




HOW TO RANK ENTERPRISE RISKS

Enterprise risks refer to financial, operational, regulatory, legal, environmental, and strategic risks that significantly impact an organization (the “enterprise”). Risks cannot be avoided, but they can be identified and ranked so that an organization can proactively address them. Risk ranking helps define an organization’s biggest gaps and vulnerabilities; by ranking risks, an organization can better allocate capital and human resources.



The first step in risk ranking is developing an inventory of risks facing the organization. A risk inventory can be assembled from employee surveys or interviews; audit plans; industry literature; risk disclosures by peer companies; and rating agency reports of peer utilities. Once an organization has a starting risk inventory, it should focus on the most material potential exposures. The risk ranking is more effective when the total number of risks to be assessed is a manageable number.

The first step is to define each risk. If a risk is not well defined, different people could have different perceptions of the risk. For example, the probability and impact of a “major storm” depends upon the type of storm, the duration, the temperatures, and other climatic events. In this case, the risk ranking participants would want to agree on the type of storm before ranking it.

Because the source and impact of the potential risks are widely varied, it can be challenging to compare and contrast them. The second step is to develop ranking criteria that can be applied to all risks. A **time horizon** is important since the risks may be different when examining short-term versus a long-term timeframe. Two other common ranking criteria are the **probability** of the risk occurring and the **impact** it would have on the organization if it occurred. Probability is a familiar concept, one that needs little definition. In contrast, defining the impact can be more challenging because a risk can have multiple impacts. For example, risks can affect an organization’s reputation, its financial position, its customer rates, and/or the safety of the workforce and community. For purposes of the ranking, the participants need to agree on the definition of impact and establish a scale for measuring minimal impact to very large impact.

Several other risk ranking criteria include the **level of internal controls** to manage the risk and the amount of **mitigation still to be done** to manage or respond to the risk. Some organizations use the internal controls measure to ensure the organization has strong controls in place to monitor and manage each risk. Others prefer to focus on estimating the amount of mitigation still to be done, as a means of prioritizing resource and capital allocation in the risk mitigation planning phase.

Another approach is to weigh risks from the perspectives of **speed on onset** and **preparedness**. The former refers to the amount of time an organization has to respond to a given risk. For example, some regulatory risks—such as new environmental regulation—have long lead times that give the utility months to plan and prepare. Other risks—like a natural disaster—may mean the utility has only a few hours to prepare. In this case, the assessment is of the organization’s preparedness. If a utility

is not prepared for a given risk, then the ranking would highlight the need for stronger efforts developing a risk response.

The third step in the risk ranking process is to include people who have a working knowledge of the issues. As subject matter experts, they bring valuable insights about the source of the risk, the likelihood of occurrence, and its impact on the organization. The exercise requires at least several hours to complete, and there should be a follow-up meeting to discuss how to use the risk information. Furthermore, the experts need to be reconvened periodically to review what risks have changed, measure reduction in risks, and discuss successful mitigation strategies.

The risk-ranking team needs to be careful not to slip into group think by agreeing too readily on impacts. Instead, debating the risk impact from different dimensions yields better results. Additionally, the team should be aware of institutional bias. The final caveat is to be careful about **perspective**. We all are inclined to discount anything that has not yet occurred and to place the greatest weight on recent information or events. Prior to starting the risk ranking exercise, it is helpful to discuss these biases.

The last step is to identify risks that can be mitigated as opposed to others that require preparation. The reason is that the risk response differs depending upon whether the risk will be mitigated or the organization will prepare for it. For example, a utility can employ mitigation strategies to reduce the risk of an accident or a safety hazard, but a utility cannot prevent a natural disaster from occurring. In the first situation, a mitigation plan would be directed at reducing the chance of the risk occurring and/or minimizing the severity of the risk. In the second situation, the mitigation plan would be to develop an appropriate response for when and if the risk occurs.

The most important part of risk ranking is not to develop specific point measurements, but instead to understand the range in impact and to see how risks compare across the spectrum. The risk ranking exercise should encourage diverse opinions and prompt debate. Effective risk ranking leads to the development of robust mitigation plans. **NWPPA**

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