



## **RISK APPETITE FRAMEWORK**

**2020/21**

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## 1. BACKGROUND

### Why risk appetite framework

The development and establishment of an effective Risk Appetite Framework is an iterative and evolutionary process that requires on-going dialogue throughout the municipality and to attain buy-in across the municipality. This framework sets the municipality's risk profile and forms part of the process of development and implementation of the municipality's strategy and determination of the risks undertaken in relation to the municipality's risk capacity.

The risk appetite framework facilitates the determination, review and oversight of risk appetite. It acts as a bridge between the municipality's strategy and its risk management framework. The risk appetite should be updated in line with changes to the strategy of the municipality (and vice versa, as neither the strategy nor the risk appetite should be developed in isolation from the other but rather as part of a unified process) and should also evolve in line with the development of its risk management framework.

The assessment of the municipality's consolidated risk profile against its risk appetite should be an on-going process. Implementing an effective framework requires an appropriate combination of policies, processes, controls, systems and procedures to accomplish a set of objectives.

### 1.1 Definition of risk appetite

The Committee of Sponsoring Organisations of the Treadway Commission (COSO)

*Enterprise Risk Management – Risk Appetite Framework*, states the following -

*"The amount of risk, on a broad level, an entity is willing to accept in pursuit of value. It reflects the entity's risk management philosophy, and in turn influences the entity's culture and operating style. ... Risk appetite guides resource allocation. ... Risk appetite [assists the organization] in aligning the organization, people, and processes in [designing the] infrastructure necessary to effectively respond to and monitor risks".*

### 1.2 Benefits of a risk appetite framework

According to COSO the following benefits flow from an effective risk appetite framework:

- It is strategic and is related to the pursuit of organizational objectives;
- Forms an integral part of corporate governance;
- Guides the allocation of resources;
- Guides the municipality's infrastructure, supporting its activities related to recognising, assessing, responding to, and monitoring risks in pursuit of organisational objectives;
- Influences the municipality's attitudes towards risk;
- Is multi-dimensional, including when applied to the pursuit of value in the short term and the longer term of the strategic planning cycle;
- Requires effective monitoring of the risk itself and of the municipality's continuing risk appetite; and

- Enhanced risk management strategy decisions through quantification of risk appetite.

### **1.3 Objectives of a risk appetite framework**

The objective of this framework is to help management make informed decisions and includes:

- Establishing a process for communicating the Risk Appetite across the municipality;
- Be driven by both top-down and bottom-up involvement of management at all levels, and embedded and understood across the municipality;
- Facilitate embedding risk appetite into the municipality's risk culture;
- Evaluate opportunities for appropriate risk taking and act as a defence against excessive risk-taking;
- Allow for the risk appetite statement to be used as a tool to promote robust discussions on risk and as a basis upon which risk management and internal audit functions can effectively and credibly debate and challenge management recommendations and decisions;
- Be adaptable to changing business and market conditions so that, subject to
- approval by senior management and Council as appropriate, opportunities that require an increase in the risk limit could be met while remaining within the agreed municipal wide risk appetite;
- Cover activities, operations and systems of the municipality that fall within its risk landscape but are outside its direct control, including suppliers; and
- Be consistent with the principles in this document.

### **1.4 Characteristics of a risk appetite framework**

- A well-defined risk appetite (framework) should have the following characteristics:
- Reflective of strategy including organisational objectives, business and stakeholder expectations;
- Reflective of all key aspects of the Municipality, documented as a formal risk appetite statement;
- Acknowledges willingness and capacity to take on risk;
- Considers the skills, resources and technology required to manage and monitor risk exposures in the context of risk appetite; and
- Has been approved by Council.

## **2. METHODOLOGY**

- Risk management is a process, not an event and requires the municipality to pay closer attention to the developments both in the external and internal control environments.
- Top management's strategic direction and commitment are also regarded as very important, if risk management processes are to be successful and effective.
- Management is expected to lead the process and ensure that everybody within the municipality understands the benefits of risk management. This represents the challenge to management to set the tone at the top or to establish a supportive internal environment.

- Involvement of all personnel and at all levels of management ensures that risk management activities are applied consistently across all levels within the municipality. Again, the philosophy that everybody is a risk manager ensures that everybody is involved in risk management process.

