



Refocus on Risk to Thrive

Insights into how Australian organisations are aligning strategy, risk appetite and culture

January 2021

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Foreword

The COVID-19 pandemic has accelerated many of the disruptors predicted by the World Economic Forum to occur in our fourth industrial revolution, and introduced challenges that could not have been foreseen. These disruptive forces have impacted Australian organisations in very different ways. For some, it has reinforced their strategic plans, enabled an acceleration of their implementation, and driven growth. For many, it has exposed weaknesses in governance, strategy, operating models and culture.

Despite the challenges, Australia has proven again to be 'the lucky country'. Our golden soil, ringed by sea, abound in nature's gifts, has provided a safe haven from which to observe and learn from the process of creative destruction occurring around us. The changes occurring are presenting opportunities, but in order to realise these opportunities we must gain comfort taking and managing risk in an uncertain environment.

Of particular concern is the gap between business confidence and business behaviour. Whilst business confidence is at pre-crisis heights, there are justified concerns that Australian businesses are not backing themselves. Business lending is down, mergers and acquisition deal volumes are down, and share buy backs by listed organisations are up. These behaviours collectively signal to the market that Australian organisations would rather hand capital back to their shareholders rather than use it to grow.

This concern is shared by the Australian government and its agencies, with the Governor of the Reserve Bank of Australia recently stating, "We all know that businesses need to take risks to innovate and grow. I understand that in an uncertain world, it can be hard to take on risk and there can be a natural tendency to avoid new risks. But, if businesses are to seize the opportunities that are out there to grow and to increase Australia's productive capital base, some degree of risk-taking is necessary"¹.

In order to thrive, Australian organisations must; lean into the opportunities presented; invest in the people, processes and systems that enable Boards and Management to make risk-informed decisions; and build cultures that understand the value in taking risk, are comfortable with taking risk, and know how to manage risk responsibly.

Bold action of this nature will be required to thrive in the world which emerges from the COVID-19 crisis. Such action will be required to deliver leading returns to shareholders, remain relevant to customers, and add value to the communities within which these organisations operate. And only if we do this will Australia remain the 'lucky country' for future generations.

This responsibility sits primarily with the Boards and Management teams of Australian organisations – public and private.

We appreciate the nature of the challenge in front of Australia's Boards and Management teams. As such, we have conducted this study with the aim of assisting these organisations to understand how they can further align their strategies, risk appetite and organisational culture. And to ultimately increase their confidence to take risk and thrive in the world which emerges out of this crisis.

¹ Philip Lowe, "COVID, Our Changing Economy and Monetary Policy", Committee for Economic Development of Australia Annual Dinner Address, Sydney, 16 November 2020

Executive summary

The purpose of the study is to give Australian organisations greater confidence to take risks and thrive in the world which will emerge from the COVID-19 crisis (the crisis). To achieve this purpose, this report shares insights from the interviews of **75** Director and Management representatives of **59** of Australia's largest organisations.

The main industry sectors represented in this study include financial services; energy, resources and industrials; government and public services; tech, media and telco; and consumer sectors.

The report contains the following sections:

- 1. Executive Summary** – insights on the journey organisations have been on prior to and during the crisis to align strategy, risk appetite and culture. Plus clear action plans for Directors and Management stakeholders to guide their response to the insights in the report.
- 2. Common Strengths** – insights on the common strengths observed in the alignment of strategy, risk appetite and culture.
- 3. Common Development Areas** – insights on the common development areas observed in the alignment of strategy, risk appetite and culture.
- 4. Insights into Better Practice** – insights on better practices observed in the alignment of strategy, risk appetite and culture.
- 5. About This Study** – insights on the approach to conducting this study.

The journey Australian organisations have been on to align strategy, risk appetite and culture can be summarised into three periods

Period 1: Pre-crisis – whilst Australian organisations have been considering their risk appetite for many years, the formal documentation and use of risk appetite accelerated in 2014 following the release of the 3rd Edition of the ASX Corporate Governance Principles and Recommendations, and other industry requirements such as APRA's Prudential Standard for Risk Management. These new requirements clearly put the onus on Boards to set risk appetite within which it expects Management to operate. Since then, most large organisations have established risk appetite statements, refined them and experimented with their use in strategic planning and other decision-making processes. This experimentation has allowed these organisations to begin to understand the link between risk appetite and culture.

Period 2: Crisis – the crisis increased risk levels and changed many of the assumptions which underpinned Australian organisations' strategies and risk appetite statements.

In response, organisations quickly updated their strategic plans and objectives, and increased the cadence of dialogue between Directors and Management to ensure they remained aligned on key decisions. Whilst there were considerable attempts to de-risk strategic plans, Boards' risk appetite levels did not materially change, resulting in many organisations operating outside of risk appetite for extended periods of time.

Strategic and tactical decisions were being made at pace, and as dialogue between the Board and Management increased, the explicit reference to risk appetite reduced.

However, the frequent dialogue led to a strong implicit alignment between the Board and Management on the Board's risk appetite. In many organisations, this regular dialogue reduced the need for an explicit consideration of risk appetite when making decisions. At the same time, a disconnect emerged between the Board and Management, with the Board believing the risk appetite statement was providing high value to decision making and Management believing it was providing low value.

Period 3: Post crisis – Australian organisations see considerable opportunity emerging from the crisis and are looking to reset and accelerate the implementation of their strategic plans, take and manage risk, and grow. Whilst remaining vigilant, Boards are reducing the frequency of dialogue with Management and moving back to pre-crisis risk governance arrangements. The return to the new normal presents several challenges which many organisations are addressing proactively. An opportunity also exists to reflect on the lessons learned from the crisis and establish a stronger alignment between strategy, risk appetite and culture.



Executive summary

Key strengths observed

The key strengths we observed in relation to how Australian organisations are aligning strategy, risk appetite and culture include:

- **Strength #1:** Most organisations see considerable opportunity emerging out of the crisis, and have made material changes to their strategic plans in order to grasp these opportunities;
- **Strength #2:** Boards and Management have been very agile during the crisis, regularly changing risk management strategies to respond to emerging risks and opportunities;
- **Strength #3:** The increase in cadence of governance during the crisis led to a strong alignment between the Board and Management on their organisation's risk appetite; and
- **Strength #4:** Cultures adjusted quickly to enable the adoption of new ways of working, but remained resilient. This enabled many organisations to operate in the face of great uncertainty and still achieve updated business plans.

Key development areas observed

The key development areas we observed in relation to how Australian organisations are aligning strategy, risk appetite and culture include:

- **Opportunity #1:** Align strategy, risk appetite and culture setting processes;
- **Opportunity #2:** Improve the quality of risk data and effectiveness of risk reporting systems;
- **Opportunity #3:** Increase understanding of the value of risk appetite and accountability for performance within risk appetite; and
- **Opportunity #4:** Use risk appetite as a tool to influence risk culture.

