By Michael J. Keegan, Forum Editor

Introduction: Pursuing Risk Management in Government —A Leadership Imperative

This world is fraught with uncertainty, and even the best-laid plans can go awry. Life brings with it varying degrees of risk as a condition of existence. This makes life both difficult, but also worthwhile. As the Lotto ad said, "You gotta be in it, to win it." Everything worth doing entails a certain level of risk. The increasing complexity and interconnectedness of today's world only ups the ante on the unknown. What makes a difference in individuals and organizations alike is how well you handle an uncertain environment, with all sorts of risks from financial to reputational to the operational. The way to manage this uncertainty is to build your capacity to anticipate and be resilient: can you anticipate the future and prepare for its effects?

Federal agencies are hardly immune to the "slings and arrows of outrageous fortune," including sequestration, budget cuts, or a government shutdown. Along with these threats, each day federal agency leaders face similar, as well as unique, risks associated with fulfilling their respective program missions. Today's headlines are full of stories of failed website launches, cyber hacks, abuses of power, extravagant spending, and a host of other risk management failures. The federal government has taken a hit, with the public's trust in government continuing to be low, as measured in numerous surveys. This view is shaped in part from some of these stories about how federal agencies could have improved their operational and mission performance, had leaders taken the time to foresee and mitigate potential risks.

It is a leadership imperative for government executives to mitigate the potency of uncertainty by managing the realities of risk. Employing an enterprise risk management (ERM) process can assist leaders in doing just that. When employed on a strategic level, ERM can help decision makers evaluate the likelihood and impact of major events and formulate the best way to either prevent them or manage their effects, if they do occur. Many changes are now occurring that hold the potential to make government function better. It is a positive change that an increasing number of federal agencies have recognized the value of ERM and are taking actions to make ERM an important part of their operational model.

The first step in tackling risk is defining it. The conventional view of risk is focusing on a potentially negative impact. Risk management in this context typically focuses on managing threats to objectives. As Dr. Douglas Webster describes in *Managing Risks and Performance: A Guide for Government Decision Makers,* defining risk as merely the threat that objectives will not be achieved leaves unanswered the question of how to actively manage the balancing of opportunities and threats. Maximizing the opportunity for success requires that threats and opportunities are actively managed together. As government leaders begin to allocate and invest resources and develop strategic plans for their agencies, it is important to consider threats as opportunities. All future events and the achievement of future results—the heart of strategic planning—are uncertain because they have yet to happen. In identifying, analyzing, and mitigating risk, ERM can also be a powerful resource for strategic planning and effective decision making. To that end, government leaders should view risk as "uncertainty that matters." When does risk matter? Webster underscores that it matters when it has a material impact on the achievement of your strategic objectives.

As this publication goes to print, the Office of Management and Budget (OMB) is expected to issue a revised Circular A-123. The updated circular is likely to evolve federal agencies' existing internal control framework to be more value-added and provide for stronger risk financial management to improve mission delivery.

This forum presents government leaders with insights, recommendations, and best practices drawn from two recent IBM Center reports that focus on ERM in government. The first contribution to this forum comes from Douglas Webster and Thomas Stanton's report, *Improving Government Decision Making through Enterprise Risk Management*. Webster and Stanton describe the evolution of federal risk management approaches and several agencies' experiences in adopting ERM. The authors asked current and former federal executives to describe the challenges of adopting an enterprise approach to risk management in their agencies and across the government. They present six challenges facing government leaders, and outline six steps that leaders can take to successfully implement ERM.

The second contribution to this forum is excerpted from *Risk Management for Grants Administration: A Case Study of the Department of Education*. Authors Young Hoon Kwak and Julia Keleher examine the experience of the U.S. Department of Education in implementing risk management initiatives in 2001. Based on their examination of the Department of Education's experience, Young and Keleher present a series of lessons learned and recommendations for other agencies. The authors caution that risk management practices may represent a major change for some agencies and should be accompanied by training and capacity-building programs. They also note that agencies should take advantage of OMB's new risk management requirements as an action-forcing event to improve their risk management capability.

This forum underscores the leadership imperative of taking risk seriously and highlights methods and practices to get out in front of an ever evolving threat environment facing government executives. ◘

This article is adapted from Douglas Webster and Thomas Stanton's "Improving Government Decision Making through Enterprise Risk Management" (Washington, DC IBM Center for The Business of Government, 2015)

Improving Government Decision Making through Enterprise Risk Management

Edited by Michael J. Keegan

The first contribution to this forum is adapted from the IBM Center report, Improving Government Decision Making through Enterprise Risk Management, *by Douglas Webster and Thomas Stanton. Federal leaders recognize the need to address risks effectively. While historically, the federal government has tended to focus risk management in the financial arena, the Office of Management and Budget has recently launched a major reassessment of the government's approach—encouraging the use of Enterprise Risk Management (ERM). Because policies don't often readily translate into action, Webster and Stanton describe the evolution of federal risk management approaches and several agencies' experiences in adopting Enterprise Risk Management. The authors present six challenges to implementing ERM and outline six steps that organizational leaders can take to make ERM a viable way to address threats and risks to their agency's mission.*

What is Risk?

There are various definitions of risk. Terry F. Buss, an international scholar of public administration, writes, "Risk is defined as the uncertainty of outcomes arising from events, laws, policies, decisions, and actions. Risk has to be assessed against the combination of the likelihood of something happening, and the impact that arises if it does actually happen." He notes that risk is often viewed in negative terms, such as in connection with disasters, but that risk can also refer to positive actions, such as when introducing innovation. The need for effective risk management in government—and the consequences of a failure to adequately address risk—have become increasingly evident. There are many classic examples of inadequate public and private sector risk management in recent decades, such as the Challenger and Columbia Space Shuttle disasters and the Deepwater Horizon oil spill, to say nothing of the public and private failures that led to the financial crisis of 2007–2008.

