In a previous article, we defined ERM and discussed its potential benefits to an entity, with a water industry focus. We will pick-up where we left off, explaining how a company can drive the process and create value.

An Enterprise Risk Management (‘ERM’) program is an extremely valuable tool for risk management. This set of systems and processes, created and implemented by management throughout the organization, synchronizes and aligns company objectives. ERM is dynamic and must be driven by support from those charged with governance (‘TCWG’ - for purposes of this discussion, this includes executives, board members, and ‘C’ level individuals) of an entity.

ERM acts mostly as a preventative tool to manage risks. Its value can be tangible or intangible - while value is often measured solely in terms of financial performance (tangible), an effectively operating ERM process can produce less visible, but equally important, benefits.

• Tangible value is much easier to quantify and present. Forms of tangible value can include the actual production of an ERM report, improvements to entity internal control structure and procedures, creation of reporting and operational efficiencies, etc.
• Intangible value is much harder to quantify and observe. Forms of intangible value can include the success of preventative measures related to identified risks, increased involvement and accountability of company personnel, improved market competitiveness through employee satisfaction, improved brand image related to decreases in negative events (water main breaks, water quality issues, water supply shortfall, etc.), etc.

However, ERM value cannot be achieved without understanding how to drive it. A successful and effective ERM process must have the support of TCWG. However, the driving force will come from the management level. A steering department or head is vital to pull it all together. Depending on the size of your operation, the ERM steering responsibilities could be performed by an individual in conjunction with their role as a manager.

Following is one possible way to drive an ERM process:

Post implementation, with the directive of TCWG, the management individuals identified as leaders within each business operation can update (at least annually) the risk profile for their department, including any new risks, and follow up on previously identified risks and action items. This process should also be completed with senior-level individuals, ensuring the results include those higher level risks.
The individual charged with steering the process should gather the information directly from each manager prior to summarizing the results in a report sent directly to TCWG and the audit committee, if any. It is important for this individual to have a direct line of communication in order to maintain independence and prevent biases. The key to this process is to delve into risks and action items to ensure they are addressed, resolved, and implemented. This monitoring function is critical to the success of the process.

A company will find that once the process is in place, some value will be inherently created by the nature of its structure. Involvement by managers will be incentivized through the fact that their personal needs, concerns, and risk issues will be formalized and shared with TCWG. The ability of the managers to create action plans and track achievements will drive them to identify and correct those risks that could promote them best while adding value to the company. It will also give TCWG another way to identify high performers and motivated employees. Personnel will also be driven to be proactive in attempting to understand the future of their industry in order to get ahead of future risks. This is not a ‘set it and forget it’ process. The water segment of Mazars USA LLP produces an annual water outlook which surveys key water industry persons. Each year, we observe a theme in risks reported by those individuals. In the previous outlook, there was a great deal of concern with regard to the aging infrastructure. Our 2017 outlook observed similar concerns for infrastructure, along with an increased risk of water scarcity reported. Each of these risks would be major items within the ERM process, but if a risk such as water scarcity becomes critical, a reactive approach would present a plethora of new risks and inefficiencies.

Although on the surface it seems that these two risks are related to infrastructure planning, each is unique and requires a different mitigation strategy. A few categories are presented below to exemplify how risk considerations can differ for these evolving trends:

<table>
<thead>
<tr>
<th>Risks</th>
<th>Water Scarcity</th>
<th>Aging Infrastructure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic</td>
<td>An unforeseen increase in water scarcity will result in reduced use and decreased revenues until tariffs are increased during a rate case.</td>
<td>Planned investment in the infrastructure system will result in a predictable, steady increase in water tariffs.</td>
</tr>
<tr>
<td>Environmental</td>
<td>Public opinion will weigh heavily on discussions about alternative supply options such as desalination, re-use, etc. A company will have to manage these options.</td>
<td>Non-revenue water (water loss) is a major factor when planning system maintenance and high loss can result in non-recoverable losses and environmental pressures.</td>
</tr>
<tr>
<td>Political</td>
<td>In areas of significant scarcity, water restrictions imposed by local governments can impact operations.</td>
<td>The agenda of those in office could create further incentive for investment in infrastructure.</td>
</tr>
</tbody>
</table>

The evolution of a risk such as scarcity can be considered more complex than others, considering its risk level is highly subject to volatilities in the weather. This risk is similar in complexity to a manufacturer or retailer trying to predict customer trends for the coming years to ensure they have the appropriate products in suitable markets.

Based on data received within the 2017 US Water Outlook, we obtained the following expected trend with regard to the evolution of water supply issues:

**Future of the Industry:** Respondents were asked when they would anticipate having water supply issues in their area:

![Water Supply Issues](image)

Based on these results, we expect that 80% of the respondents would have included water scarcity as a key topic within their ERM process. To provide insight as to how this particular ERM risk can evolve, we can look at the drought in California. The responses accumulated in the table above were completed just prior to the 2017 winter when California was in an extreme drought condition. The 2017 winter has proved to be a historically wet winter with many areas now in a surplus situation (such as the recent overflow of the Oroville Lake reservoir and dam). The initial reaction of customers and water utilities in these areas might be to resolve that the drought is finally over and there is no longer any need to worry. This would most likely reduce a water utility’s risk level related to water scarcity. However, weather is unpredictable and there is no basis to eliminate the risk in an area predisposed to droughts. Most current solutions to combat the risk of water scarcity include long-term infrastructure changes (such as construction of desalination plants) or changes in consumer consumption trends. Each of these solutions requires planning years in advance, so even when the levees are completely full, planning and discussion should continue.

The basic keys to success of an ERM process include a balance of frequent updates and monitoring in a dynamic approach to anticipate, react, and execute plans to face future challenges. In the end, a process which identifies key risks timely, with appropriate action plans attached, will continue to be the goal. Those companies who manage this process the best will be the companies that are most successful.

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