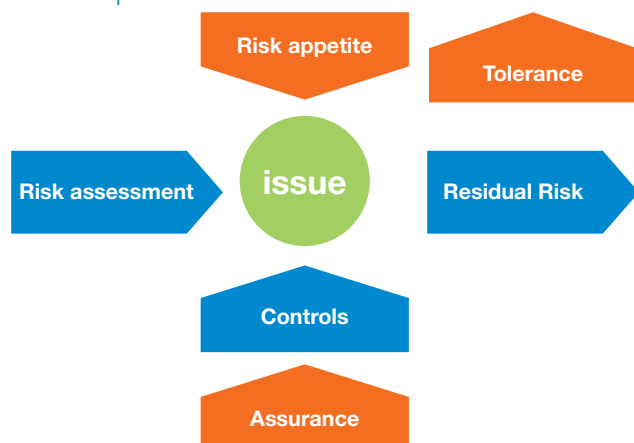
Building an understanding of risk

Each risk needs to be assessed against the risk appetite that must be determined by the Board and communicated. A framework is needed for describing and analysing risks and assessing them according to a common currency.

Risk registers that have listed risks individually with their ratings may not indicate how the ratings compare to the risk appetite. They may also fail to facilitate the identification of pressure points, imbalances and inconsistencies in approach.

With the risk appetite defined, individual risks can be assessed against the risk appetite descriptors and decisions can be made about whether the optimum level of residual risk has been reached. Most NHS organisations use a board assurance framework (BAF) which summaries strategic objectives, the principal risks that can impact on these and the controls and assurance put in place to mitigate risk. We believe that this is too static and would be owned and used by boards if enhanced by first articulating the risk appetite for the risk and expressing the residual risk which can be tolerated. Controls and assurance can then provide a proportionate and dynamic response with clear need to revisit when risk extends beyond agreed tolerances.

First steps



1 Agree and articulate your general Risk Appetite

For example:

- Avoid** Avoidance of risk and uncertainty is a key organisational objective.
- Minimalist** Preference for ultra-safe business delivery options that have a low degree of inherent risk and only have a potential for limited reward.
- Cautious** Preference for safe delivery options that have a low degree of residual risk and may only have limited potential for reward.
- Open** Willing to consider all potential delivery options and choose the one that is most likely to result in successful delivery while also providing an acceptable level of reward (and value for money etc.).
- Seek** Eager to be innovative and to choose options offering potentially higher business rewards, despite greater inherent risk.

2 Identify specific issues and risks

Boards should focus on strategic risks expecting managers to identify operational risks.

3 Determine a) your risk appetite and b) risk tolerance

Risk appetite is the aggregated account of the board's willingness (to allow management) to take risks in the pursuit of strategic objectives.

Risk tolerances reflect the boundaries within which the executive management are willing to allow the true, day to day, risk profile of the enterprise to fluctuate, while they are executing strategic objectives in accordance with the board's strategy and risk appetite.

4 Accept risk tolerance for Residual Risk

Be clear of the exposure to loss remaining after other known risks have been countered, factored in, or eliminated. i.e. controlled

5 Seek Assurance that controls have been actioned and risk is within tolerance

6 Amend risk appetite/tolerance in context of change

Reflect changes in context and public 'outrage' e.g. when a similar issue has gone awry elsewhere.