We have continued to see an ongoing cavalcade of decisions reflecting poor risk management. The front pages of national newspapers routinely report on actions by private companies, federal leaders, or agencies that do not appear to have considered the risks associated with various decisions and actions. There appears to be a common thread running through these events: a failure to adequately consider risk "up front" and address it as part of an organization's overall management.

Risks come in many different dimensions. The federal government has traditionally focused on managing financial risk, but is now beginning to address risk more comprehensively by incorporating other dimensions. The following presents examples of external and internal risk that organizations face.

Why Is There Increased Attention to Risk in the Federal Government?

Assessing risk has long been a management imperative in the private sector, especially in the financial and insurance industries. The federal government has also paid attention to risk that is inherent in selected functions, such as natural disaster response and air traffic control. But in recent years, there has been an organic growth in the amount of attention that is being paid to addressing risk across a spectrum of agencies. There are two sets of factors that account for this increased attention:

- **External Factors.** Environmental factors as diverse as an aging workforce, changing social norms, or increased cybersecurity threats have an impact on federal agencies in multiple ways. Having limited control over external risks, however, does not mean that they should be ignored. Instead, they must be considered as part of evaluating the achievability of future goals and considering alternative approaches to reaching those goals.

- **Internal Factors.** There are many risks internal to an organization over which it often does have significant control. The adequacy of internal processes, for example—such as associated controls, training, appropriate organizational values and culture, and many other factors—are under the direct influence, if not outright control, of the organization.

An important distinction between risks generated externally or internally is the degree of planning and incisive leadership required to appropriately identify and manage risks. The management of risks that occurs as a result of delivering current products and services is not a trivial task. It requires an understanding of the resources and processes involved and an understanding of where the uncertainties lie in the delivery of those products and services. Budget cuts increase the risks confronting an agency. In both the private and public sectors, major risks have materialized when:

- An organization undergoes a serious reduction in budget; and

- Top management, for any of a variety of reasons, seeks to "do more with less" without first undertaking the necessary work of organizational rebalancing.

Examples of Types of External and Internal Risks Organizations Face

Hazard risks, such as:
- Liability suits (e.g., operational, products, environmental)
- Fire and other property damage
- Theft and other crime

Financial risks, such as:
- Price (e.g., interest rate, commodity)
- Liquidity (e.g., cash flow, opportunity costs)
- Credit (e.g., default by borrowers)

Operational risks, such as:
- Customer service
- Succession planning
- Cybersecurity

Strategic risks, such as:
- Demographic and social/cultural trends
- Technology innovations
- Political trends

Reputational risks, such as:
- Procedural and policy mistakes by staff
- Perceptions of misuse of government resources
- Fraud or contract mismanagement

Source: Adapted from Brian Barnier, "Creating and Keeping Your Options Open — It's Fundamental," Chapter 5 in Managing Risk and Performance: A Guide for Government Decision Makers*, by Thomas H. Stanton and Douglas W. Webster, eds. Hoboken, NJ: John Wiley & Sons, Inc., 2014, p. 123.*

What Is the Value of a Risk Management Focus?

Effective use of risk management strategies can improve senior leadership decision making by strengthening both the quantity and quality of the information available for decision making and offering the opportunity for the fact-based information flow that can challenge the leadership team's assumptions.

- **Risk Management as a Tool to Strengthen Decision Making.** Risk management plays an important role in a decision-making process. By institutionalizing the presentation of information about "downside risks" associated with a decision, an executive, such as a risk officer, can facilitate the presentation of important information to help inform the decision-making process.

- **Risk Management as a Tool for Improving Information Flow.** The quality of organizational decision making improves because effective risk management creates an institutionalized process for encouraging the flow of information across the organization and up the hierarchy to the relevant decision makers. Once information is available, a leader needs to exercise judgment and make decisions about whether and how to proceed.

OMB's Attributes of Effective Risk Management

In its Circular A-11, *Preparation, Submission and Execution of the Budget,* the Office of Management and Budget (OMB) lists the attributes of effective risk management.

Effective risk management:

- Creates and protects value
- Is an integral part of all organizational processes
- Is part of decision making
- Explicitly addresses uncertainty
- Is systematic, structured, and timely
- Is based on the best available information
- Is tailored and responsive to the evolving risk profile of the agency
- Takes human and cultural factors into account
- Is transparent and inclusive
- Is dynamic, iterative, and responsive to change
- Facilitates continual improvement of the organization

Source: OMB Circular A-11, Preparation, Submission and Execution of the Budget, *Section 270.24, "Performance and Strategic Reviews," August 2014.*

Evolution of Enterprise Risk Management in the Federal Government

Risk has been managed within relatively narrow domains. These domains may be functional in nature, such as risks associated with responsibilities of the chief financial officer, chief information officer, or other functional areas. Risks are also addressed within programmatic domains, such as within an agency's or bureau's particular programs or projects.

All programs, functions, and other organizational elements have objectives related to their roles in the organization. They also have risks in achieving those objectives. Understanding and managing these risks typically requires specialized knowledge and experience relevant to the objectives sought and the risks encountered. Avoiding the risks of a failed financial audit, for example, requires individuals with the proper training and background to understand finances, Generally Accepted Accounting Principles (GAAP), and internal controls, as well as possess other skills needed to ensure a well-functioning financial system.