To enable Australian organisations to further understand these 'areas for improvement' further, we have shared further insight below:

Opportunity #1: Align strategy, risk appetite and culture setting processes

The study identified that as Board and Management engagement increased during the crisis, formal consideration of risk appetite when making decisions reduced. On its own, this fact is not a concern. But when combined with the observation that Directors are materially more confident than Management, that their organisation's risk appetite is well defined, well understood, adding value to decision making, is supported by good quality data, and influencing their organisation's employees' behaviours and attitudes, then it does present a concern.

Leading organisations are now looking at the lessons of the crisis and are establishing new ways of working that enable Directors and Management to remain aligned during a period of less frequent dialogue. At the same time, they are addressing the historical disconnect between Directors and Management on the approach to defining and using risk appetite.

This disconnect is compounded by the finding that most organisations would have higher confidence in executing their strategic plans and achieving their objectives if there was a stronger link between strategic plan and risk appetite setting processes.

To address these development areas leading organisations are aligning strategy, risk appetite and culture setting processes, creating playbooks to guide risk-based decision making, and refreshing risk appetite statements to have a greater focus on value creation over value protection.



Executive summary

Opportunity 2: Improve the quality of risk data and risk reporting systems

Directors have moderate confidence, whilst Management have low confidence in the quality of data supporting reporting of performance within risk appetite. This is driven by the highly manual nature of risk reporting processes, particularly in the areas of non-financial risk which have not been prioritised for digitisation beyond establishment of general Governance, Risk and Compliance (GRC) applications.

Furthermore, the low confidence in risk data quality has contributed to the limited use of analytics as a tool to understand performance within risk appetite.

To address these development areas leading organisations have prioritised the digitisation of the collection of risk data and investment in the people, processes and systems required to give Directors and Management access to this data in easy to access and use tools. Considerable work is also going into improving the availability and visualisation of management information which supports more proactive action taking.

Opportunity 3: Increase the understanding of risk appetite and accountability for performance within risk appetite

The strategic plans which Management are proposing to the Board for approval still contain limited insight as to how the proposed plan changes the organisation's risk profile, mitigates these risks and under what conditions assumptions the plans can be achieved within the risk appetite.

Management accountability to operate within the risk appetite continues to be opaque and complex. Management often finds it hard to interpret and operationalise the Board's risk appetite statement, and in most sectors management incentives are loosely linked to performance within risk appetite, if at all.

Risk appetite is poorly communicated and understood within most organisations, and largely limited to a few senior stakeholders.

To address these development areas, leading organisations are driving a clearer articulation of risk appetite during strategic planning and ensuring business plans articulate how risks will remain within risk appetite during execution of the business plan. They are developing performance management frameworks that embed risk management responsibilities in job descriptions and embed performance within risk appetite into balanced score cards. Balanced score cards typically have dedicated risk measures.

In these instances, Management are being held accountable for breaches of risk appetite and greater focus is placed on establishing clear 'paths to green' within appetite, and/or risk acceptance.

Opportunity 4: Using risk appetite as a tool to influence risk culture

Australian organisations continue to experiment with the definition of their desired culture, approaches to measuring and monitoring culture and ways to influence this culture.

Considerable difficulty is still being experienced in establishing frameworks which ensure the alignment of the organisation's strategy, risk appetite and culture. Definition of desired culture is still often not formally connected with the behaviours and attitudes required to achieve the outcomes agreed to in the strategic plan, nor clearly linked to the organisation's mission, purpose and values. This ongoing disconnect between 'desired' culture versus 'lived' culture is having negative impacts.

Whilst most Director and Management representatives believed their risk appetite statements and measures influenced their employees' behaviors and attitudes, many representatives had difficulty describing how the link between risk appetite and employee's behaviours and attitudes worked in practice in their organisation.

To address these development areas, leading organisations are establishing tailored and desired culture definitions which reflect the language used in their organisation and support the achievement of the strategic plan. Key management teams are involved in development of the desired state and measurement and monitoring techniques using a combination of quantitative and qualitative methodologies. Further culture monitoring capabilities are being built in each of the three lines of defence, and at Board level.



Executive summary – key insights

1. Optimistic about opportunities emerging out of the crisis

Most organisations believe the crisis presents **considerable opportunity** for them, and have refreshed **their strategic plans** in order to realise these opportunities.

74%

Of participants believe there is a moderate to high amount of opportunities for organisations emerging from the current crisis.

54%

Of participants identified they had made a moderate to high number of changes to their strategy, business plan and objectives during the crisis.



2. Increased agility of decision making

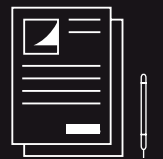
Boards and Management have been very agile during the crisis, **regularly updating their risk management strategies** to respond to emerging risks and opportunities.

80%

Of participants believe their risk appetite is moderately to very well defined within their organisation.

84%

Of participants made at least some change to their definition of risk appetite during the crisis.



Areas of strength



The increase in cadence of governance during the crisis led to a strong **alignment between the Board and Management** on their organisation's risk appetite.

81%

Of participants indicated their Board and Management were moderately to very well aligned on the organisation's appetite for taking risk to achieve its objectives.

55%

Of participants believed their definition of risk appetite was adding moderate to high value to their decision making.

3. Increased cadence of governance



Cultures adjusted quickly to enable the adoption of new ways of working, but remained resilient. This enabled many organisations to operate in the face of great uncertainty and still achieve updated business plans.

68%

Of participants indicated that their risk appetite is moderately to highly communicated and understood across the organisation.

64%

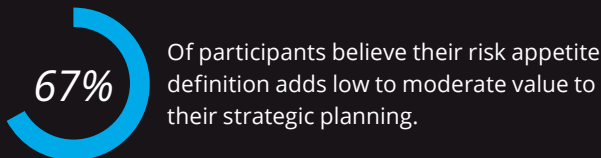
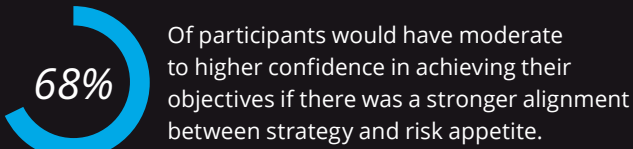
Of participants indicated that their risk appetite definition has a moderate to high influence on the organisation's culture.

4. Cultures adapted quickly, but remained resilient

Executive summary – key insights

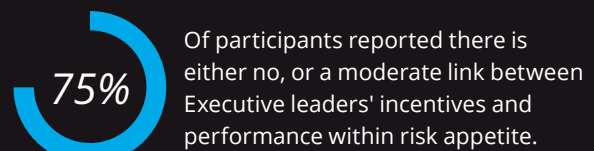
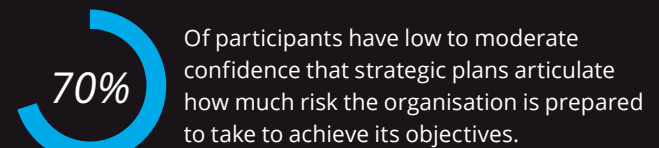
1. Align strategy, risk appetite and culture setting processes

Australian organisations **would have higher confidence in achieving their objectives** if strategy and risk appetite was further aligned.



