

Thought Leadership

It's Time to Seize Opportunity

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As Federal Agencies begin their ERM journey, some will embrace this new (and for a select few, old) way of doing business. Some, though, may view ERM as just another regulatory requirement, for which their ability to “check the boxes” is a cost of staying off the radar screen. They may be skeptical as to whether ERM will appreciably move their organization’s risk needle. Others may say, even though not in a formal, disciplined manner, they already intuitively manage their risks and see no payoff from doing more. Or, they may question the wisdom of publicly airing their risks through a risk profile.

No matter where your Agency falls on the continuum, it’s not about implementing ERM per se to meet the requirements in Office of Management and Budget (OMB) Circular A-123, but about seizing opportunity. We take risks because we hope to receive rewards or positive results. Put simply, we see opportunity. When someone changes jobs, for example, they are seeking a new opportunity. The opportunity may be financial, career enhancing, fulfilling a personal interest, improving one’s quality of life, the thrill of a new experience, escaping a toxic organization or supervisor, and/or a myriad of other outcomes. They all represent opportunity in the mind of the job seeker, and it may be different for others seeking the same job.

The Federal government faces a current year budget deficit, a long-term fiscal sustainability shortfall under current law,¹ and a credibility gap, with trust in government hovering in the low 20 percent range.² What better reasons for seizing the opportunity ERM represents for introducing the concept of risk and reward?

Alcoa demonstrates what’s possible

Consider the story of the Alcoa Corporation and its former Chairman Paul O’Neill, who subsequently served as Secretary of the Treasury and was earlier the OMB Deputy Director. While he may not have been thinking about ERM per se, his passionate focus on safety risks to Alcoa workers demonstrates the power of seeking opportunity, led from the top. Upon joining Alcoa as its CEO in 1987, he made clear that worker safety was his highest priority –

¹ U.S. Government Accountability Office (GAO), “Fiscal Outlook: Federal Fiscal Outlook” (http://gao.gov/fiscal_outlook/federal_fiscal_outlook/overview#t=0fiscal).

² See <http://www.people-press.org/2014/11/13/public-trust-in-government/and> <http://www.gallup.com/poll/183605/confidence-branches-government-remains-low.aspx>.

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“I intend to go for zero injuries.” He kept reiterating this theme over and over. The market expected talk about profitability. After all, Alcoa’s safety track record was better than the national norm, especially considering the inherent safety challenges in its industry. But O’Neill was steadfast in telling everyone to look at the safety numbers to know how well Alcoa was doing as a company.³

He had a bigger picture in mind and saw opportunity in what these results could do for Alcoa’s employees as well as the business. In a 2002 speech to Harvard University MBA and Kennedy School of Government students, he said “I was prepared to accept the consequences of spending whatever it took to become the safest company in the world.” O’Neill was personally engaged in changing the corporate culture of safety, including being open to the views of workers at all levels. Work days lost from injury plummeted from almost two days annually per worker to less than two hours and continued to decline. Not only was Alcoa safe, but safety initiatives resulted in significant continuous improvements to manufacturing processes and operations through heightened worker engagement and their input on better ways of doing the job. One year later, Alcoa’s profits hit record highs. By the time he retired as CEO in 1999, Alcoa’s reported market value had risen from \$3 billion to \$27 billion, annual revenues had increased from a reported \$1.5 billion to \$23 billion, and reported net income had gone from \$200 million to almost \$1.5 billion.⁴

Alcoa demonstrates what’s possible when an organization focuses on risk from an enterprise perspective. There was a higher purpose of worker safety and the recognition that cultural and operational changes were necessary to seize opportunity. Ultimately, the focus on safety risk also translated into bottom line profitability. ERM is not about nibbling at the edges, but looking holistically at programs and operations from a different lens. As Albert Einstein said, “We can’t solve problems by using the same kind of thinking we used when we created them.” Reflecting on achieving Agency missions in times of continuing fiscal challenge and a widespread lack of public trust, there is a need to recognize the power of identifying and strategically addressing enterprise risks in a manner that seizes opportunities to reduce costs, while enhancing program results and service delivery.

So how does an organization get started?