Limitations of the Traditional Approach

No matter the degree of sophistication in managing functional risks, shortcomings can easily remain when risks are managed in one functional or programmatic area, independent of risks in other areas. These shortcomings can present themselves in a number of ways:

- Gaps in the identification, assessment, and treatment of risks between functions, programs, or organizational subdivisions.
- Inefficiencies due to overlaps in the treatment of shared risk.
- Inconsistencies in the treatment of risks by various functions due to dissimilar risk appetites and approaches to risk management.
- Lack of strategic alignment.
- Reduced return on investment in the application of limited resources to the delivery of a portfolio of products and services.

What is Enterprise Risk Management?

As organizations become more experienced in the application of risk management, the shortcomings of the traditional siloed approach to managing risks within functional and programmatic sectors have become more obvious. This has led to slow but ongoing progress toward implementing the principles of Enterprise Risk Management (ERM). One of the earliest formal definitions of ERM was introduced by the Casualty Actuarial Society (CAS). In a report by its Advisory Committee on Enterprise Risk Management, the CAS in 2001 defined ERM as follows:

> ERM is the process by which organizations in all industries assess, control, exploit, finance, and monitor risks from all sources for the purpose of increasing the organization's short- and long-term value to its stakeholders.

More recently, AFERM defined ERM as:

> … 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.

These definitions are instructive, in part because they point out that ERM is more than simply "good" risk management as traditionally practiced in silos. The AFERM definition references "the full spectrum of an organization's risks," while the CAS definition cites risks "from all sources." These definitions inherently require a top-down, strategically driven approach to risk identification. The problem of "white space" means that such a comprehensive view of risk will not emerge simply from a bottom-up aggregation of risks identified within functional and programmatic silos. The need to incorporate risk management into the strategic planning process is an inherent part of any meaningful ERM program, and again, this requires a comprehensive view of major risks to the agency and its programs.

While the concepts of ERM outlined above have been maturing in the private sector for the past two decades, their introduction into the public sector is more recent. What is believed to have been the first enterprise-wide implementation of ERM in the federal government can be found at the Office of Federal Student Aid (FSA) in the Department of Education. In 2008, Doug Webster, a co-author of this report, was serving as the chief financial officer (CFO) of the U.S. Department of Labor. With a strong belief in the value of ERM, he reached out to other federal executives who shared that interest. Early in 2008, this informal group established itself as the Federal ERM Steering Group and joined with George Mason University to convene the first Federal ERM Summit. In 2011, the Federal ERM Steering Group was formally incorporated as the aforementioned Association for Federal Enterprise Risk Management (AFERM).

As the authors of this report have sought to explain in describing ERM, there is a need for a central office or function generating centralized risk management policy, establishing cross-functional risk management processes, facilitating collaborative risk management discussions, and prioritizing risks. An additional effort aimed at helping inform the federal community about ERM principles and practices was the publication of the book *Managing Risk and Performance: A Guide for Government Decision Makers* (Wiley, 2014), co-edited by the authors of this report.

Despite the initially slow progress and misunderstanding of the term ERM, concrete progress is now demonstrably underway. In the book just referenced, one of the 10 recommendations offered to the federal government was to "incorporate ERM explicitly into Circular A-11 and OMB reviews of agencies." On July 25, 2014, OMB released an update to Circular A-11 (its annual guidance to agencies on the preparation of their budget submissions) that recognized ERM as an important practice for managing agency risk.

OMB Efforts to Encourage an Enterprise Risk Management Approach

OMB's current interest in ERM has evolved over time, but became more evident early in 2013. OMB began working with the GAO to provide input on an update to Standards for Internal Control in the Federal Government ("The Green Book"), and to consider how evolution of the Green Book might influence internal controls policy reflected in OMB Circular A-123, *Management's Responsibility for Internal Control*. The next version of A-123 is thus expected to broaden the role of A-123 beyond internal controls to include other aspects of risk management.

In October 2014, David Mader, then-OMB controller, stated in a panel discussion, "We have begun talking about how do we think about risk more broadly than just financial risk? I think when you look at [Circulars] A-11 and A-123, those were all borne out of the CFO Act. So everyone is narrowly focused on 'well, it's about financial risk and it's about internal controls.' What we are doing now is stepping back and thinking, isn't there really a way to take the lessons learned and what we've accomplished with A-11 and A-123 and broaden that perspective across the entire organization, particularly around mission programs?" Mader went on to state that OMB believes that there needs to be an enterprise risk protocol across government, and that OMB would provide that guidance late in 2015.

Challenges to ERM Implementation: Insights from Federal Executives

ERM poses basic challenges that must be addressed before it can become ingrained in an agency's processes and culture.

Our interviewees identified six challenges that need to be overcome in the implementation of ERM. Four of these challenges relate to the distribution of power within the organization and two relate to conceptual issues and basic understanding of ERM. For a fuller description of these challenges, please download the complete report at businessofgovernment.org.

Challenges relating to the distribution of power in an agency:

1. Sustaining support from the top
2. Addressing power concentrated in silos
3. Overcoming a culture of caution
4. Reconciling roles of the risk function with those of the inspector general or auditor

Challenges relating to basic understanding of ERM and its value:

5. Educating agency staff about ERM
6. Demonstrating the value of ERM

Six Steps to Successful Implementation of Enterprise Risk Management in the Federal Government

Based on research for this report, the authors believe that progress is being made to infuse federal agencies with more effective risk management, but as noted in the previous section, challenges remain. Perhaps the greatest danger for an agency or other organization is that risk management becomes a largely empty gesture of compliance with a set of documented actions, rather than a meaningful process that adds value to decisions. In simplest terms, there are six key steps that need to be taken to implement risk management in a government agency.

Step One: Establish a Risk Governance Framework

The first step is to define key players' roles and responsibilities. This needs to be done both government-wide and within each agency. Many different organizations are now involved to some extent in risk management in government.

