What Is It and Why Is It Important to Federal Executives?

Enterprise risk management (ERM) is an enigma. Many executives in the private sector claim their organizations do it, yet get a group of them together and they won't agree on what it is. North Carolina State University issued research concluding that risk management processes in most organizations are relatively immature and ad hoc. Standards & Poor's (S&P) issued a report on how nonfinancial companies are managing risk based on its reviews, declaring that the state of development of ERM in non-financial companies is at a relatively immature stage. While we see some improvement since these publications were issued, we see little evidence that the state of the art has changed significantly.

In the public sector, in particular the Federal environment, ERM is also at an immature state. That assertion shouldn't be a surprise, as ERM has only recently become a topic of interest to Federal executives. To be sure, there are challenges in implementing ERM at a Federal government agency. The reality of political appointees with limited time in which to make their mark, the annual budgeting and appropriations process, the recent impact of the budget sequestration, and the reality of fragmentation and silos (that are so common in government) all combine to present formidable obstacles to implementing a forward-looking discipline like ERM. This is important because ERM adds limited value in an immature state leaving agency and departmental managers with a list of risks and very little insight as to what to do next.

ERM may increase risk awareness across an agency or department, but it will not be effective in driving decisions if it isn't integrated with policy setting and management's decision-making processes. As a result, risk is often an afterthought to policy and risk management is an appendage to performance management.

So what is ERM? The Committee of Sponsoring Organizations (COSO) points out that ERM: (a) is an ongoing process; (b) is applied in policy setting and across the enterprise; (c) is designed to identify potential events that will affect the entity if they occur; and (d) provides reasonable assurance regarding the achievement of the organization's business objectives and the management of risk to within its risk appetite.

ISO 31000 states that risk management is an integral part of organizational processes and a critical part of decision making.

While these and other frameworks provide valuable insight in defining ERM, we believe ERM
can be summed up as follows:

ERM is the discipline, culture and decision-making structure an organization has in place to continuously improve its risk management capabilities in a changing environment.

Why is ERM important? The following “governing realities” shed light on this question:

(1) ***The time may come sooner than Federal executives may expect when the fundamentals affecting their unit are about to change.*** Like any other organization, Federal departments and agencies need an integrated view of their risk profile to ensure the risks they face are consistent with their mission and appetite for risk. ERM is about securing “early mover” positioning to take advantage of opportunities and deal with emerging risks. Managing in an uncertain environment requires an understanding of the key assumptions underlying policy and monitoring changes in the environment to ensure that these assumptions remain valid over time.

(2) ***It is not what we know that matters; it is what we don’t know that makes the difference.*** Is our approach to assessing risk identifying emerging risks and telling us something we don’t know? Are we focusing on the risks that really matter? Are there soft spots in our plan needing further analysis and dialogue to improve our chances for success? Does everyone who matters feel free to raise their hands and express concern over a project, plan or initiative without fear of repercussions? ERM can facilitate the focus on the critical agency/departmental risks.

(3) ***Reputation is everything; lose it and it’s game over.*** The spiraling national debt, unrelenting political gridlock, increasing taxpayer burden and intensive media scrutiny all suggest that Federal government agencies and departments face performance issues and reputation risk, just like organizations in the private sector. Federal executives need to prioritize and focus on what is really important. The times demand “sun setting” of programs and initiatives that contribute little value to accomplishing mission. ERM can contribute a risk-based perspective to resource allocation decisions by ensuring that significant risks are identified and appropriate risk responses are in place to reduce the risks to an acceptable level.

(4) ***Sooner or later, there will be a crisis that will test your department or agency.*** Even the most effective risk management cannot prevent this exposure. Decision-making should consider alternatives and the “fish bowl” environment in which the Federal government operates. Risk assessments should consider the speed and persistence of impact over time to different scenarios and the organization’s response readiness to high impact, high velocity and high persistence scenarios.

(5) ***In the Federal government, “risk” is more than just “bad things happening,” it is also about “good things not happening.”*** Mission is vitally important, but so is delivering on commitments to citizens and taxpayers. ERM facilitates better decision-making in driving resource allocation, improving efficiency and effectiveness of critical processes and keeping everyone on mission to provide quality and reliable service, while exercising appropriate stewardship over government funds, information, and other assets.

These above governing realities are forcing Federal executives to take a fresh look at risk and crisis management, which is why the topic of ERM is attracting more attention. An effectively functioning ERM process is important, because it can help executives address these realities.

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