How can Federal Agencies begin the process of embedding a consideration of enterprise risk into day-to-day programs and operations, so the consideration of risk versus reward becomes part of the organizations’ DNA? This will not happen overnight, nor will it be easy. ERM is transformative, requiring Agencies to be more anticipatory and to break down deeply-

³ “The Power of Habit: Why We Do What We Do in Life and Business,” chapter titled “The Power of Safety Leadership: Paul O’Neill, Safety and Alcoa,” by Charles Duhigg, February 2012; <http://www.industryweek.com/iw-manufacturing-hall-fame/manufacturing-hall-fame-2012-inductee-paul-oneill>; and “Paul O’Neill: Values into Action,” Harvard Business School, *Working Knowledge*, by Martha Lagace, November 4, 2002 (<http://hbswk.hbs.edu/archive/3159.html>).

⁴ See note 3.

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rooted cultural barriers and oftentimes hardened stovepipes that may inhibit the broad consideration of risk across the enterprise.

Government is certainly not “home alone” on this hurdle. The May 2013 results of a global risk management survey conducted by the Economist Intelligence Unit (EIU)⁵ of more than 1,000 C-suite executives reported they faced significant challenges adopting ERM concepts for some of the same reasons that will prove challenging in government.⁶ For example, most respondents did not have a consistent way of assessing enterprise risk, thereby limiting usefulness of the results. Almost half reported having difficulties understanding enterprise risks, and less than 44 percent believed they were effective at developing stakeholder understanding.

Top management is also faced with many competing priorities. In fact, as discussed in the April 2016 “The State of Risk Oversight: An Overview of Enterprise Risk Management Practices,” published by the ERM Initiative at the North Carolina State University Poole College of Management, 46 percent of 441 private sector survey respondents viewed competing priorities as a barrier to ERM progress.⁷ This reality, combined with the turnover of top leadership with the Presidential transition, add to the Federal government’s challenge.

Often attributed to Mark Twain, “*The secret of getting ahead is getting started. The secret of getting started is breaking your complex overwhelming tasks into small manageable tasks, and then starting on the first one.*” It will be easy to become overwhelmed quickly if Agencies try to do everything at once. They should first analyze the task at hand in light of objectives to add greater value in anticipating and mitigating risks so they become opportunities.

Valuable lessons were learned during the early years of implementing the Federal Managers’ Financial Integrity Act of 1982.⁸ It is critical to avoid those pitfalls, whereby assessment and reporting processes quickly became the end game and grew into massive paperwork

⁵ The EIU is an independent business within The Economist Group that is a sister to the well-known journal *The Economist*. EIU provides KPMG with a range of services, such as this sponsored study, that offer analysis, forecasts, and data for countries around the world in a consistent and comparable way to aid understanding of the environment of countries over time.

⁶ KPMG International, “Expectations of Risk Management is Outpacing Capabilities – It’s Time for Action, May 2013 (<https://assets.kpmg.com/content/dam/kpmg/pdf/2013/08/expectations-risk-management-survey-v3.pdf>).

⁷ “The State of Risk Oversight: An Overview of Enterprise Risk Management Practices,” by Mark Beasley, Bruce Branson, and Bonnie Hancock of the Enterprise Risk Management Initiative at the North Carolina State University Poole College of Management, April 2016. This, the seventh annual report in this series, was based on research by the ERM Initiative on behalf of the American Institute of Certified Public Accountants’ Business, Industry, and Research Team. (See https://erm.ncsu.edu/az/erm/i/chan/library/AICPA_ERM_Research_Study_2016.pdf.)

⁸ Public Law 97-255, September 8, 1982 (https://www.whitehouse.gov/omb/financial_fmfi1982).

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exercises.⁹ Guard against the process becoming the measure of success. The measure of success is whether ERM is adding value through better management of risks consistent with the Agency's risk appetite, which must clearly articulate the risk/reward tradeoff top management seeks.

We are not suggesting Agencies start slowly, but rather start smartly. Leading organizations adopt incremental steps. They focus on a relatively small number of risks and then build from the initial foundation. Understand the nature and extent of risk and the reward for taking that risk. Include risks that are emerging or have a long tail, meaning a low likelihood of occurrence, but whose risk/reward payoff is large.