2. Increase understanding of and accountability for performance within risk appetite

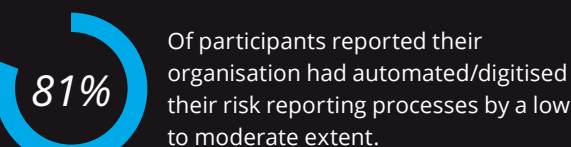
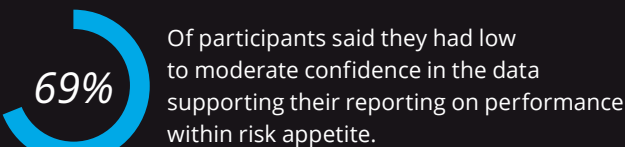
Management are not **clear on how much risk they are prepared to take to achieve their objectives**, or how to effectively operationalise the Board's risk appetite.



Areas of development

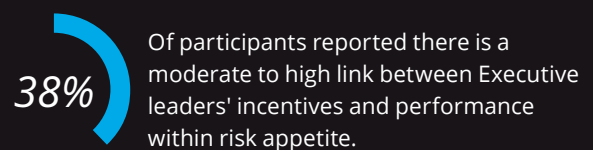
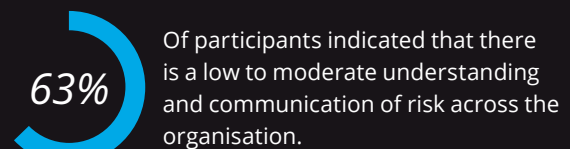


Management have **low confidence in the quality of data** they use to understand their performance within risk appetite.



3. Improve the quality of risk data and effectiveness of risk reporting systems

Boards and Management are **not clear on how to use the definition of risk appetite to influence their organisation's culture**.



4. Use risk appetite to influence risk culture



Executive summary –

Call to action for Directors

01

Obtain greater insight into, and set clear expectations regarding, how your definition of risk appetite is being operationalised, influencing employees' behaviours and attitudes, and adding value.

02

Establish a clear view of 'risk leadership' and communicate this to your organisation's leadership team. Then lead the explicit consideration of, and reference to, risk appetite when making key decisions.

03

Ensure the strategic plan can be delivered within risk appetite, whilst under stress. This should involve the consideration of alternate scenarios which stress the financial and non-financial risks inherent in the proposed plan.

04

Refresh the risk appetite statement with a view to making it more concise, quantitative and focused on guiding value creation over value protection. Ensure a plan exists to improve the quality of data which support reporting against this statement.

05

Ensure Management establishes clear plans to bring risk exposures back within the Board's risk appetite. Hold Management accountable to performance within risk appetite, including ensuring Management incentives are linked to performance within risk appetite.



Executive summary – *Call to action for Management*



Establish clear accountabilities and escalation processes across the three lines of defence for setting and operating within risk appetite.

01

Establish a strategic planning playbook that ensures the proposed strategic plan is aligned with the Board's risk appetite and desired culture.

02

Assess the quality of data which supports reporting on performance within risk appetite, and establish a program of work to address risk data quality issues. This should include digitising risk data collection, analysis and reporting.

03

Develop a list of decisions, in addition to the development of the strategic plan, which need to involve an explicit consideration of risk appetite.

04

Embed the Board's expectations of 'risk leadership' into the capability development and performance management frameworks of all senior management.

05

Key strengths observed

Strength #1: The review of strategy and risk appetite has led to the identification of opportunities

The crisis has delivered an unprecedented stress to all organisations' strategic plans, risk appetites and cultures. In response, the extent of change to strategic plans varied greatly, with equal percentages changing their plans to low, moderate and high extents.

Australian organisations' approach to updating their definition of risk appetite during the crisis varied greatly, noting that the majority of organisations only made a small extent of changes.

Consumer and financial services sectors undertook the highest degree of change to their strategic plans and risk appetite, whilst tech, media and telco sectors undertook the least amount of change.

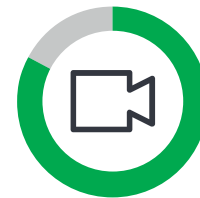
Interestingly, whilst tech, media and telco did not change their strategies, they have the highest confidence that the crisis presents opportunities for

them. In contrast the energy, resources and industrials sector representatives held the lowest confidence that the crisis would present opportunities for their organisations.

Strength #2: Ongoing improvement in the articulation of risk appetite

Whilst consideration of risk appetite has always been implicit within decision making, in 2014 the 4th Edition of the ASX Corporate Governance Principles and Recommendations introduced the requirement for Boards to define their risk appetite and ensure Management operate within it. More recently, more detailed requirements have been set for Boards in financial services and government industry sectors. Correspondingly, these same sectors had the highest confidence in the extent of definition of their risk appetite, and had relatively more positive views on the value their definition of risk appetite was adding to strategic planning and other decision-making processes.

Increasingly, organisations were moving from having just a Board approved risk appetite statement and supporting metrics, to also having more detailed statements and measures in management functions which could be used day-to-day.



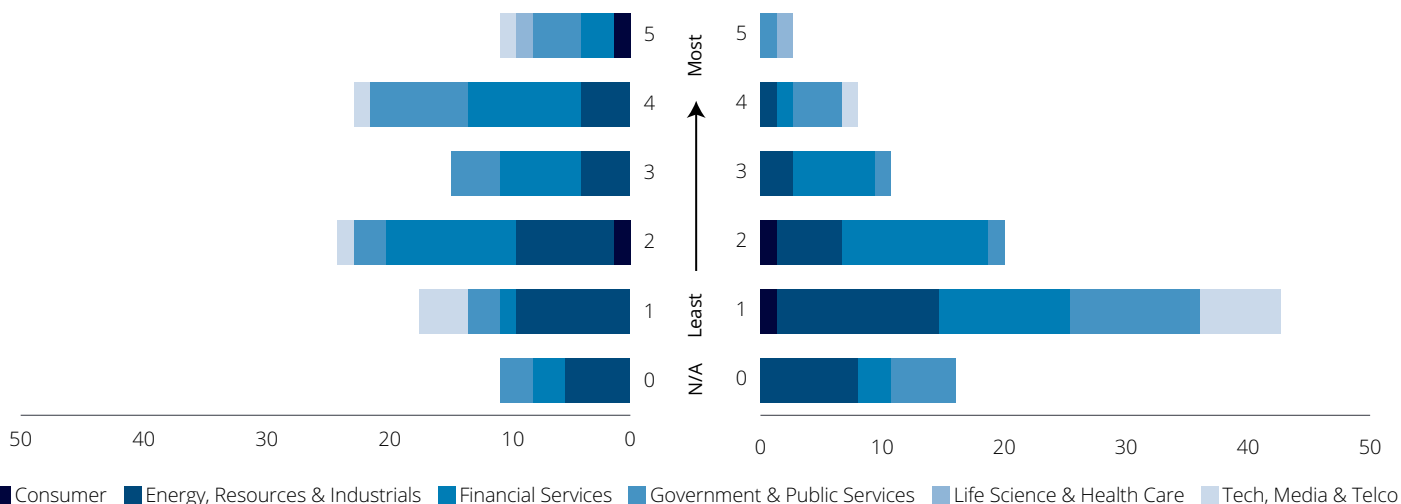
83% of participants from the tech, media and telco sectors had high confidence the crisis would present opportunities



