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Features:

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Leveraging Strategic Risk Assessments to Inform Strategic and Budgetary Decisions

by Denise Lippuner, CGFM, CPA & Ann-Cecile McDermott, CPA

A key responsibility of leadership is to understand an organization's strategies and the risks that are associated with those strategies, and to ensure the organization's risk management practices balance the amount of risk taken with the amount of value they are expected to produce. A systematic risk management approach is essential for making certain that scarce resources are assigned to address the most critical needs.

The Department of Defense (DoD) recently released the DoD Risk, Issue and Opportunity Management Guide for Defense Acquisition Programs that provides a five-step management process to understand, anticipate, and mitigate risks before they become issues, and recognize and pursue opportunities that may significantly benefit program outcomes. This process can be applied to the identification, assessment, and mitigation of risks related to strategy through a Strategic Risk Assessment (SRA), which serves as a means to inform both strategic planning and budgeting. As explained by the Risk Management Society, an SRA focuses on the identification and management of strategic risks — those risks that are most consequential to an organization's ability to execute its strategy, achieve its strategic objectives, and build and protect value. ***Conducting an SRA does not need to be a separate activity and can be accomplished by building upon existing risk management activities and focusing on the impact of strategic risks.*** The focus on strategic risk reinforces the direct relationship and critical link connecting strategic planning, budgeting, strategy execution, and risk management processes.[1]

Risks and the Strategic Planning Process

Strategy and risk are integrally related, and the success of any strategy is closely linked to an organization's understanding and command of risk. As stated in DoD Risk, Issue and Opportunity Management Guide for Defense Acquisition Programs, the most important decisions to control risk are made early in a program life cycle when program managers and teams must perform a detailed analysis to identify key risks. The purpose of an SRA is to focus on identifying strategic risks, allowing leadership to consider how each strategy will drive the organization to achieve objectives, allocate resources, and develop capabilities.

Figure 1: *Marine Corps Base Camp Pendleton, California — An Assault Amphibious Vehicles, with 15th Marine Expeditionary Unit, departs Red Beach during the Marine Air- Ground Task Force demonstration for the 75th Anniversary on Camp Pendleton, Calif., June 14, 2017*

[1] Mark L. Frigo and Richard J. Anderson, *Strategic Risk Assessment: A first step for improving risk management and governance* (New Jersey: Strategic Finance, 2009), 25-33.

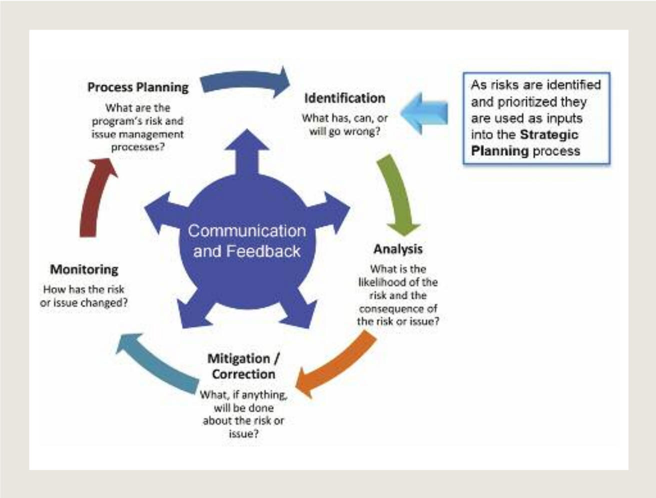

Figure 1: *DoD Risk and Issue Management Process Overview — Strategic Planning*

As risks are identified for each potential strategy, the top risks should be scored by determining the likelihood and consequence (i.e., impact) of each risk, resulting in a risk profile — those risks that could have the greatest impact to the organization's ability to achieve its strategic objectives. DoD policy requires programs to summarize the top program risks and associated risk mitigation plans in the Acquisition Strategy. The program Acquisition Strategy is then structured to mitigate these identified key risks. As leadership evaluates various alternatives to reach strategic goals, it considers the risks related with each alternative to determine how much risk the organization is willing to take on (its risk appetite) to obtain the expected value. ***Optimal risk-taking, or the "sweet spot," occurs when the organization is able to take enough risk necessary to obtain the most amount of value without taking on excessive amounts of risk.***[2]