The goal is to also be anticipatory rather than reactive. No manager wants to be in a position of having to explain why something negative occurred on his or her watch that should have been foreseen, or to realize later that his or her new idea would have exponentially improved the program if only he or she had stepped forward and seized the opportunity.

While compliance is important, always view laws and regulations as the floor, or the bare minimum of what is required. In some cases, that may be enough; but where the likelihood and/or the impact are high, it simply may not get the job done. Embed ERM into business processes as the normal way of doing business so it adds value. Agencies should aim to achieve the appropriate balance between control and risk.

Don't think you have to reinvent the wheel. Leverage tools, such as the *Playbook: Enterprise Risk Management for the U.S. Federal Government*¹⁰ developed by the Federal Chief Financial Officer Council and the Federal Performance Improvement Council, as well as ERM guidance documents in the private sector. Seek the assistance of peers and of private sector practitioners, who have a track record of successfully assisting organizations in implementing ERM, including managing the difficult cultural transformation that must take place.

Widely share both early successes and lessons learned. Early in its journey, Alcoa suffered a loss of life from an accident that it deemed avoidable. It thoroughly reviewed the situation with Paul O'Neill taking the lead. The company was open and transparent and took actions to address the lesson learned more broadly than the plant where the accident occurred. It

⁹ FINANCIAL MANAGEMENT: Effective Internal Control is Key to Accountability, Statement of Jeffrey C. Steinhoff, GAO Managing Director, Financial Management and Assurance, GAO-05-321T, February 16, 2005 (<http://gao.gov/assets/120/111338.pdf>).

¹⁰ See <https://cfo.gov/wp-content/uploads/2016/07/FINAL-ERM-Playbook.pdf>.

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doubled down on its commitment.¹¹ Agencies need to be able to demonstrate to all levels of the organization, as well as to stakeholders, the value of ERM. Use stories of positive results to reinforce desired behaviors. Conversely, negative results should be embraced as learning opportunities. In both instances, the end game is to change the risk culture.

Last but not least, get ownership from the top. Top leadership ownership is paramount. It may seem like a worn-out cliché, but the ***tone at the top really, really matters***. In organizations considered to be “advanced” in risk management, ERM is a priority of top management, who lead by example.¹² True top management leadership can literally move mountains as demonstrated by Alcoa.

Final thoughts on initial action steps

Success in adopting ERM will require cultural change in most, if not all Federal Agencies for which the tone at the top will be paramount. A challenge to the AFERM community is to demonstrate the benefits of ERM so that it’s not only on top management’s radar screen, but is something they understand and care about.

To recap, here are several initial action steps in getting started.

- Engage the new administration. Incoming political leadership will want to demonstrate tangible progress in addressing existing problems. They will not want to be encumbered by the fallout from risks that went unmitigated, which can undermine key policy changes.
- Remember, it’s not about doing everything on day one. Carefully analyze the task at hand and how cultural change can be best driven, so risk considerations become imbedded in the Agency’s DNA.
- Seek the advice of others that have successful ERM programs and leverage existing tools and leading practices.
- Avoid the compliance-exercise trap. Don’t take your eyes off the ultimate prize that ERM can offer. As you go along, take frequent time outs to reflect on the end game and make sure you are steering in that direction. If not, recalibrate the program.
- Make sure you are enabling the goals of ERM: (1) *driving risk to an acceptable level*, consistent with management and stakeholder expectations, (2) *providing value* by focusing on the right things, and (3) *optimizing mission results*, with full accountability and transparency.

¹¹ See note 3.

¹² See “Navigating uncertainty through ERM: A practical approach to implementing OMB Circular A-123, KPMG Government Institute, November 2016, for a broader discussion of meeting the ERM challenge (<http://www.kpmg-institutes.com/content/dam/kpmg/governmentinstitute/pdf/2016/A123-erm.pdf>).