- OMB should continue to encourage agencies to create cultures and processes that support ERM and inform budget examiners of the principles of ERM so that, in annual budget reviews, they ask agencies to identify major risks and explain how these are being addressed.
- GAO should regularly review best practices in risk management, and ERM in particular, in federal departments. They should also analyze the risk practices of particular agencies and assess the extent to which agencies are accruing vulnerabilities that their risk management processes have failed to identify and address.
- Organization heads and chief operating officers should create an organization-wide operating committee to regularly identify major risks that could impede achievement of the agency's mission and objectives, prioritize these risks, and help to devise treatment plans to deal with the highest priority risks. They should encourage a culture of communication in the agency; establish a formal risk function; and enhance their budget processes so that they consider resources, targeted performance, and risk in an integrated manner.
- Inspectors general and other officials with oversight and audit responsibilities should meet with the agency's risk managers and determine how best to ensure that the effectiveness of the risk function can be evaluated without chilling the necessary flow of risk-related information to the agency-wide operating committee.

Step Two: Create Conditions for Risk Management to Be Effective

Whether an agency adopts ERM or merely focuses on specific types of functional risk, the agency head must work to ensure that information flows up and down the hierarchy so that risk-related information can flow to decision makers. To ensure information flows across the agency—and, indeed, to better manage the agency in general—the agency head should seek to assemble into a management team the heads of major units. It is also important to staff the risk function with the right people and tools. In the end, the quality of risk officers and their access to information are more important than the size of the office and its budget.

Step Three: Integrate Risk Management into Organizational Decision Processes

To be effective, risk management must actually inform organizational decisions. Integrating risk information into the budgeting and performance management processes allows the agency to allocate limited managerial and funding resources to remediate major risks that might otherwise prevent the agency from accomplishing its mission. Integrating risk management with strategic planning allows decision makers to integrate information about major risks into the agency's planning for achieving goals and objectives. The agency head can also ensure that the risk function is represented at the table at major specialized committees that the agency may establish according to its mission and structure.

Step Four: Protect the Risk Function

It is essential for the organizational head to protect the risk function, especially with respect to major players whose fiefdoms may expose the agency to serious risk. This was a pattern that distinguished firms that successfully navigated the financial crisis from those that went out of business or otherwise failed.

Step Five: Build Risk Awareness into the Agency's Culture

The organization head has the ability and opportunity, as the saying goes, to "set the tone at the top." This includes establishing a culture in which feedback is heard and respectfully considered. Building cooperation and collaboration into individual performance standards is a good way to encourage

staff, and especially senior officials, to accept and listen to feedback about risks. Encouraging constructive dialogue between unit heads and the risk function is another important step. The agency head will need to continue to nurture risk awareness as a cultural value so that it remains integral to the way people in the agency carry out their activities.

Step Six: Manage Organizational Change

Moving from traditional risk management conducted in functional and programmatic silos to truly collaborative ERM requires significant organizational change management. A complete set of policies and procedures reflecting best practices in ERM will be of little value if those called upon to execute the policies and procedures resist the required behavioral changes. An organization's culture must support ERM, if it is to be effective. ◘

TO LEARN MORE

Improving Government Decision Making through Enterprise Risk Management by Douglas Webster and Thomas Stanton. The report can be obtained:

- In .pdf (Acrobat) format at the Center website, www.businessofgovernment.org
- By e-mailing the Center at businessofgovernment@us.ibm.com
- By calling the Center at (202) 551-9342

This article is adapted from Young Hoon Kwak and Julia B. Keleher's "Risk Management for Grants Administration: A Case Study of the Department of Education" (Washington, DC IBM Center for The Business of Government, 2015)

Risk Management for Grants Administration: A Case Study of the Department of Education

Edited by Michael J. Keegan

The previous contribution to this forum introduced the concept of enterprise risk management, described the evolution of federal risk management approaches, and outlined six steps that government executives can take to realize the benefits of pursuing ERM within their departments. The final contribution to this forum offers a case study and is adapted from the IBM Center report, Risk Management for Grants Administration: A Case Study of the Department of Education, *by Young Hoon Kwak and Julia B. Keleher. The authors examine the experience of the U.S. Department of Education in implementing risk management initiatives and creating its Risk Management Service. Drawn from Education's experience, Young and Keleher present a series of lessons learned and recommendations for other agencies. A major lesson is that the use of an automated, data-driven risk assessment tool enabled the department to apply uniform and consistent risk assessment procedures and make better use of audit data. The authors also learned that effective risk management is an iterative process that requires thoughtful use of existing data sources and consistent efforts to incorporate new ones.*

Introduction

The Department of Education

The Department of Education's (ED) mission is to promote student achievement and prepare them for global competitiveness by fostering educational excellence and ensuring equal access to education. In order to realize its mission, ED offers grants to individuals, institutions of higher education, local education, nonprofits, state education agencies, and other organizations. Thirty-three years after its creation, ED dedicated its $68 billion budget in 2013 to:

- establish policies on federal financial aid for education and on the monitoring of those funds;
- make grants to states, school districts, and other organizations that provide education and related services;
- collect data on America's schools and disseminating research;
- focus national attention on key educational issues; and
- prohibit discrimination and ensuring equal access to education.

ED has outlined six goals in its 2014–2018 strategic plan. The first three goals focus on specific education program areas. The remaining three goals address the crosscutting efforts within ED. Risk management falls within the scope of the last crosscutting goal, which is to improve ED's organizational capacities to implement its strategic plan. Within this goal, ED has defined the strategic objective of improving the department's program efficacy through comprehensive risk management, and grant and contract monitoring.

