A SIMPLER WAY TO ASSESS RISKS?

The vast majority of companies assess risks by evaluating both the likelihood that a risk event will occur and the impact of the risk event if it does occur. The actual ranking of risks is then determined by either calculating the product of likelihood x impact scores, or in some cases the sum of a risk's likelihood and impact scores. When using this methodology, the organization must develop rating scales for both likelihood and impact (and any other dimensions to be assessed, such as velocity or preparedness) as well as definitions for each point on the scales.

THE PROBLEM

Individuals within the organization who provide input on the ranking then must separately score each risk on a list of often 30-50+ risks on both likelihood and impact. As I've observed this assessment process over time, it seems to frequently result in risk scores that are "bunched" together at the middle of the scales. And while such an assessment process may give the perception of some level of precision, the end result is just an average of a number of individual person's opinions or judgments regarding likelihood and impact of each risk.

Let me illustrate. The typical process involves a number of individuals rating the likelihood that each risk event will occur on a scale of 1 to 5, and then they rate the impact of each of those risks using another 1 to 5 point scale. An average is then calculated for all likelihood scores and then all impact scores.

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Two things seem to occur with some frequency when this process is used. First, when an individual doesn't have a strong opinion about or direct knowledge of a particular risk, the default rating tends to be a 3, on the 1 to 5 point scale. Further, the process of averaging tends to "smooth" out any differences in views, so that many risks will have scores that are close to 9 (product of average likelihood rating of 3 and average impact rating of 3). While you can still arrive at your top ten risks in this manner, there may be a relatively small difference in total risk scores (LxI) between risk # 5 and risk #15, for example.

AN ALTERNATIVE APPROACH: FORCED RISK RANKINGS

I have found that a "forced ranking" of risks better separates the more significant risks and simplifies the risk ranking process. There are several benefits to the forced rankings process. First, no assessment scales are needed when organizations use this kind of forced rankings process. Second, the risk assessment process can be faster to complete as compared to requiring individuals to assess a number of risks across multiple dimensions (e.g., likelihood, impact, velocity, etc.). Third, this methodology typically results in more "separation" of risk scores making it easier to identify the top risks. While the rank ordering may seem more subjective on the surface, it is important to note that there is also a high degree of subjectivity when individuals make assessments using 1 to 5 point scales for the various dimensions discussed above.

In a forced ranking process, each individual providing input on the assessment is asked to choose what they believe are the top ten risks in rank order. The first risk they identify is assigned 10 points, the second 9 points, on down to the tenth risk being assigned 1 point. Scores provided by all individuals are summed for each risk and rank ordered from highest to lowest total score.

Let's look at a simple example. Let's say that you asked nine different executives (e.g., the CEO, CFO, etc.) to prioritize 23 different risks (Risks "A-W") by providing their individual list of top 10 risks in rank order. **Table 1** shows how each executive (shown in the column headings) ranked Risks "A-W". The numbers in the column under each executive's title represent their rankings of risks 1-10. For example, the CEO ranked Risk "M" as their #1 risk concern, followed by Risk "R" as their #2 concern, Risk "B" as their third risk, and so forth.

TABLE 1:

Individuals Providing Their Risk Rankings									
Risk	CEO	CFO	COO	CTO	Gen Counsel	SVP Strategy	CHRO	Chief Compliance	Internal Audit
A	6		6	5	4		2		
B	3	6		6	5		1		
C		9	7			8		10	
D	4	5	1			2		1	4
E						3		2	5
F	8	7	10	7				7	
G					6	4	3		1
H						9		6	
I	9		9	8	7		10		6
J	10	10		9	9		9		
K			8		10		8		
L									
M	1	2	5	1	1	5			7
N									
O	7	8			3	6	7	5	3
P		3	2	2			4	9	8
Q									
R	2	1	4	3		1		3	2
S						10		8	10
T									9
U	5	4	3	4	2		5	4	
V							6		
W				10	8	7			

The next step involves identifying how many times each risk was ranked in at least one of the executives' top 10 list of risks and, if so, the relative position(s) the various executives ranked that particular risk. Continuing with our example, as shown in **Table 2,** none of the executives ranked Risk "A" as their number 1 risk in their list of top 10 risks, while one executive ranked Risk A as their number two risk, another executive ranked Risk A as their number four risk, a different executive ranked Risk A as their number 5 risk and two other executives ranked Risk A as their number 6 risk. In contrast, none of the executives ranked Risk "L" in any of their top 10 rankings of risks.