Only **23%** of participants from the energy, resources and industrial sectors had high confidence the crisis would present opportunities

Q: To what extent did you update your definition of risk appetite during the crisis?
(grouped by industry sector)

Q: To what extent did you update your strategy, business plan and objectives during the crisis?
(grouped by industry sector)



Key strengths observed

Strength #3: Strong alignment between the Board and Management

The definition of risk appetite is increasingly becoming a collaborative process, with Chief Risk Officers facilitating discussions between the Board and Management. This approach increases understanding of, and buy into, the approved risk appetite and ensures risk appetite statements remain valuable to all stakeholder groups.

During the crisis, Directors increased the frequency of meetings with Management to enable them to understand how the changes were impacting their organisation and ensure they were aligned on key decisions. This significant increase of the flow of information and dialogue between the Board and Management resulted in a heightened perception of alignment on the organisation's risk appetite.

Boards and Management are now considering how they remain aligned as their risk meetings return to the pre-COVID-19 frequency.

Strength #4: Growing expectations for Boards and Executives to communicate and understand risk appetite

Increasingly, organisations are seeing their risk management framework as a tool which adds value to the formulation and execution of their strategic plans, and enables them to differentiate themselves from their competition.

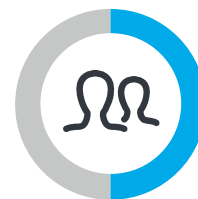
As such, Management are expected to have a strong understanding of the design and operation of the risk framework. In particular, they are expected to have a strong understanding of the Board's risk appetite and how to operationalise this in their business areas.

Boards typically give Management discretion as to how to communicate and ensure teams understanding how to operate their risk appetite. The study identified that organisations believed risk appetite was typically moderately well communicated and understood, but noting Directors were more optimistic than Management.

A common view that emerged from the study was that only senior management were required to explicitly understand the Board's risk appetite. Whereas all other employees only need to follow policies and processes informed by the Board's risk appetite.

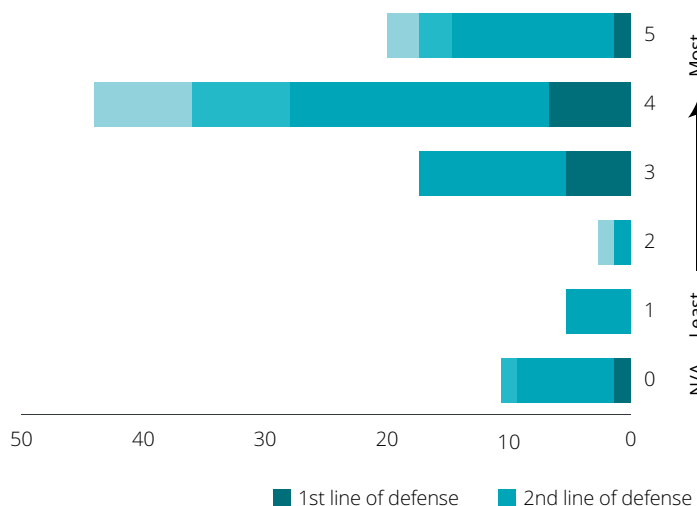


90% of Directors believed the Board and Management had a moderate to high alignment on the organisation's appetite for taking risk to achieve objectives

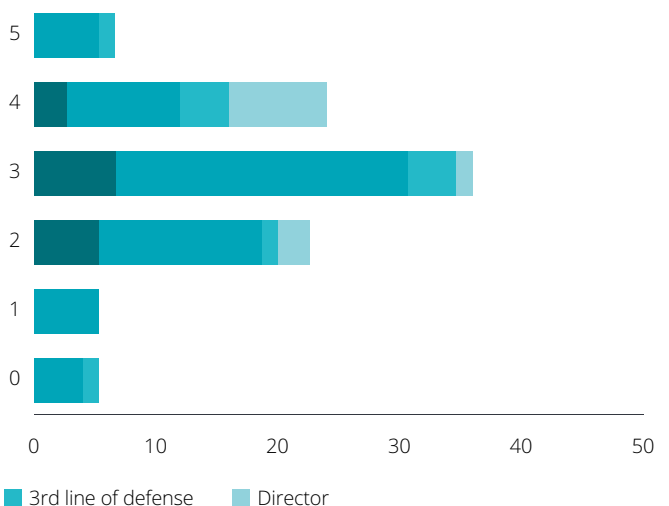


50% of first line Executives believed the Board and Management had a moderate to high alignment on the organisation's appetite for taking risk to achieve objectives

Q: How aligned are the Board and Management on your organisation's appetite for taking risk to achieve your objectives? (grouped by respondent type)



Q: To what extent is the concept of risk appetite communicated and understood in your organisation? (grouped by respondent type)



Key development areas observed

Opportunity #1: Align strategic planning and risk appetite setting processes

While both strategic plans and risk appetite statements were reviewed throughout the crisis, generally there was limited alteration of the organisation's risk appetite. Despite the recent update to both documents, all stakeholder groups interviewed were more likely to agree than disagree that they would have higher confidence in the ability to achieve their strategic plans and objectives if there was clearer alignment between strategy and risk appetite.

The study identified a number of drivers for the poor alignment of strategy and risk appetite, including the difference in ownership of the strategy and risk appetite setting processes, the timing of performance the processes, and the stakeholders involved in the separate processes. It also identified that risk appetite was commonly only explicitly considered quite late in the process and that its consideration needed to be brought forward.

In addition, Boards commonly did not set clear expectations on when and how Management should consider risk appetite when forming the strategic plan.

Gaining alignment between strategy and risk appetite can, in part, be achieved by explicitly requiring strategic plans to clearly articulate the amount of risk required to be taken to achieve the proposed strategic outcomes. Overall, most participants were of the view that their organisation's strategic plan documents did not do this very clearly.

The financial services industry sector was the only sector to have moderate confidence that their strategic plan articulates how much risk they're prepared to take to achieve their objectives. By comparison, all other industry sectors had lower confidence.