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ERM works, and can do great things in the Federal government, but only if you **seize opportunity!**

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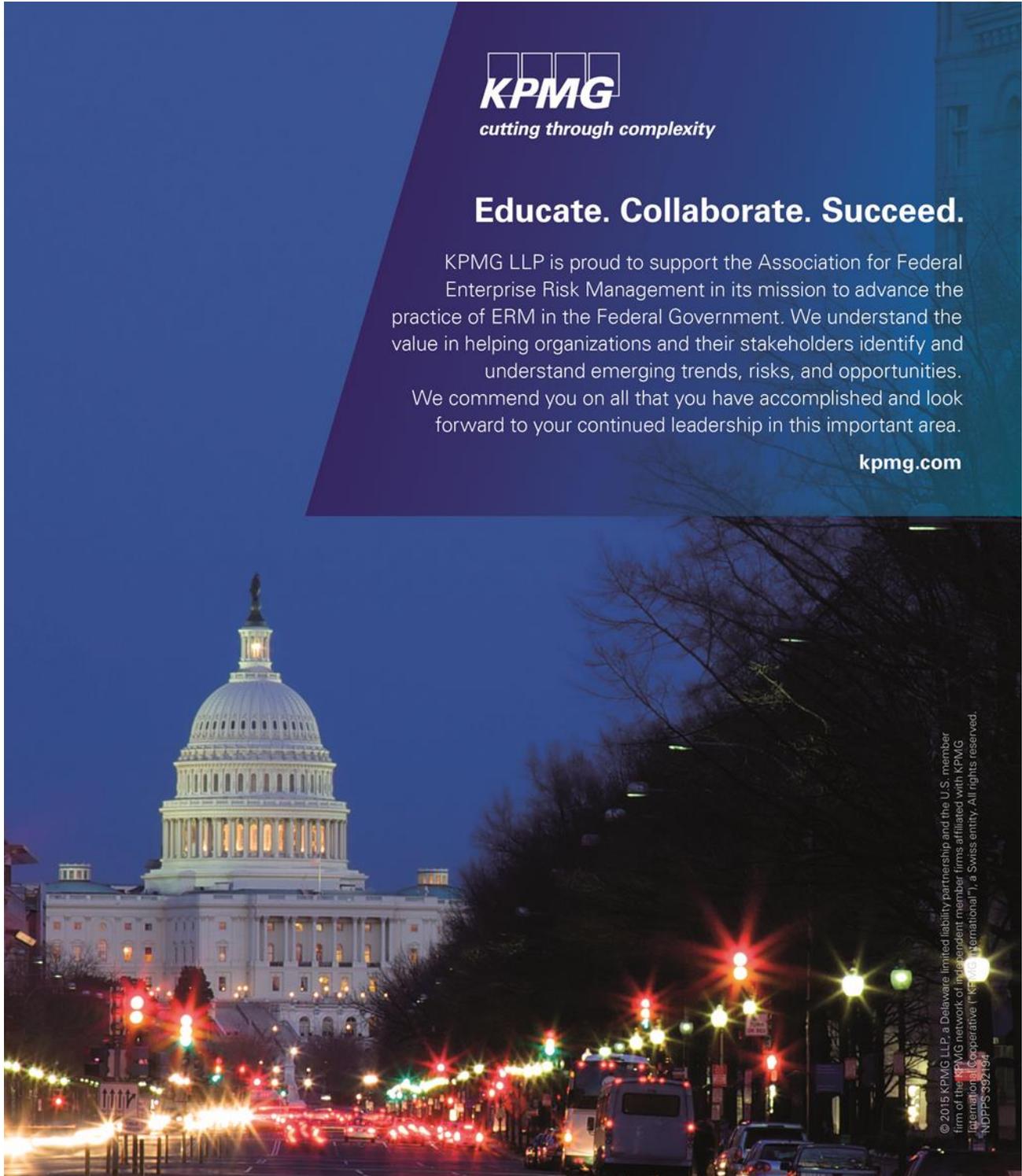
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KPMG LLP is proud to support the Association for Federal Enterprise Risk Management in its mission to advance the practice of ERM in the Federal Government. We understand the value in helping organizations and their stakeholders identify and understand emerging trends, risks, and opportunities. We commend you on all that you have accomplished and look forward to your continued leadership in this important area.

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