Federal Grant Making

The federal government's discretionary grant programs are designed to enable agencies to accomplish their strategic performance goals and objectives. Federal agencies need to make effective use of grants management best practices and internal controls to ensure effective administration of these grant programs. In addition, agencies must maintain necessary policies and procedures to ensure compliance with applicable laws, regulations, and published priorities.

Federal agencies award discretionary grants through a competitive process. The government and the public expect the process of competing for federal grants to be fair, objective, efficient, and transparent. In addition, the process should be executed consistently across all grantees. Despite these expectations, a 2012 Government Accountability Office (GAO) study found that, when internal controls in grants management and oversight are weak, federal grant-making agencies face challenges in achieving program goals and ensuring the proper and effective use of federal funds. This finding suggests that efforts to examine the discretionary grant-making process and identify opportunities for improvement would be beneficial to grant-making agencies.

Department of Education's Approach to Risk Management

The Risk Management Service (RMS), which is housed within the Office of the Deputy Secretary within ED, is responsible for ensuring that the agency provides effective oversight of its discretionary grants. To this end, RMS develops and coordinates an agency-wide risk management strategy, which focuses on:

- ensuring high-quality management of ED's formula and discretionary grants;
- developing risk analysis tools and creating and codifying risk mitigation strategies; and
- providing training to increase the agency's internal capacity to engage in risk management.

Effective implementation of these strategies should enable grant-making program offices to administer grants in ways that bring about the realization of the intended education goals. In addition, these strategies promote prudent stewardship of public dollars.

For more than 25 years, ED has recognized the importance of assessing grantee risk. The Education Department General Administrative Regulations (EDGAR) establish how ED assesses and responds to risk. According to EDGAR, risk conditions are present if a grantee demonstrates:

- a history of poor performance or poor business practices,
- financial instability, and/or
- lack of a management system that meets the required financial management standards (EDGAR §§ 74.14 and 80.12).

ED incorporated the EDGAR risk assessment requirements into its Discretionary Grants Handbook (DGH). The DGH requires program officers to ensure before awarding federal funds that grant recipients are competent, responsible, and committed to achieving grant objectives. The DGH also establishes the requirement that program officers examine grantee audits before issuing a grant award.

Risk Management Across the Grant Life Cycle

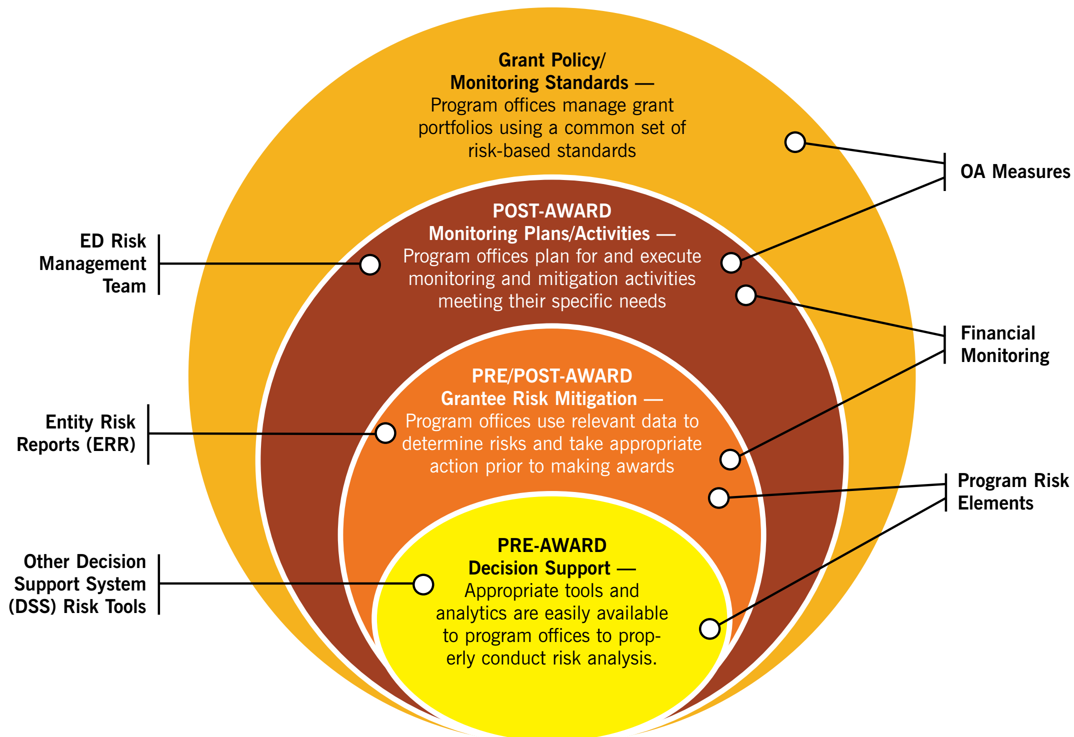
The foregoing description of risk management at ED has focused on risk assessments that are conducted prior to making a grant award. However, it should be noted that a risk designation can be made before or after a grant award has been made.

There are four phases in a grant's life cycle:

- **Pre-award:** The pre-award process involves reviewing submitted grant applications, making funding decisions, and preparing the grant award notice.
- **Award:** The award process involves creating the legal documentation required to make the grant award and notifying the grantee of the terms and conditions of the funding.
- **Post-award:** The post-award process begins after the grant has been awarded. This phase requires program officers to conduct various administrative, financial, and programmatic oversight activities.
- **Closeout:** The closeout process requires the grantee to report on the fiscal, programmatic, and other grants-related activities it has completed. During this phase, the program officers conduct activities to ensure that the grantee has complied with all other federal guidelines.