The approach to consideration of risk within the strategic plan was observed to be inconsistent and commonly added limited value to the overall design and use of the strategic plan document.



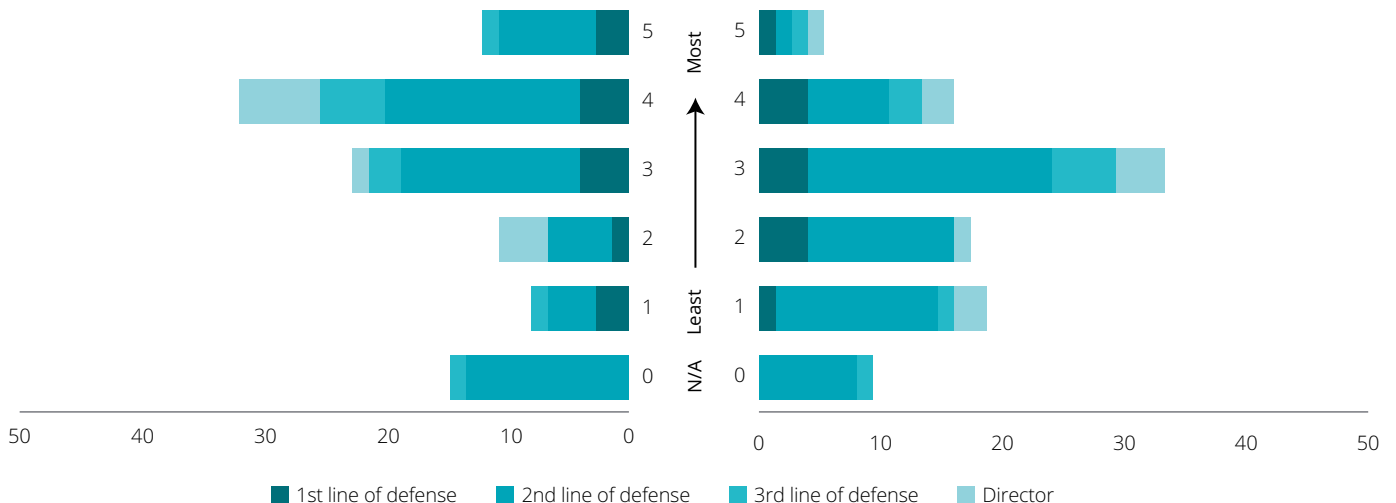
22% of participants had a high confidence their strategic plan articulated the amount of risk the organisation was prepared to take to achieve its objectives

'The crisis has made it a stronger imperative to take the risk afforded to us in the risk appetite statement. The crisis has sped this up.'

CRO, Financial Services Industry

Q: Would you have greater confidence in achieving your strategy if there was a clearer articulation and alignment between your strategy and risk appetite? (grouped by respondent type)

Q: How clearly does your strategy/business plan articulate the amount of risk you are prepared to take to achieve your objectives? (grouped by respondent type)



Key development areas observed

Directors are typically gaining a high amount of value from their definition of risk appetite whereas Management are only gaining low to moderate value from these statements. This played out during the crisis where Boards and Management infrequently used their definition of risk appetite to inform decisions.

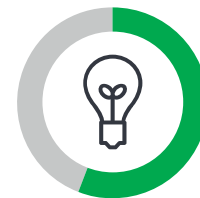
Management concerns included that the risk appetite was defined to meet regulatory requirements and that the high level directional statements were not easy to operationalise. In addition, whilst risk appetite statements guided strategic planning at a high level, they did not guide other key decisions that needed to be made.

Over 70% of interviewees indicated that their Board and Management explicitly used their definition of risk appetite when making decisions during the crisis. This may be due to the increased frequency of Board and Management dialogue reducing the need to explicitly refer to risk appetite, but it may also be due to the low level of value organisations are gaining from their current definition of risk appetite.

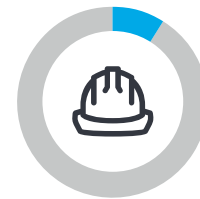
Australian Directors' opinions on the explicit use of risk appetite in decision making vary significantly. Some Directors considered it to be a key feature of decision-making whilst others believed it is not required.

'We don't pull out the risk appetite statement when making decisions, it's just not how it works.'

Director, Resources Industry

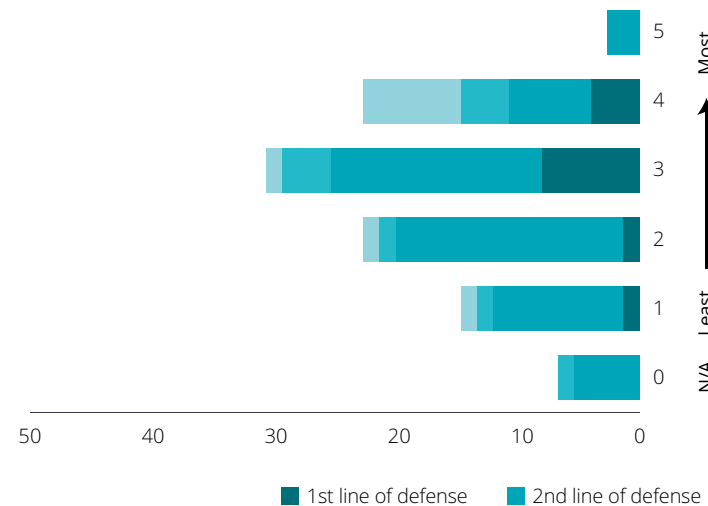


56% of participants from the financial services industry believed the definition of risk appetite added a high degree of value to decision-making processes

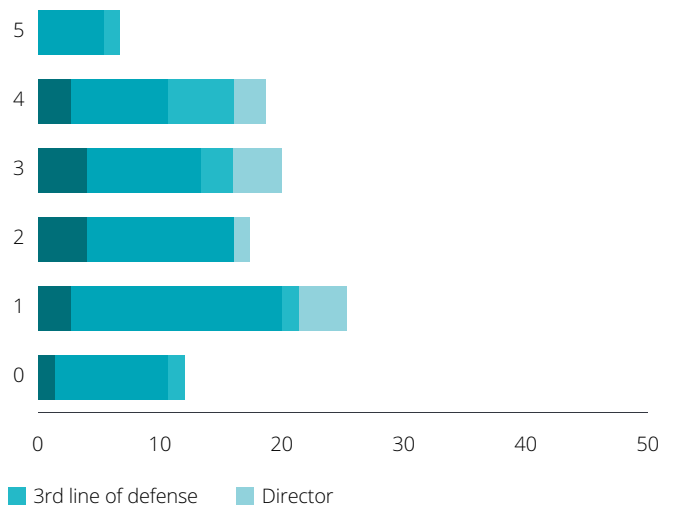


9% of participants from the energy, resources and industrial industry sector believed the definition of risk appetite added high degree of value to decision-making processes

Q: To what extent is the definition of risk appetite adding value to your strategic planning and other decision-making processes? (grouped by respondent type)



Q: To what extent did the Board and Management explicitly use your definition of risk appetite to inform decisions made during the crisis? (grouped by respondent type)



Key development areas observed

Opportunity #2: Improve the quality of risk data and effectiveness of risk reporting systems

Overall, respondents had low confidence in the quality of data supporting reporting against risk appetite, and the capabilities to analyse and understand this data. Only 20% of participants had high confidence in the quality of the data supporting performance within risk appetite. All industry sectors had an average response to this question which was below 'a moderate level of confidence'.