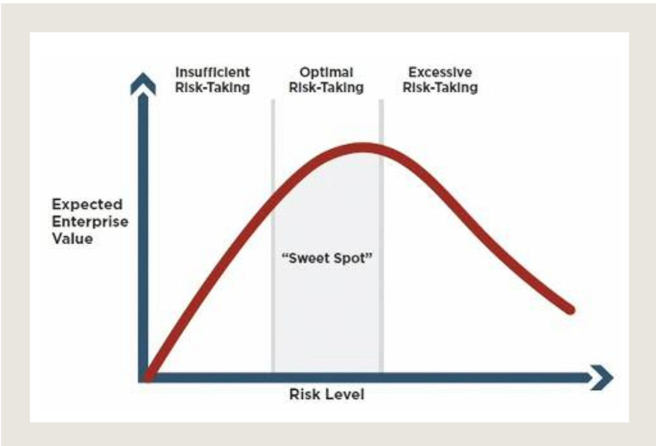

Figure 2: *Optimal Risk-Taking*

Risks and Budgeting

For the DoD, the Planning, Programming, Budgeting, and Execution (PPBE) process provides an established framework to support resource management decisions in accordance with annual requirements for the strategic and budgetary process including the GPRA Modernization Act of 2010 and OMB Circular No. A–11, Part 7. However, while laws, policies, and procedures specify how agencies will formulate their annual budget requests and execute their budgets, there is little guidance on how to ensure budgeting is aligned to the achievement of agency strategic goals and objectives. ***Conducting an SRA can provide the additional insight so that, as much as may be practicable, strategies and their associated risks drive programming decisions that lead to budgetary justifications.*** SRAs can be a useful tool to support the rationale for resource allocations. SRAs justify mission requirements in technical terms by explaining the associated risks and risk mitigations and the criticality of strategies being planned and those currently in place.

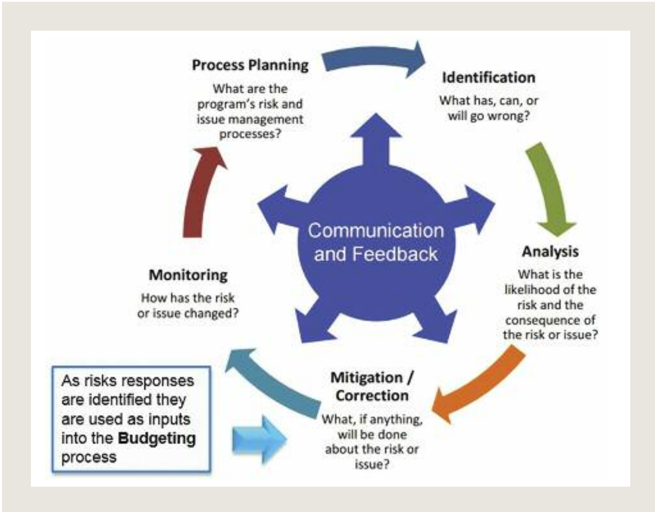

Figure 3: *DoD Risk and Issue Management Process Overview — Budgeting*

Conducting an SRA for USMC P&R

The Programs & Resources department (P&R) of the United States Marine Corps (USMC) is the principal staff agency responsible for developing, defending and overseeing Marine Corps financial requirements, policies, and programs to support the Commandant of the Marine Corps in executing his responsibilities as a Service chief. Throughout the PPBE process, P&R considers the strategic risks involved and includes these when developing a Program Objective Memorandum (POM). The POM includes an analysis of missions, objectives, alternative methods to accomplish objectives, and allocation of resources based on priorities and potential trade-offs, consequences, and risks. Additionally, throughout

[2] Dr. Patchin Curtis and Mark Carey, *Risk Assessment in Practice* (Committee of Sponsoring Organizations of the Treadway Commission, 2012)