### **2.1 Criteria**

The risk appetite framework helps the municipality to articulate the risk that could potentially impact on the achievement of the strategic goals (positively or negatively). The municipality should take into account:

- The municipality's core strategy;
- If the municipality has a zero tolerance approach regarding legislative noncompliance, fraud and loss control, it should be clearly documented in policies and as such enforced;
- Before setting risk appetite, it helps to classify risk into different categories that the municipality is, or may be, exposed to in the pursuit of its performance objectives;
- It is important to have a holistic view of all the risks to which the municipality is exposed, including what approach it will take in managing them; and
- Capacity and maturity of the risk management function.

### **2.2 Stakeholder engagement**

The municipality should engage with all stakeholders to ensure that both risk taking and control activities are aligned and that possible differences are identified at this stage. The following stakeholders need to be at least considered when setting risk appetite:

- Municipal Manager;
- Executive Directors;
- Senior Manager: Executive Support Services;
- Internal Audit & Risk Management Unit;
- Members of Risk Management Committee; and
- Audit and Performance Committee members

### **2.3 Development of the risk appetite**

- The development of risk appetite must take the following into account:
- Obtain the risk registers for the entire municipality;
- Combine the risk registers into one global risk register;
- Sort the risk as per the global risk register from high to low in terms of residual risk; and
- Determine the average rating as per the Residual Risk Register rating.

## **2.4 Approval of the risk appetite**

Risk Management Committee and Audit & Performance Committee should then recommend the risk appetite statement prior to communicating it to all the stakeholders.

## **2.5 Implement**

Once the risk appetite has been approved, it should be:

- Clearly communicated and cascaded through the municipality;
- Integrated into the risk management framework; and
- Actively used in the strategic management of the municipality.

## **2.6 Reporting**

The internal reporting refers to reporting to management on regular intervals and externally reporting via the annual report. Reporting can include the following:

- Risk above the risk appetite;
- Trends in average risk rating over time; and
- Risk above your appetite where no actions have been developed.

The overall reporting process needs to be facilitated by a comprehensive governance framework in order to ensure that an appropriate escalation process is in place.

## **2.7 Review**

The Risk Appetite Statement should be reviewed whenever there is a significant change to the municipality's operating environment to ensure alignment with the ever evolving municipal strategy, risk environment and the municipal performance. An analysis could also be done taking into consideration of what worked well, what failed and what needs to be done differently next time.

## **3. CONCLUSION**

It is clear that the process of determining an appropriate risk appetite is a challenging one. There are many technical aspects to be tackled as well. These include how to measure risks and how to set appetite. Risk appetite needs to become embedded into the municipality. It does not stand alone, but rather fits into the fabric of the risk management process. It requires support from key control functions such as Internal Audit and Risk Management in order to operate effectively. Above all though, it needs to achieve buy-in from all stakeholders.

## **4. GLOSSARY**

### **Terminology Definition of terminology**

**Enterprise Risk Management (ERM)** - Entity Risk Management is a structured and consistent approach across the municipality that aligns strategy, processes, people, technology and knowledge with the purpose of evaluating and managing the risks (threats and opportunities) to create stakeholder value.

**Process** - Structured set of activities within an entity, designed to produce a specified output.

**Risk** - Risks are uncertain future events (threats and opportunities) that could influence the achievement of the goals and objectives of the municipality.

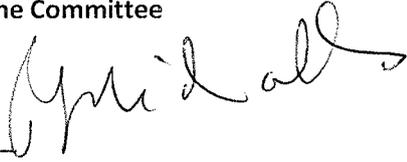
**Risk Assurance** - The Risk Assurance functions are that of External Audit (Auditor General of South Africa) and it is in their scope of work to provide assurance opinions.

**Risk Appetite Framework (RAF)** - The overall approach, including policies, processes, controls, and systems through which risk appetite is established, communicated, and monitored. It includes a risk appetite statement, risk limits, and an outline of the roles and responsibilities of those overseeing the implementation and monitoring of the RAF. The RAF should consider material risks to the financial institution, as well as to the institution's reputation vis-à-vis policyholders, depositors, investors and customers. The RAF aligns with the institution's strategy.

**5. ACKNOWLEDGEMENT OF APPROVAL**

This document will remain effective until a new one is approved.

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Adopted by Council Resolution

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