ED's approach to risk management across a grant's life cycle is presented in Figure 1. The strategy of formalizing the risk management practices in each aspect of the grant life cycle is

Figure 1: Risk-Based Grant Oversight at Department of Education



a recent development at ED. As such, the work to institutionalize this framework is ongoing and is considered a work in progress. Figure 1 is intended to clarify the risk management activities that should take place during the grant life cycle.

Figure 2 illustrates the application of ED's risk management practices for one grant program. The risk management practices are similar across most grant programs within ED.

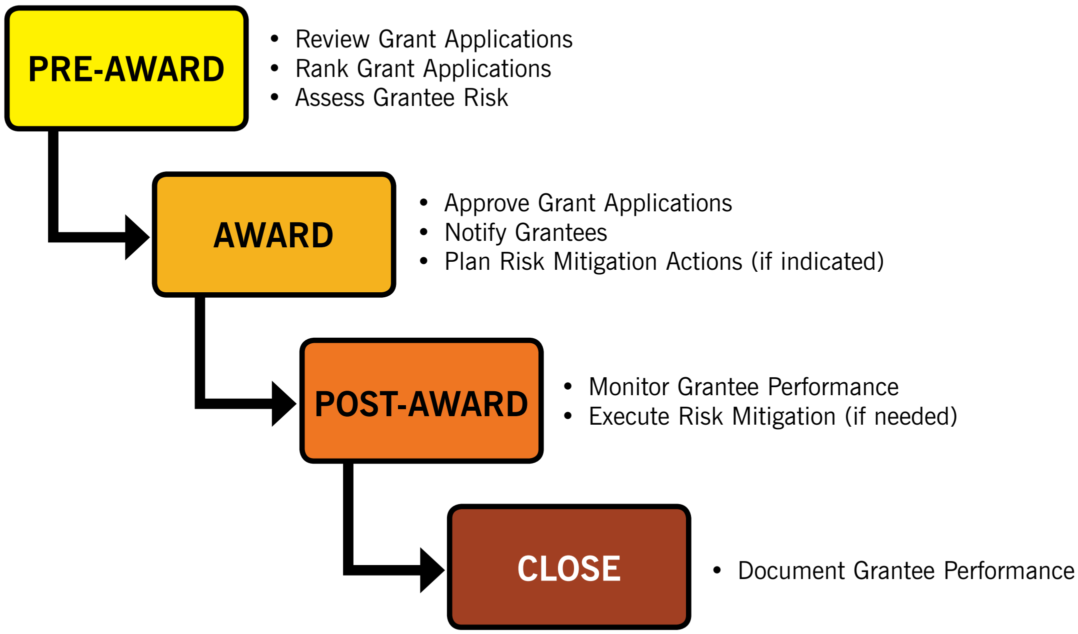
Creating New Risk Assessment Policies

In 2010, ED created an official policy requiring program offices to conduct more extensive pre-award risk assessments. This internal policy established an agency-wide requirement for program offices to assess an entity's risk by reviewing, at a minimum, prior and/or current financial and performance information. There were three driving forces behind the creation of this new policy. First, ED's risk policy affirmed the Obama Administration's commitment to ensuring effective stewardship of federal funds. Second, the creation of a policy requirement for risk assessment helped to clarify the role and importance of the RMS at ED. Third, the new risk policy provided a context for program offices to understand the relevance of the newly available risk assessment tools (called the Entity Risk Review (ERR), which is discussed in the next section). The 2014 version of ED's risk policy states that data in the Entity Risk Reviews are intended solely to provide information about applicants and/or grantees of awards funded by ED and, when used with other relevant information, to identify potential areas of risk. These reports are not intended to be the sole determinants of grantee risk; if a program officer identifies a potential risk, the officer must clarify how the risk will be mitigated.

Alignment Between Risk Management at ED and the New OMB Requirements

In comparing OMB's *Uniform Administrative Requirements* and ED's EDGAR and the Discretionary Grants Handbook, one finds a high degree of consistency and overlap. Both agencies' policies require an examination of a grantee's financial stability and internal management capacity and a review of audit data and historical performance. Finally, both agencies encourage the use of multiple data sources when assessing risk. One notable difference between the two agencies' policies is that only OMB has formalized risk criteria that take into consideration the unique aspects and characteristics of a grant program.

Figure 2: Risk Management Across the Grant Life Cycle



It took RMS several years to develop an agency-wide capacity to engage in grant risk management. The next section explains how RMS began the process of formalizing its approach to grant risk management and of disseminating these practices across the agency before creating new risk assessment policies and procedures.