Directors appeared to have notably higher confidence than Management in the quality of data supporting risk reporting. First line Management (the owners of data) had the lowest level of confidence in the quality of data.

Organisations commonly noted that data quality issues were mostly driven by non financial risk data sets.

A key driver of the poor data quality was the low level of automation and digitisation of risk reporting processes. All industry sectors had a low level of confidence in their response to this question.

Similarly, all sectors, except for the financial services industry, indicated they only used data analytics to a limited extent to understand their performance within risk appetite. The national average response to this question was the lowest to any of our questions.

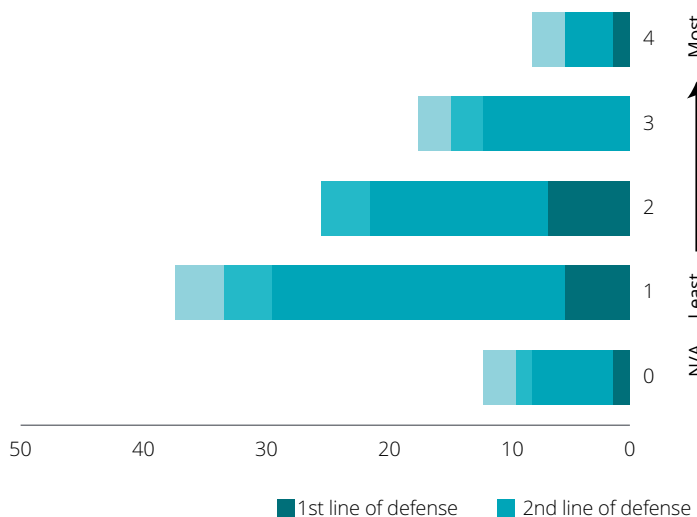


9% of participants used data analytics to understand their performance within risk appetite

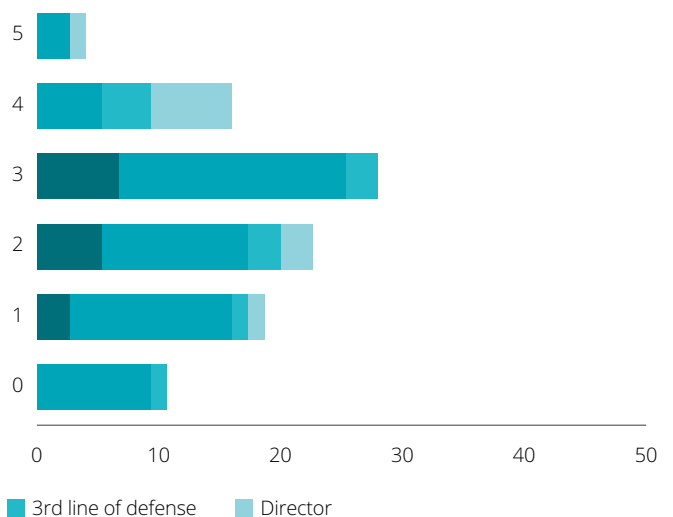
'Data driven reporting and the effective usage of data is one of our main priorities, and simultaneously our number one bug bear. We run on many old and legacy systems that do not integrate well, and hence we have data quality issues that we need to deal with first.'

Director, Energy Industry

Q: What extent are the risk reporting processes automated/digitised? (grouped by industry sector)



Q: How confident are you in the quality of data supporting your reporting on performance against risk appetite? (grouped by respondent position)



Key development areas observed

Opportunity #3: Increase understanding of risk appetite and accountability for performance within risk appetite

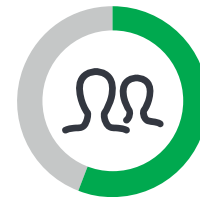
Management's explicit use of risk appetite in decision making processes varies greatly, but is typically low. This can be seen during strategic planning, where there is varied levels of formal consideration of risk appetite throughout the strategic planning process and limited consideration of risk appetite in the Business Plan document.

Management's accountability to operate within the Board's risk appetite is commonly unclear and poorly documented. This issue is then perpetuated by a weak link between Executive incentives and performance within risk appetite.

Risk appetite is poorly communicated and understood within most organisations, with only 30% of participants believing the concept of risk appetite was well understood in their organisations.

Management are challenged with the task of operationalising the Board's risk appetite into day-to-day processes and controls. Whilst this can often be difficult, Management are not being held accountable when these operational processes and controls are the reason for exceeding the Board's risk appetite.

Holding management to account for performance within risk appetite is made more difficult by the poor quality of data supporting reporting of performance within risk appetite.

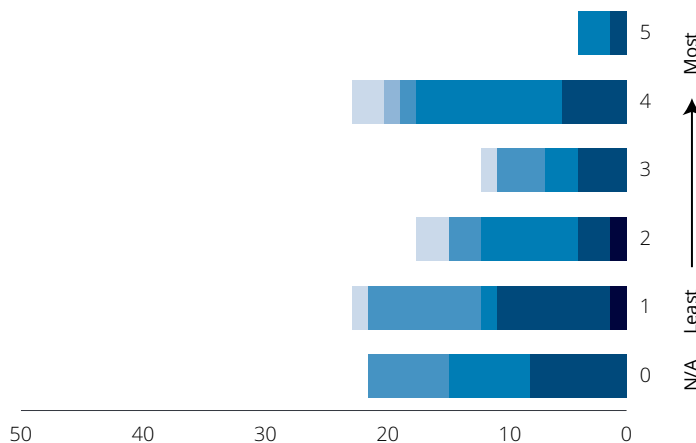


56% reported there is a moderate to no link between Executive incentives and performance within risk appetite

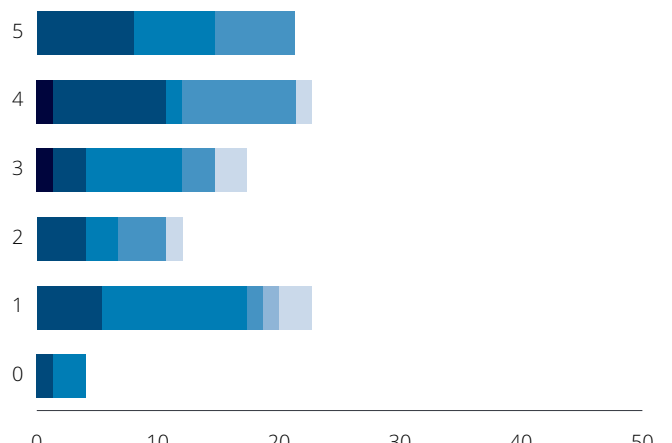


Only 30% of participants believed the concept of risk appetite was well understood in their organisations

Q: To what extent are your Executive leaders' incentives linked to performance within risk appetite?
(grouped by sector view)



Q: To what extent did the Board and Management explicitly use your definition of risk appetite to inform decisions made during the crisis?
(grouped by sector view)



Key development areas observed

Opportunity #4: Use risk appetite as a tool to influence risk culture

Most participants believed that the definition of risk appetite had a moderate to high influence on their employees' behaviours and attitudes but found it difficult to articulate how this relationship between risk appetite definition and culture worked in practice.

