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Measuring ERM maturity: adopting a multi-dimensional approach

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Establishing ERM as the heart of Office of Management Budget (OMB) Circular A-123 represents transformative change to the way federal agencies have historically viewed risk management and internal controls.[1] It will take time for agencies to build mature ERM capabilities that become part of normal day-to-day programs and operations; thereby providing continuing long-term value.

A maturity-based approach to ERM adoption continually evaluates how implementation is progressing, while providing accountability and a roadmap for future progress. Agencies can benefit from a multi-dimensional approach to measuring maturity aligned to the expectations and requirements of Circular A-123. This allows for ongoing evaluation of key ERM elements, such that agencies can better understand their accomplishments and shortfalls and better facilitate a targeted, iterative approach to further advance ERM implementation. Leading organizations view ERM as a marathon, not a sprint. Adding value to the business of government, and not rote compliance, is the ultimate measure of maturity.

The challenge

Circular A-123 calls for agencies to “develop a maturity model approach for the adoption of an ERM framework.” The Circular “recognizes that not all components of an ERM program are fully operationalized in the initial years, and agency leadership must set priorities in terms of implementation.” By design, Circular A-123 provides high-level maturity model guidance, arming agencies with flexibility to tailor their ERM programs to their specific needs. The Federal ERM Playbook (Playbook) provides additional guidance based on leading practices.[2] The Playbook advises against taking on “too much too quickly” and suggests that “management should consider an incremental approach.” The Playbook notes that “Evaluating and improving the ERM of an organization is a long-term process that needs to develop and change over time and will be shaped by the unique needs, formal and informal decision making structures, culture, capacity, and mission of the organization.”

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[1] OMB Circular A-123, *Management’s Responsibility for Enterprise Risk Management and Internal Control*, July 15, 2016. (https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/memoranda/2016/m-16-17.pdf).

[2] “Playbook: Enterprise Risk Management for the Federal Government,” Federal Chief Financial Officers Council and the Performance Improvement Council, July 29, 2016 (https://cfo.gov/wp-content/uploads/2016/07/FINAL-ERM-Playbook.pdf).

The Playbook also points out that by assessing ERM maturity, agencies can set realistic improvement targets that align with their overall strategy, technical and financial capacity, and cost-benefit analysis. The Playbook provides two models as examples – a multi-level model and a multi-dimensional model. Neither model is meant to provide the "how to," which is left up to each agency. For either ERM model (and there are other models as well), the agency would need to establish an evaluation approach to identify needed changes over time in establishing and maintaining a mature ERM program.

A multi-level maturity model

The multi-level maturity model highlighted in the Playbook includes five levels as shown below in Exhibit 1.

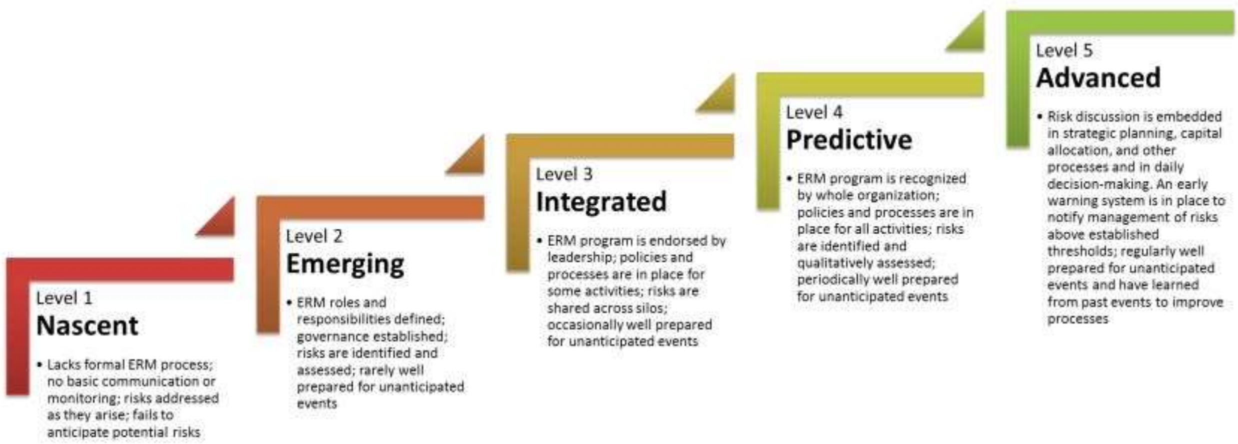

Exhibit 1 – *Federal ERM Playbook "Five Step" Maturity Model*

There is progressive ERM maturity as agencies move through the five levels. This may work for some agencies, but not for others. For example, consider an agency with the following eight characteristics:

1. ERM is recognized as an agency-wide initiative.
2. All agency offices have policies and procedures in place for risk identification and assessment.
3. Risks are identified, assessed, and shared across organizational silos.
4. There is endorsement by top leadership.
5. There is not yet strong "tone-at-the-top" to drive ERM as a fundamental principle and management priority.
6. Formal governance has yet to be established.
7. Identified risks are not examined to determine how well the agency is prepared to address unanticipated events.
8. Risk appetite and risk tolerance have not yet been defined.

Applying the first four characteristics, an agency may gauge that it falls in Level 4, "Predictive," or is close to it. However, characteristics five through eight could represent an organization still grappling to navigate Levels 1 and 2. Also, not all key elements are covered in the five levels. For example, risk appetite, described by Circular A-123 as "key to achieving effective ERM," is not a criteria in this maturity model.

