OMB Circular No. A-123
Management’s Responsibility for Enterprise Risk Management and Internal Control

From 1-2-3 to E-R-M

Council of the Inspectors General on Integrity and Efficiency
Federal Audit Executive Council
Annual Conference
September 26, 2017
Opening Remarks
Current Risk Environment Facing Federal Government

- The Federal government is facing greater change than at any other point in time
- Current budget realities mean government agencies compete for limited resources as never before
- Budgets will go to those who best show value
- There is greater scrutiny and expectations from internal and external stakeholders for agencies to respond to risk faster and more effectively
- The continual focus of risk management on financial areas has limited the broader considerations of risk within organizations

**Major Management Challenges**

Could they have been avoided?
Could the impact have been minimized and more manageable?

*What will be next?*
**Risk** is the effect of uncertainty on objectives. It is typically addressed within functional, programmatic, or organizational silos.

**Enterprise Risk Management** is:
“a discipline that addresses the full spectrum of an organization’s risks, including challenges and opportunities, and integrates them into an enterprise-wide, strategically aligned portfolio view. ERM contributes to improved decision-making and supports the achievement of an organization’s mission, goals, and objectives.”

**Internal Control** is a process effected by an entity’s oversight body, management and personnel that provides reasonable assurance that the objectives of an entity will be achieved. (GAO Green Book)

A process to help achieve objectives (GAO Green Book)

*In other words, things you do to make sure good things happen and bad things don’t.*

**Internal Control System** is a continuous built-in component of operations, effected by people, that provides reasonable assurance, not absolute assurance, that an entity’s objectives will be achieved. (GAO Green Book)

**Outcomes:**
- An increased likelihood of successfully delivering on agency goals and objectives.
- Fewer unanticipated outcomes encountered.
- Better assessment of risks associated with changes in the environment.
Background and Context

President’s Management Agenda

We are kicking-off a process to set the President’s Management Agenda. The Administration will take action to ensure that by 2020 we will be able to say:

1. Federal agencies are managing programs and delivering critical services more effectively.

2. Federal agencies are devoting a greater percentage of taxpayer dollars to mission achievement rather than costly, unproductive compliance activities.

3. Federal agencies are more effective and efficient in supporting program outcomes.

4. Agencies have been held accountable for improving performance.
The Decision We Made

- Compliance with New GAO Internal Control Standards
- Treating Risk as only Negative
- Heavy Emphasis on Financial Reporting
- Regarding Risk Management as Separate
- Check the Box on 3 Year A-123 Assessments

- Risk Based Approach with New Internal Control Standards
- Treating Risk as Positive (i.e., opportunity) and Negative
- Balanced Emphasis on Financial Reporting
- Integrating Risk Management and Internal Control
- Manage Risks Across Silos
ERM and Internal Controls The Cube Version

A-123 Section III. Update (Internal Controls)

A-123 Section II. Update (Enterprise Risk Management)

Source: GAO Green Book

Source: Based on COSO
Expanding on the Green Cube To Include ERM

2017 Requirements to A-123, Incorporating Strategic Objectives

The inclusion of a strategic process to risk management and internal control

2016 Update to A-123, Internal Controls

The organization of internal controls as introduced in the 2014 Green Book

2017 Requirements of A-123, Expansion of Risk Assessment

The introduction and refinement of ERM components to be integrated into existing internal control processes
Enterprise Risk Management Model

Overview:
• **7 Cyclical Components**
  • Establish the Context
  • Identify Risks
  • Analyze and Evaluate
  • Develop Alternatives
  • Respond to Risks
  • Monitor and Review
  • Continuous Risk Identification and Assessment

• **3 Enterprise Components**
  • Communicate and Learn
  • Extended Enterprise
  • Risk Environment/Context
What Is Required by A-123 to Implement ERM?

- **Governance**: Agencies must establish an ERM governance structure.
  - Agencies have discretion and flexibility in overall governance structure.
  - Should be led by high ranking policy official, COO or equivalent.
  - Agencies may establish a Chief Risk Officer, but are not required to.
  - Should include a process for considering risk appetite and risk tolerance.

