Risk Angles

Five questions on risk assessment

An interview with Dr. Patchin Curtis, director, Deloitte & Touche LLP.

Companies can spend an enormous amount of effort cataloguing the risks that could affect them at any given moment, on every front. While it's important to develop that visibility, it's just as important to measure and prioritize risks so that the organization is prepared to respond to them in an appropriate manner. Because the environment in which you're operating is constantly — and quickly — evolving, it's important that organizations are focusing on the right risks, at the right time, in the right ways.

That's where risk assessment comes in. Assessment is the technique companies use to determine the significance of individual risks in light of business goals. In this issue of Risk Angles, Dr. Patchin Curtis, director, Deloitte & Touche LLP offers her thoughts on some questions the executive team should consider asking about the risk assessment process. Then, Dr. Mark Beasley, Deloitte Professor of Enterprise Risk Management at North Carolina State University, takes a closer look at risk prioritization, probabilities, and appetite.

Question	Patchin's take
Our assessments already cover everything we know can affect our business. Why would we invest time in worrying about the unknown?	Your current assessment is only a snapshot reflecting what you know today. But your risk environment can change in a matter of days, or even hours. So your risk assessment process should incorporate monitoring activities as dynamic as your business and the threats and opportunities it faces. For example, recent advances in text analytics makes it possible to analyze large quantities of text to identify emerging threats and generate alerts.
We conduct formal risk assessments once a year. Isn't that enough?	A once-a-year assessment just isn't enough for most organizations. It may be fine for "static" risks, but dynamic risks require ongoing monitoring. Consider the rate at which the risks to your organization change. Some organizations are developing near real-time monitoring capabilities for internal and external conditions using big data mining, text analytics, and data visualization techniques. These mission control centers can feed actionable information to decision makers and form the basis for a dynamic risk assessment process.
It's hard to make the business case to invest more resources on risk management when we can't measure the results. How do you measure the avoided costs from an improved risk assessment?	This is one of the tougher questions in risk assessment, and the truth is that there's no commonly accepted way to measure avoided costs. But you can and should identify the range of potential cost avoidance — and the ability to do that has improved significantly in recent years. Also, don't forget that an effective risk assessment may equip leaders with the information they need to take advantage of value-creating risks.
Can't we just invest in more technology to improve our risk assessments?	Technology can play a big role in an improved risk assessment initiative. Technology can make it easier to micro-target particular audiences and risk challenges, analyze large amounts of data from different parts of the business, and develop actionable intelligence. But technology is only as good as the underlying processes you have in place, and the people running them. Don't expect better technology to do all the work — people are still required to validate and interpret results.
So far we haven't been hit with any major surprises when it comes to risk. Why change?	The dynamics affecting the risks you're already taking evolve endlessly, changing the potential impact to your business, and to each other. If you haven't been struck by a major risk event, don't take that as a reason for standing still.

A closer look: Risk prioritization, probabilities, and appetite

Dr. Mark Beasley, Deloitte Professor of Enterprise Risk Management, North Carolina State University

As is true with the risks themselves, context is everything in risk assessment. Here are some important dimensions to keep in mind when planning, designing, deploying and using risk assessment tools.

- **Prioritization: Taking a multi-dimensional look at risk.** It's natural to push certain risks to the top of the priority list. That's why those with the highest likelihood or greatest potential impact get all the attention. But there are other dimensions to consider when assessing risks. Some may appear to have a low probability of occurrence, but when conditions change, they are almost guaranteed to occur. That makes speed of onset (velocity) an important dynamic to build into the assessment process. Similarly, certain risks may appear to have a minimum impact on their own merits. But risks don't usually unfold in isolation. One risk event can trigger other related risks, contributing to a snowball effect in which different risks become connected and gain momentum, possibly leading to catastrophic events that can persist for long stretches of time.
- **Probabilities: Treating root-cause risk drivers.** Risk assessment isn't of much value if the organization fails to adequately prepare for risk events and determine whether additional responses to manage risks are warranted. Some invest most of their time and energy in identifying and assessing risks, but under-invest in evaluating the design and effectiveness of current risk responses. Understanding the root-cause drivers contributing to their most significant risks can help leaders proactively treat risks in the early stages. Treating root-cause drivers can help leaders make big strides toward lowering risk probabilities and minimizing the impact on the organization before a risk event has time to noticeably emerge. If root causes can't be treated, then considering intermediate events that occur after a root cause emerges may still provide opportunities to intervene and head off a larger event.
- **Appetite: Start simple.** The main point of assessing risks is to determine which ones require responses first. Determining the need for response requires some articulation of the degree to which risk-taking is acceptable. But, not all risks are the same. So trying to define a single risk appetite for an organization is usually not practical. In reality, different organizations have different appetites for achieving certain types of objectives — or not achieving them at all. For example, not meeting the profitability goals of a new product launch may be a more acceptable outcome than not complying with an important regulatory requirement. Maintaining an open dialogue with key leaders in the organization regarding their risk tolerances can go a long way toward helping them determine exactly when and how they might respond to the risks being addressed in the assessment. So start simple. Set up some conversations. And don't overcomplicate things in the early stages by seeking to define risk appetite metrics too formally at first.

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