A multi-dimensional maturity model

Certain limitations of a multi-level maturity model can be alleviated when multiple dimensions of maturity are independently evaluated. The Playbook's multi-dimensional maturity model example consists of five major risk maturity dimensions—culture, process-analytical, process-organizational, implementation, and outcome –along with 11 sub-dimensions. Multi-dimensional models are more adaptive to evaluating agency risk challenges and also specifically address risk tolerance. This more comprehensive model would be enhanced by adding an additional dimension covering risk monitoring, which is critical to ERM.

Multi-dimensional evaluations provide critical insight into an agency's true level of maturity and offer the following benefits:

- **More targeted evaluation of maturity.** As noted with the multi-level maturity model example, it can be difficult and potentially misleading to simply find one aggregate level of maturity for the agency. Multi-dimensional models help remove areas of ambiguity by targeting dimensions and sub-dimensions. This is not to say that a multi-level maturity model could not be designed to provide more detailed insights within a maturity level.
- **Better understanding of strengths and weaknesses.** With multi-dimensional models, more mature processes in certain areas of ERM can be identified, allowing for replication and targeted investments to bolster less mature areas. Similarly, maturity models can be applied throughout an organization by risk dimension at the individual program and operational levels. Such evaluations can identify areas within an organization where higher-level risk maturity standards are already in place and can be used as leading practice for others in the agency to emulate.
- **More sophisticated strategies of identifying the target maturity state.** n agency may determine that a specific dimension or sub-dimension may not require the highest state of maturity given the environment, cost, and/or impacts on mission achievement. As a rule of thumb, "[t]he advanced level may not always be the target maturity at a particular point in time, especially when agencies are just beginning to adopt ERM. Rather, the target should reflect

> management's view on what is critical to successfully manage risk and the benefits it wants to achieve."[3]

For example, in the Playbook's multi-dimensional model, the "Outcome: Unanticipated Risks" sub-dimension's highest maturity level is described as having "Regularly executed well-prepared responses to unanticipated events and learned from the events to avoid recurrence of related events while also integrating the level of understanding throughout the performance management process." While achieving the highest level is certainly valuable, based on facts and circumstances and risk to the agency, it may be reasonable to adopt a level of maturity one level lower. In this case, the maturity level is described as having "Periodically executed well-prepared responses to unanticipated events and learned from the events to avoid recurrence."

It is important to note that multi-dimensional models have their limits. Consider a hypothetical model with 100 dimensions of ERM maturity. Tracking this many dimensions of maturity would certainly allow low levels of granularity and greater specificity, but it may also miss how processes in ERM are designed to be interrelated. Risk governance should help define risk assessment, which should in turn affect risk monitoring. A few dimensions are too few, while 100 are assuredly too many.

Dimensions of risk maturity

When determining what dimensions should exist in an ERM maturity model, agencies can look to the requirements in Circular A-123 and the Playbook for guidance. For example, **Risk Governance** has a dedicated section within A-123, and there is a spectrum of guidance, ranging from ad hoc councils and individual manager priorities to formally recognized agency-wide risk management councils to a dedicated chief risk officer. **Risk Appetite and Tolerance** should also be evaluated given its key nature to the functioning ERM process. Additionally, both Risk Governance and Risk Appetite and Tolerance are primary drivers of many ERM-related activities, such as monitoring, and should certainly have some level of dedicated evaluation of their maturity.

Methods of evaluation – **Risk Assessment, Management, Monitoring, and Reporting** – should be examined, as well the underlying **Data and Technology** supporting ERM at an agency. These may be combined or separated as appropriate within each maturity model.

A key dimension of risk maturity is the **Risk Culture,** which together with leadership-related challenges, is considered the most prominent barrier to ERM implementation.[4] Culture needs to be an enabler. A sophisticated risk culture "is paramount to

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[3] "Navigating uncertainty through ERM – A practical approach to implementing OMB Circular A-123," KPMG Government Institute, November 2016 (https://institutes.kpmg.us/content/dam/institutes/en/government/pdfs/2016/A123-erm.pdf).

[4] "2018 Federal Enterprise Risk Management Survey," Guidehouse in collaboration with AFERM, October 2018.

successfully implementing ERM. The culture focus must come from top leadership and be widely understood and embraced throughout the organization."[5] In order to develop a stronger, more mature risk culture, agencies should examine if "leaders and all staff will have to be motivated to the right thing and recognize the critical importance of installing a positive risk culture in the fiber of the organization, so that it becomes a facilitator and not a barrier to ERM."[6]

Final remarks

There is a natural tendency for any executive or manager to want to know the bottom line answer to the question "How are we doing?" Multi-level maturity models offer a seductive answer to such a question. However, just as ERM is designed to help drive a view with a "full spectrum of the organization's external and internal risks,"[7] the full spectrum of maturity generally cannot be confined to just one answer. A multi-dimensional approach, with a targeted number of dimensions together with sub dimensions as needed, provides a full maturity spectrum. At the same time, properly designed, it does not divide the answer to the question into segments so discrete and small as to defy a bottom line answer and practical actions to address identified maturity shortfalls.

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[5] "Your Risk Culture: An ERM enabler or barrier?" KPMG Government Institute in collaboration with AFERM, October 2018 (https://institutes.kpmg.us/content/dam/institutes/en/government/pdfs/2018/risk-culture-erm.pdf).
[6] See footnote 3.
[7] See footnote 1.