- **Risk Profiles**: Establish a “risk profile” with the following components:
  - Identification of Objectives
  - Identification of Risk
  - Inherent Risk Assessment
  - Current Risk Response
  - Residual Risk Assessment
  - Proposed Risk Response
  - Proposed Risk Response Category

- **Integration**: Risk profiles to be integrated with management evaluation of Internal Control (Reasonable Assurance Process)
Revised OMB Circular A-123
ERM Implementation

As soon as practicable, prior to June Initial Risk Profile

ERM Implementation Plans

Agencies are encouraged (not required) to develop an approach to implement Enterprise Risk Management.

June ‘17

Initial Risk Profile

Agencies must complete their initial risk profiles in coordination with the agency Strategic Reviews. Key findings should be made available for discussion with OMB as part of the Initial Risk Profile in FY 2017, assurances on internal control processes must be presented in the Agency FY 2017 Annual Financial Report (AFR) or Performance and Accountability Report (PAR).

Sept ‘17

Integration with Management Evaluation of Internal Control

For those risks for which formal internal controls have been identified as part of the Initial Risk Profile in FY 2017, assurances on internal control processes must be presented in the Agency FY 2017 Annual Financial Report (AFR) or Performance and Accountability Report (PAR).

Annually, June 3, 20XX

Updated Risk Profile

No less than annually, agencies must prepare a complete risk profile and include required risk components and elements required by this guidance. CFO Act Agencies, at a minimum, must complete their risk profiles in coordination with the agency Strategic Review. For these Agencies, key findings should be made available for discussion with OMB by June 3rd as part of the Agency Strategic Review meetings and/or FedSTAT.
Creating an Enterprise-Level Risk Profile

Agencies have discretion in terms of content and format for their Risk Profiles; however, in general risk profiles should include the following components:

- Identification of Objectives
- Identification of Risk
- Inherent Risk Assessment
- Current Risk Response
- Residual Risk Assessment
- Proposed Risk Response
- Proposed Risk Response Category

### Table: Sample Agency Risk Diagnostic by Risk Type - April 2016

<table>
<thead>
<tr>
<th>Inherent Risk</th>
<th>Residual Risk</th>
<th>Trending</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>High</td>
<td>Neutral</td>
</tr>
<tr>
<td>High</td>
<td>Medium</td>
<td>Neutral</td>
</tr>
<tr>
<td>High</td>
<td>High</td>
<td>Strategic</td>
</tr>
</tbody>
</table>

### Diagram: Strategic Objective - Improve program outcomes

- Agency 1 may fail to achieve program goals due to lack of capacity at program partners.
- Agency 1 has high mitigation capacity.
- Agency 1 monitors residual risk.
- Agency 1’s risk assessment process is primary.
- Agency 1’s strategic review process is primary.
Risk Profile: An Illustrative Example

Policy/Guidance

A-11
A-123
Green Book
Playbook

Risk Response

RISK

Strategic Objective

Management Challenge
Chief Risk Officer (CRO)
**ERM Key Terminology**

**Risk Appetite**

“The broad-based amount of risk an organization is willing to accept in pursuit of its mission/vision. It is established by the organization’s most senior level leadership and serves as the guidepost to set strategy and select objectives.”

**Risk Tolerance**

“The acceptable level of variance in performance relative to the achievement of objectives. It is generally established at the program, objective or component level. In setting risk tolerance levels, management considers the relative importance of the related objectives and aligns risk tolerance with risk appetite.”
Heat Map – Illustrative Example

Risk Profile Map

Probability of an event taking place

Very High
6
10
15
20

High
8
8
12
16

Occasional
3
6
9
12

Very Low
2
4
10
8

Improbable
1
2
4
7

Impact of Event

Marginal
Significant
Critical
Catastrophic

Proactive measures needed BEFORE the events take place

The organization's Risk Tolerance Line:
Every organization has a different tolerance for risk.
• **Portfolio View of Risk**

“Provides insight into all areas of organizational exposure to risk (such as reputational, programmatic performance, financial, information technology, acquisitions, human capital, etc.), thus increasing an Agency’s chances of experiencing fewer unanticipated outcomes and executing a better assessment of risk associated with changes in the environment.”
**Playbook Purpose:** To provide an ERM Framework and practical guidance to support A-123 compliance and effective ERM implementation across agencies.