Overall, the financial services sector had the highest confidence that their definition of risk appetite influenced employees' behaviours and attitudes. This is driven by the requirement for financial services sector Boards to define their desired risk culture and demonstrate how they monitor, measure and influence the risk culture of the organisation.

Interestingly, Directors believe their definition of risk appetite heavily influenced employees' behaviours and attitudes, whilst Management had a lower level of confidence in the influence of the definition of risk appetite.

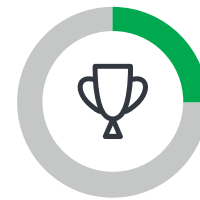
A key area where we would expect to see the operationalisation of risk appetite is the linking of Executive incentives to performance within risk appetite.

More than three quarters of participants identified that performance against risk appetite was either not formally linked to incentives or that it was linked to a limited extent. Notably, some participants were quick to comment that this was likely to change in the future.

The financial services sector representatives were most confident that performance within risk appetite was linked to incentives. This is a reflection of the driver of financial services specific regulatory requirements. The government and public services sector was least likely to link Executive leader incentives to performance within risk appetite.

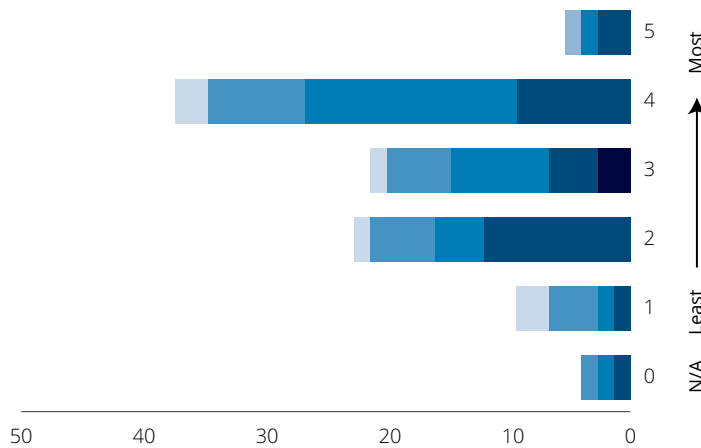
'It [risk appetite] is not explicitly linked to performance management or discussed through that lens'

Director,
Government Industry

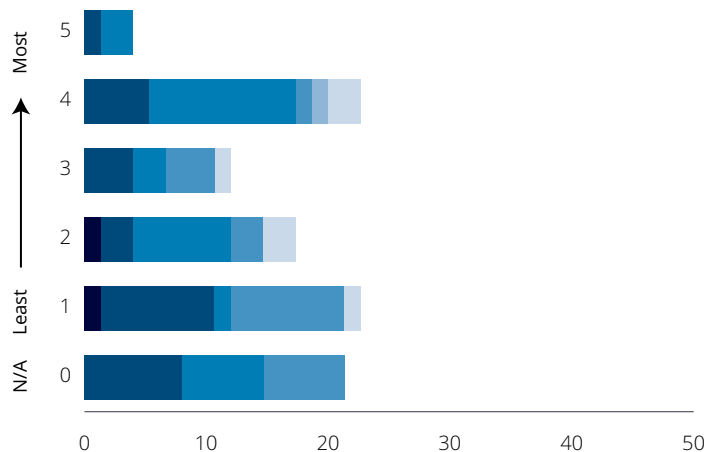


25% of respondents indicated Executives' incentives were strongly linked to performance within risk appetite

Q: To what extent does your definition of risk appetite influence your organisation's employees' behaviours and attitudes? (grouped by industry sector)



Q: To what extent are your Executive leaders' incentives linked to performance within risk appetite? (grouped by industry sector)



Insights into better practices



1

Align strategy, risk appetite and culture setting processes

Integrating consideration of risk appetite throughout the strategic planning process is giving Australian organisations greater confidence in the achievement of their objectives.

Examples of better practices we observed through the study included:

1. **Playbook** – The strategic planning approach is set out within a policy, procedure or playbook that explicitly includes consideration of risk appetite at each stage in the process.
2. **Value creation over value protection** – The risk appetite statement makes a clear distinction between risk that generates value (upside risk) and risk that does not (downside risk).
3. **Strategic plan** – The strategic plan clearly articulates how the plan will change the risk profile and the likelihood the plan can be delivered within the risk appetite.
4. **Metrics that matter** – There is alignment between the metrics that matter to the business performance, key risk indicators; and the monitoring of under and over utilisation of risk appetite.
5. **Scenario analysis** – On an appropriate frequency the Board and Management perform realistic scenario analysis to ‘break’ the business model and test their risk appetite.



2

Increasing understanding of and accountability for performance within risk appetite

Enabling Management accountability, ownership and use of risk appetite is integral for its successful implementation as a tool to drive value creation.

Examples of better practices we observed through the study included:

1. **Risk leadership role modelling** – Risk Leadership behaviours and attitudes are documented and used as a basis for training. These behaviours are then lived by senior management and considered when reviewing their performance.
2. **Management ownership** – Accountabilities for setting, measuring, monitoring and responding to performance within risk appetite are clearly set and cascaded from senior management to employees.
3. **Clear purpose and intent** – Risk appetite has a clear purpose to strengthen the governance and oversight of risk. There is a clear understanding of the value of risk appetite, who the risk appetite should be communicated to and what level of risk capability is required.
4. **Board communication tool** – A living Board document, supported by an Executive view and detailed performance and risk measures that inform the Board and Management of the strategy's effective execution.
5. **Management actions** – Where risk exceeds appetite, Management is accountable for managing risk back within appetite. Consequences are applied where these actions are not prioritised or do not occur in a timely manner.

Insights into better practices



3

Improving the quality of risk data and risk reporting processes

The accessibility, availability, quality and completeness of an organisation's data is heavily reliant on the systems and processes in place to capture risk information. Australian organisations are increasingly citing simplification and usability as core principles in data and analytic strategies.