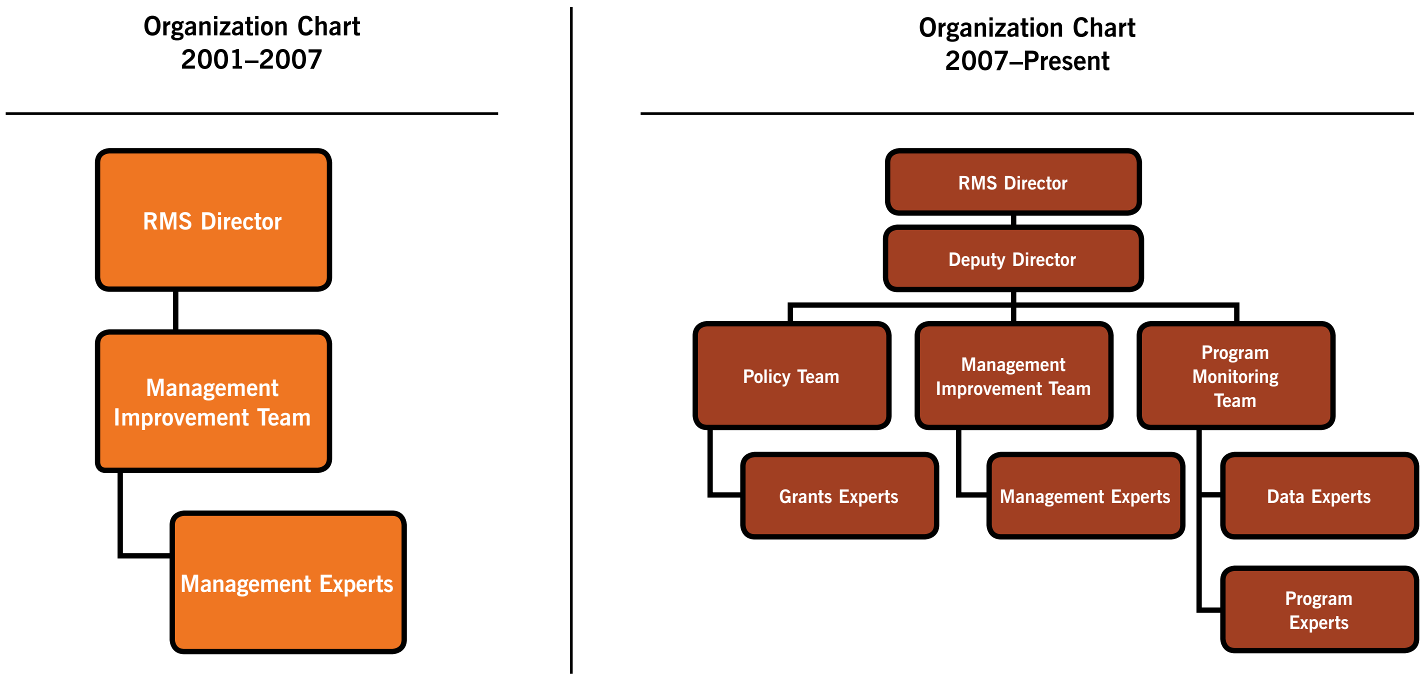
Operationalizing Risk Management at the Department of Education

The size and scope of risk management efforts has changed and expanded greatly since 2001. Figure 3 shows how the organizational structure and scope of work of the RMS has expanded over the past decade. In 2001, RMS had five employees, all of whom focused on management practice. Today, RMS has 25 members and three distinct teams: Management Improvement, Policy, and Program Monitoring. These three teams provide critical support to the grant-making process and enable the department to effectively administer its grants.

The Need to Improve the Effectiveness of Risk Designation

RMS identified several limitations to ED's approach to making risk designations using EDGAR and the Discretionary Grants Handbook criteria. The first limitation was the fact that this assessment and decision-making process was decentralized and nonstandardized. As a result, different program officers in different offices could review the same data and information on a grantee and make different determinations of risk. The second limitation was that program officers felt that the EDGAR criteria were not useful for programmatic risk determinations, because they only assessed serious failures of internal administrative systems, rather than programmatic capacity to implement a federal education program. The third limitation was that EDGAR and the DGH criteria did not establish clear performance thresholds to determine "poor performance" or "financial instability." These three limitations, when taken together, result in the creation of a risk assessment system that is largely subjective.

Figure 3: Evolution of RMS's Internal Organization



As a result, RMS sought to provide program officers with access to new types of data and information related to grantees' capacity to administer education programs. It also began to explore new ways of identifying other factors that inform assessments of grantees' future capacity to implement federal grants. These changes in approach marked the initial shift away from using risk management to respond to observed performance issues. The agency as a whole was beginning to search for a more proactive approach to avoiding or minimizing risk and increasing the likelihood of grantee success.

Creating New Risk Management Tools

State Score Cards

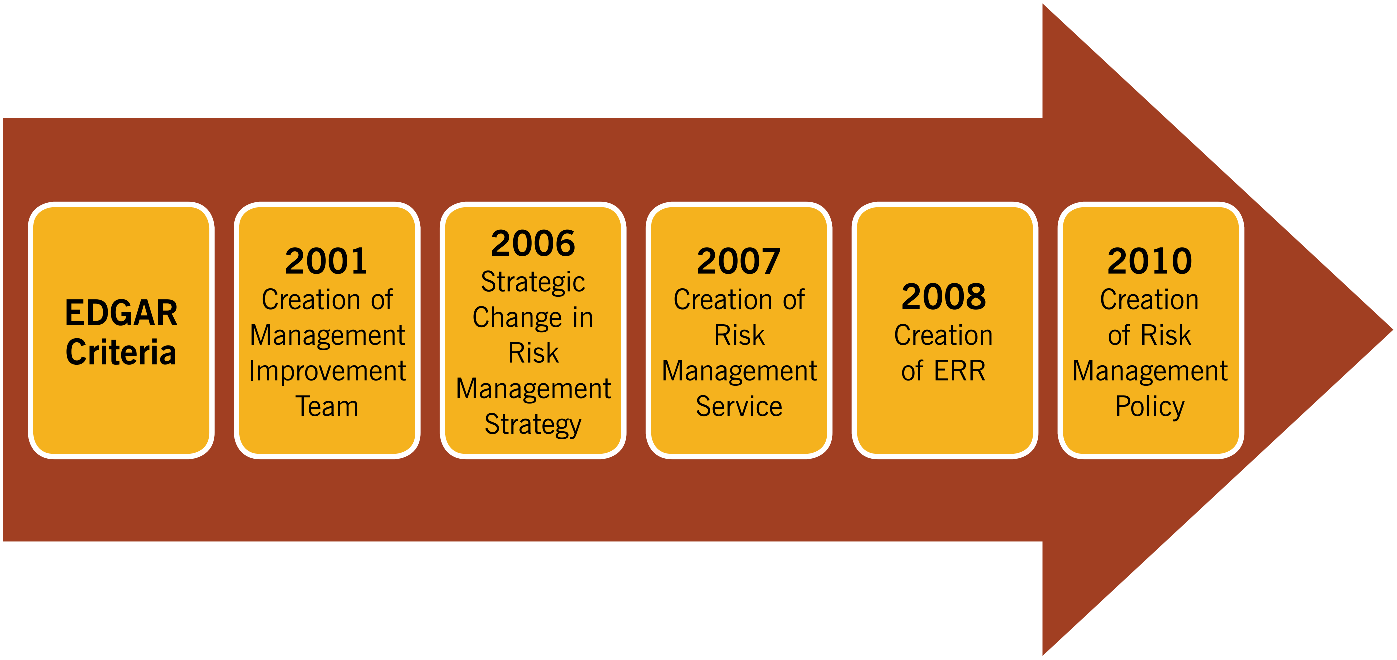
RMS's initial effort to standardize the collection and review of data to inform risk assessments was the creation of a state profile. To create the state profile, RMS staff had to sort through a variety of paper reports and collect individual data on states that received funding from ED. Once collected, this information was matched to fiscal data extracted from ED's grants management system. The determination of risk in a state profile was based on professional judgment about the significance of performance reported for each indicator. A formula was used to combine the assessment of programmatic, management, and fiscal indicators and create a risk assessment result. The risk assessment results were color-coded: red indicated high risk, yellow indicated moderate risk, and green indicated low risk.