ERM Playbook Steering Committee
*Set project policy and established the timeline for the project.*

ERM Playbook Working Group
*Implemented the project goals set by steering committee and keyed up decisions and recommendations for the Steering Committee.*

Multi-disciplinary representation from across the federal government

- Financial Management
- Procurement
- Risk Management
- Internal Controls
- Human Capital
- IT
- Performance Management
- Grants Management
- Federal Credit

Over twenty federal agencies represented

Access the Playbook at these websites

**CFO Council:** [www.cfo.gov](http://www.cfo.gov)

**AFERM:** [www.aferm.org](http://www.aferm.org)
ERM - Key Factors

Leadership

Process

Culture
A-123/ERM Assessments

CURRENT MATURITY

Less Mature

More Mature

Less Mature, Higher Capabilities
Agencies are at early stages of implementation, but have the capabilities necessary to mature

More Mature, Higher Capabilities
Agencies are on track. Look for best practices.

Less Mature, Fewer Capabilities*
Agencies are at early stages of implementation and face significant hurdles in maturing

More Mature, Fewer Capabilities
Agencies have some mature processes, but capabilities hinder further progress

*Agencies in this quadrant exhibit higher levels of component autonomy.
A New Set Of Parameters Towards a More Resilient Government

• “Successful implementation of this Circular requires Agencies to establish and foster an open, transparent culture that encourages people to communicate information about potential risks and other concerns with their superiors without fear of retaliation or blame.

• “Similarly, agency managers, Inspectors General (IG) and other auditors should establish a new set of parameters encouraging the free flow of information about agency risk points and corrective measure adoption.”

• “An open and transparent culture results in the earlier identification of risk, allowing the opportunity to develop a collaborative response, ultimately leading to a more resilient government.”

-- OMB Circular No. A-123
ERM and the Role of the Auditor

Core internal audit roles in regard to ERM

- Reviewing the management of key risks
- Evaluating the reporting of key risks
- Evaluating risk management processes
- Giving assurance that risks are correctly evaluated
- Giving assurance on the risk management process

Legitimate internal audit roles with safeguards

- Facilitating identification & evaluation of risks
- Coaching management in ERM activities
- Consolidating reporting on risks
- Maintaining & developing the ERM framework
- Championing establishment of ERM
- Developing risk management for board approval
- Setting the risk appetite
- Imposing risk management processes
- Management assurances on risk
- Making decisions on risk responses
- Implementing risk responses on management’s behalf
- Accountability for risk management

Roles internal audit should not undertake

Source: Based on IIA model for internal audit role with ERM
Core Internal Audit Roles in Regard to ERM

- Reviewing The Management Of Key Risks
- Evaluating The Reporting Of Key Risks
- Evaluating Risk Management Processes
- Giving Assurance That Risks Are Correctly Evaluated
- Giving Assurance On the Risk Management Process

Evaluating and Reviewing Established Risk Processes

- Evaluating the agency’s established risk management processes.
- Evaluating the agency’s efforts at reporting on key risks.
- Providing assurances on the agency’s risk management processes.

Source: Based on IIA model for internal audit role with ERM
Roles Internal Audit Should Not Undertake

Active Management and Ownership Over ERM

- Making decisions and actions typically in the purview of management.
- Taking responsibility for risk decisions and responses
- Giving assurances for ERM and risk responses.

Source: Based on IIA model for internal audit role with ERM
Legitimate Internal Audit Roles With Safeguards

- Developing Risk Management For Board Approval
- Championing Establishment of ERM
- Maintaining & Developing The ERM Framework
- Consolidating Reporting On Risks
- Coordinating ERM Activities
- Coaching Management In Responding To Risks
- Facilitating Identification & Evaluation Of Risks

Assisting and Improving ERM Development

- Advocating ERM as a good management tool.
- Working with management to identify, evaluate, respond to risks
- Coordinating with management to develop and improve ERM frameworks

Source: Based on IIA model for internal audit role with ERM
ERM and the Role of the Auditor

The Three Lines of Defense Model

1st Line of Defense
- Management Controls
- Internal Control Measures

2nd Line of Defense
- Financial Control
- Security
- Risk Management
- Quality
- Inspection
- Compliance

3rd Line of Defense
- Internal Audit

Adapted from ECIIA/FERMA Guidance on the 8th EU Company Law Directive, article 41
• “Why does a car have brakes? A car has brakes so it can go fast. If you got into a car and you knew there were no brakes, you’d creep around very slowly. But if you have brakes you feel quite comfortable going 65 miles an hour down the street. The same is true of [risk] limits.”

-- John Reed, former CEO of Citigroup to the Financial Crisis Inquiry Commission
Questions?
More Questions?

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