Examples of better practices we observed through the study included:

1. **Single source of truth** – Risk system solutions with a single point of aggregation were adopted; either through using one vendor application or overlaying a single user interface on top of multiple systems to achieve the same effect.
2. **User experience** – Systems are designed with the end-user in mind and appropriately consider the accessibility, usability and functionality of systems.
3. **Centre of excellence** – Developing data enabled people is achieved through both enterprise-wide training and a technology centre of excellence approach. This can be supported by additional data analytics capability via a hub and spoke model.
4. **Dedicated data governance function** – A central function for data quality strategy and governance to define, collect and maintain data and data quality.
5. **Lead and lag indicators** – Key risk indicator methodologies include lead and lag indicators across core and non-core risk areas.



4

Use risk appetite as a tool to influence risk culture

Australian organisations continue to experiment with cultural levers to improve and mature their cultures. In the domain of risk culture, risk appetite as a cultural lever is increasingly being utilised as a tool to influence organisations' risk culture.

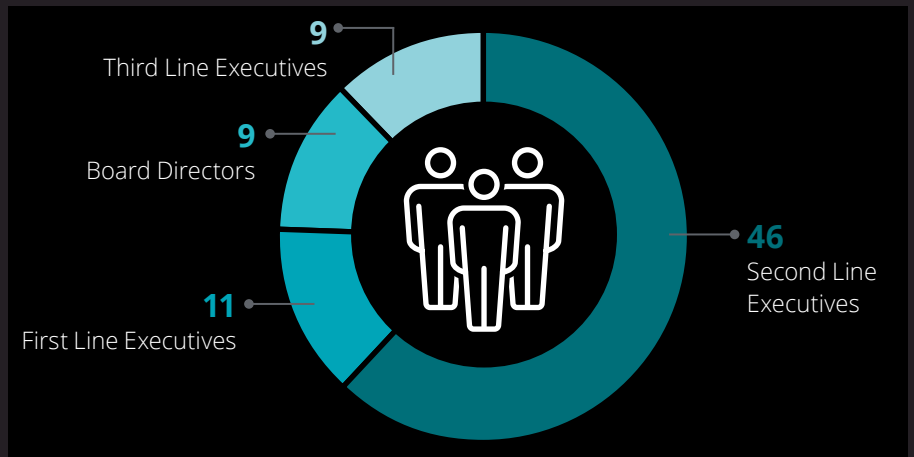
Examples of better practices we observed through the study included:

1. **Desired state** – The desired state risk culture is defined and supported by an action plan with an explicit link to risk appetite and its implementation.
2. **Performance management** – Executive incentives are linked to performance within risk appetite for both short and long-term incentives.
3. **Purpose and values** – Risk appetite is clearly linked to the organisation's purpose and values and embodies the language used in these artefacts.
4. **Monitoring** – Monitoring of an organisation's risk culture includes oversight of performance against risk appetite and key risk indicator information through a risk culture lens.
5. **Embedded in decision making** – Risk appetite is embedded in Management's decision making and features in Executive committees and papers.

About this study

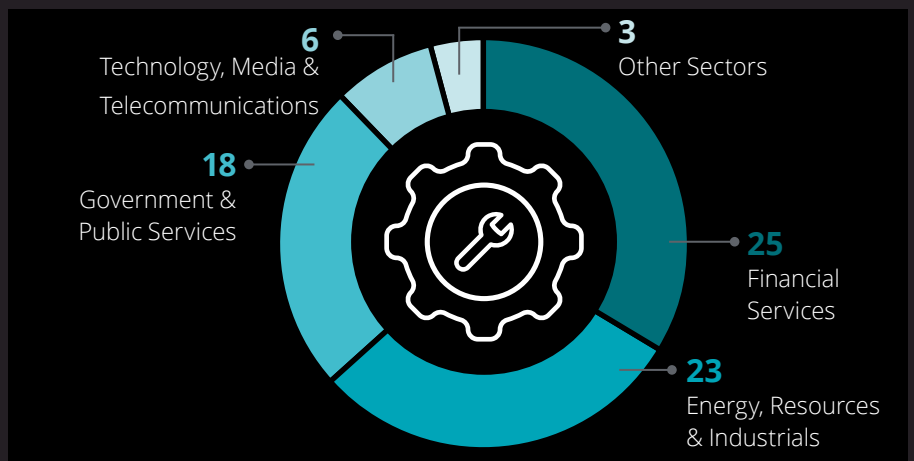
Deloitte Australia conducted **75** interviews which consisted of Directors and Management representatives in Australia's largest organisations. These Management representatives have been categorised in line with the three lines of defence risk governance model.

Participant breakdown is as follows:



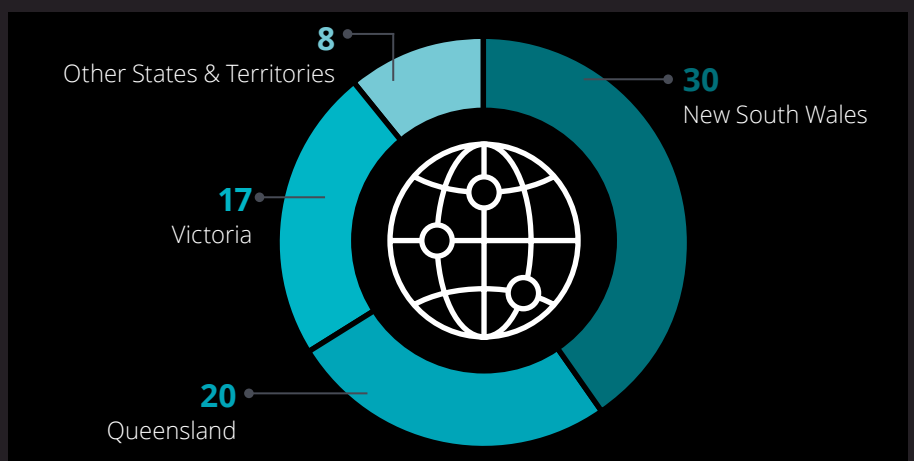
The participants interviewed represent Australia's largest public and private organisations. The industry sectors detailed make up a large portion of Australia's economy.

Participant breakdown is as follows:



The organisations represented have head offices based in each of Australia's states and territories.

Participant breakdown is as follows:



Lead Author



Jerome is a Partner in Deloitte Australia's Risk Advisory business. Deloitte Australia's Risk Advisory business comprises over 1,000 professionals who provide a suite of powerful and practical risk solutions in cyber, strategy, regulation and controls, backed by deep business knowledge across multi-disciplinary teams. Deloitte Risk Advisory helps clients worldwide take the opportunity to connect trust, resilience, and security for a more positive outcome.

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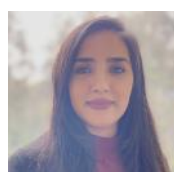
Nick Potter



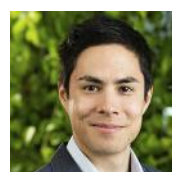
Peter Horsman



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