Entity Risk Review

RMS began working on developing an automated method for extracting data from various systems to create these standardized reports. By late 2009, RMS had created a viable prototype of the new automated risk assessment tool, the Entity Risk Review (ERR). The ERR consolidated the disparate data sources into one report and included data from Dun & Bradstreet (DUNS), ED's internal G5, and FAC. Data elements within each of the three categories (administrative, financial, and internal control risks) were scored to create a risk indicator.

In order to help program officers incorporate the new risk assessment practices into their daily business activities, RMS

Figure 4: Evolution of Risk Management at ED



developed customized training sessions for each program office. These training sessions focused on teaching program officers how to analyze and interpret risk assessment data that were most relevant to their programs. The training sessions also included strategies and techniques for identifying and responding to grant-specific risks.

RMS continues to work on developing the agency's capacity to implement risk management principles. Program officers have requested additional training and guidance on the use of the ERR and effective mitigation strategies. The nature and complexity of this conversation continues to evolve and is much different from the types of conversations that took place in 2007. Since 2011, RMS has worked hard to improve the user-friendliness of the ERR. The original ERR was an Excel spreadsheet with various tabs. Program officers found the spreadsheet to be cumbersome and difficult to navigate. As of December 2014, RMS is finalizing a new delivery format for the ERR, using a web interface. During the past three years, RMS has made modifications to improve the ERR that have focused on:

- increasing the accuracy of indications of risk and
- reducing the instances of identifying risk that are not significant enough to require further investigation.

Additional efforts to enhance the ERR are focusing on ways risk analyses could be customized, based on program offices' needs.

Figure 4 summarizes the evolution of risk management services at ED. Our complete report highlights two case examples—the Detroit Public Schools and Puerto Rico Department of Education—that illustrate the application of ED's risk management practices. We describe how ED updated its long-standing approach to risk assessment to improve the effectiveness and efficiency of these business processes. These examples illustrate the evolution of risk management practices at ED. The cases begin with a description of the performance weaknesses each entity demonstrated. Next, the risk mitigation efforts provided for each entity are described. The cases conclude with a sample ERR report for each entity.

Lessons Learned and Recommendations for Risk Management in Grants Administration

This section concludes with a summary of the lessons learned from ED's efforts to incorporate risk assessment and risk mitigation practices into grants management. Based on our research, we present recommendations on how federal agencies can enhance the effectiveness of their risk management efforts and comply with OMB's new Uniform Administrative Guidelines.

There are four lessons learned from ED's risk management practices:

Lesson One: The department benefited by creating a defined and codified business process for managing risk in the department's grants portfolio.

Lesson Two: The use of an automated, data-driven risk assessment tool enabled the department to apply uniform and consistent risk assessment procedures and make better use of audit data.

Lesson Three: The department's success in implementing a department-wide enterprise risk management program required the creation of new internal policies and support from agency leadership.

Lesson Four: Effective risk management is an iterative process that requires thoughtful use of existing data sources and ongoing efforts to incorporate new ones.

Based on the lessons learned from ED, other agencies trying to implement risk management practices should consider the following:

Recommendation One: Agencies should move to a data-driven system to collect and manage data that can be used to make risk assessments.

Recommendation Two: Agencies should create tools and processes that facilitate program officers' interpretation of data and standardize the decision-making process.

Recommendation Three: Agencies should take advantage of the opportunity that the new OMB requirements create for improving risk management in awarding and overseeing federal grants.

Recommendation Four: The introduction of new risk management practices may represent change for some federal agencies and should be accompanied by training and capacity-building programs.

Managers and leaders in grant-making federal agencies can use the information presented in this report to improve or create new risk management practices. ED's example provides managers and leaders with important insights into how they should structure planning and implementation activities. It also highlights the importance of creating the infrastructure necessary to support the development and use of risk management policies and tools. Developing a better understanding of the experience of their colleagues at ED will enable federal grants managers in other agencies to develop risk management practices that result in more effective and compliant stewardship of federal funds among grantees. ◘

TO LEARN MORE

Risk Management for Grants Administration: A Case Study of the Department of Education by Young Hoon Kwak and Julia B. Keleher. The report can be obtained:

- In .pdf (Acrobat) format at the Center website, www.businessofgovernment.org
- By e-mailing the Center at businessofgovernment@us.ibm.com
- By calling the Center at (202) 551-9342