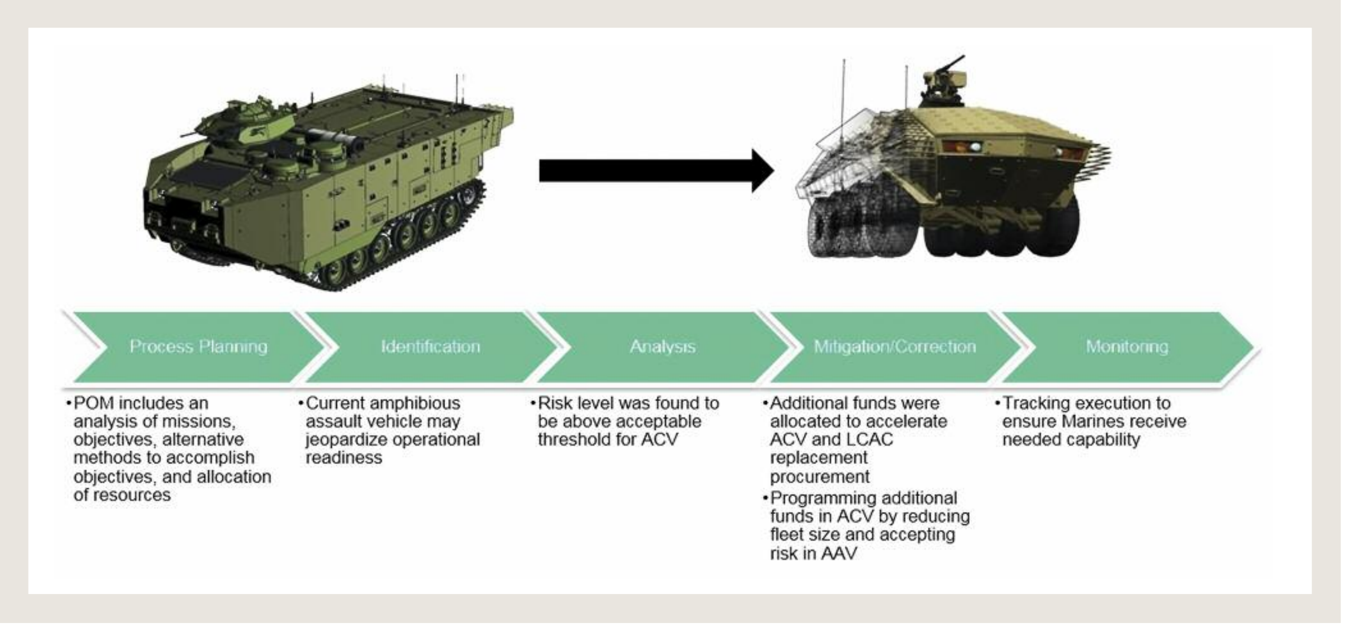

Figure 4: *P&R POM-18 SRA for ACV and AAV*

the PPBE process, P&R considers the tactical risks of ensuring that its expenditures support operational requirements and comply with approved guidance.

For example, the USMC is tasked with being capable of conducting a Marine Expeditionary Brigade (MEB) size force amphibious assault. The current amphibious assault vehicle (AAV), which is almost 40 years old, has been deemed inadequate to accomplish the mission and protect Marines in an evolving combat environment. Strategic Risk Analysis led to programming reprioritizations that reduced legacy platform AAV sustainment funding. The savings from this reprioritization were then allocated to other service priorities, including modernization investments such as the replacement amphibious combat vehicle.

Summary

Strategic Risk Assessments can be a useful tool to inform decision making as part of the strategic planning and budgeting processes. As part of the strategic planning process, you want to identify the risks to achieving your strategic goals and objectives. Consideration of strategic risks can help inform any alternatives or changes in strategy. As you evaluate various strategic alternatives to reach strategic goals, you should consider the risks related with each alternative to determine how much risk you are willing to take to obtain the expected value. Optimal risk-taking occurs when the organization is able to take enough risk necessary to obtain the most amount of value without taking on excessive amounts of risk. For budgeting, as much as may be practicable, operational requirements and risk levels, not the previous year's budget, should drive budgetary decisions. By leveraging Strategic Risk Assessments, budgetary decisions for resource allocation can be made based on the comparison of priorities and potential trade-offs, consequences, and risks .

Denise Lippuner, CGFM, CPA

Denise Lippuner is a partner at Grant Thornton and is responsible for leading its Public Sector Financial Management and Risk Advisory Services. She has presented at numerous conferences as a speaker on financial and risk management and is a contributing author on several books and research papers on these topics. Denise is also the Chair of the Corporate Advisory Group for the Association of Federal Enterprise Risk Management.

Ms. Ann McDermott, CPA

Ann-Cecile M. McDermott is the Assistant Deputy Commandant for Programs and Resources and the Fiscal Director of the United States Marine Corps (USMC). Prior to assuming her current position, Mrs. McDermott was the Assistant Deputy Commandant, Resources/ Fiscal Director of the USMC and she held other senior executive positions in the USMC and United States Air Force. Mrs. McDermott is a member of the American Society of Military Comptrollers, Washington Chapter. She is also a Certified Public Accountant (C.P.A.) and she holds a Level 3 Department of Defense Financial Management Certificate.