TABLE 2:

	Number of Executives Who Ranked that Risk as Their									
Risk	**#1 Position**	**#2 Position**	**#3 Position**	**#4 Position**	**#5 Position**	**#6 Position**	**#7 Position**	**#8 Position**	**#9 Position**	**#10 Position**
A	0	1	0	1	1	2	0	0	0	0
B	1	0	1	0	1	2	0	0	0	0
C	0	0	0	0	0	0	1	1	1	1
D	2	1	0	2	1	0	0	0	0	0
E	0	1	1	0	1	0	0	0	0	0
F	0	0	0	0	0	0	3	1	0	1
G	1	0	1	1	0	1	0	0	0	0
H	0	0	0	0	0	1	0	0	1	0
I	0	0	0	0	0	1	1	1	2	1
J	0	0	0	0	0	0	0	0	3	2
K	0	0	0	0	0	0	0	2	0	1
L	0	0	0	0	0	0	0	0	0	0
M	3	1	0	0	2	0	1	0	0	0
N	0	0	0	0	0	0	0	0	0	0
O	0	0	2	0	1	1	2	1	0	0
P	0	2	1	1	0	0	0	1	1	0
Q	0	0	0	0	0	0	0	0	0	0
R	2	2	2	1	0	0	0	0	0	0
S	0	0	0	0	0	0	0	1	0	2
T	0	0	0	0	0	0	0	0	1	0
U	0	1	1	3	2	0	0	0	0	0
V	0	0	0	0	0	1	0	0	0	0
W	0	0	0	0	0	0	1	1	0	1

In order to create a risk score for each risk based on the various individual rankings, points are given to each rank position to weight risks in the number one position more than risks in the number 10 position as shown in the chart on the right.

Ranking Position	Weighted Points Given
#1 position	10 points
#2 position	9 points
#3 position	8 points
#4 position	7 points
#5 position	6 points
#6 position	5 points
#7 position	4 points
#8 position	3 points
#9 position	2 points
#10 position	1 point

Using those weightings, risk scores are calculated and then risks are sorted in rank order based on their risk scores to develop a consensus ranking of risks across all nine executives. As shown in **Table 3**, Risk "R" received the highest risk score of 61 points. That is the case given two executives ranked that risk as their #1 risk concern, two other executives ranked that risk as their #2 concern, an additional two different executives

ranked it as their #3 concern, and an additional executive ranked it as their #4 concern (2x10+2x9+2x8+1x7 = 61 points). In contrast, Risk "E" is ranked as the 10th top risk based on its risk score of 23. Risks L, N, and Q are at the bottom of the overall ranking given none of the executives included those risks in their ranking of top ten risks. This would be used to create the consensus list of top 10 risks across the nine executives. Notice the dispersion of risk scores ranging from 0 to 61 points across the 23 risks.

TABLE 3:

	Number of Executives Who Ranked that Risk as Their											
Risk	**#1 Position**	**#2 Position**	**#3 Position**	**#4 Position**	**#5 Position**	**#6 Position**	**#7 Position**	**#8 Position**	**#9 Position**	**#10 Position**		**Risk Score**
Tier 1 Risks (Top 10)												
R	2	2	2	1	0	0	0	0	0	0		61
M	3	1	0	0	2	0	1	0	0	0		55
U	0	1	1	3	2	0	0	0	0	**0**		50
D	2	1	0	2	1	0	0	0	0	0		49
O	0	0	2	0	1	1	2	1	0	0		38
P	0	2	1	1	0	0	0	1	1	0		38
B	1	0	1	0	1	2	0	0	0	0		34
A	0	1	0	1	1	2	0	0	0	0		32
G	1	0	1	1	0	1	0	0	0	0		30
E	0	1	1	0	1	0	0	0	0	0		23
Tier 2 Risks (Risks #11-#20)												
I	0	0	0	0	0	1	1	1	2	1		17
F	0	0	0	0	0	0	3	1	0	1		16
C	0	0	0	0	0	0	1	1	1	1		10
J	0	0	0	0	0	0	0	0	3	2		8
W	0	0	0	0	0	0	1	1	0	1		8
H	0	0	0	0	0	1	0	0	1	0		7
K	0	0	0	0	0	0	0	2	0	1		7
S	0	0	0	0	0	0	0	1	0	2		5
V	0	0	0	0	0	1	0	0	0	0		5
T	0	0	0	0	0	0	0	0	1	0		2
Tier 3 Risks (#21-#23)												
L	0	0	0	0	0	0	0	0	0	0		0
N	0	0	0	0	0	0	0	0	0	0		0
Q	0	0	0	0	0	0	0	0	0	0		0

This table could be used to generate additional dialogue about different executive views regarding a given risk. For example, seven executives included Risk "O" in their individual list of top 10 risks, but there is variation in

relative rankings with two executives listing Risk "O" as their #3 risk concern while three executives had it lower (in the seventh and eight positions). Discussion about different views of the significance of Risk "O" might shed insights for all to consider about that risk.

If your organization has been assessing on both likelihood and impact, it may be worth updating your assessment using forced rankings to see if the results change in any significant way. In those situations where I have seen the forced ranking methodology used, individuals providing the rankings have appreciated the simplicity of the process, and the results have shown much more separation among the risks, particularly when comparing results between different demographic groups (e.g. Board, C-Suite, VP's, etc.). In some instances, although a lot less frequently, I do hear that there are individuals who have difficulty ranking risks without explicitly ranking likelihood and impact; so this process may not be for everyone. The range of methods employed in risk assessments illustrates once again the importance of tailoring Enterprise Risk Management processes to the needs of the organization.

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