Enterprise Risk Management

2016 Federation of Tax Administrators Award

Management and Organizational Initiative

Department of
Revenue
Washington State

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Background

Like other state tax agencies, the Washington State Department of Revenue (Revenue) has an essential role in collecting the funds that help provide critical public services that citizens have come to expect. In the most recent fiscal year, Revenue collected and processed $20.8 billion in state and local taxes from 60 different sources.

With that comes the responsibility for Revenue to have in place safeguards that ensure every dollar collected is accurately accounted for and distributed to the right accounts. There is no room for error.

While local governments count on Revenue for accurate distributions to fund their services, the state legislature entrusts Revenue with collecting all the taxes due so it can budget for state operations. Getting it wrong at either level puts at risk funding for health care, education, better transit and increased public safety, among many other services.

And perhaps even more importantly, errors erode public trust in the agency and government in general.

Policies and procedures have long been the gold standard for organizations to establish protocols so the risk of mistakes is minimized. But Revenue has undertaken an approach to better identify and address the unique risks faced by a tax agency: enterprise risk management.

This discipline is part of Revenue's comprehensive performance management system and, even in its early years, has begun to demonstrate its value. It is a tool that can be used by state tax organizations across the nation.

Enterprise Risk Management

Enterprise risk management – also known as ERM – is widely practiced in the private industry, particularly the financial sector. Its roots can be traced back to the 1990s, when the Committee of Sponsoring Organizations of the Treadway Commission (COSO) first issued an internal controls framework. COSO built upon that foundation and issued in 2004 a complementary framework intended to help organizations identify and manage risk more effectively.[1]

During development of this new risk framework in the early 2000s, the country was rocked by high-profile financial scandals and failures that had widespread effects on shareholders and the public's trust. These events led to federal legislation such as the 2002 Sarbanes-Oxley Act and cemented the need for companies and boards of directors to clearly identify and manage the risks faced by their organizations. The financial industry meltdown that contributed to the Great Recession of 2008 further reinforced the need for ERM.

Around the same time COSO was creating the new framework, Washington legislators were faced with their own crisis: budgeting for a quadruple increase in tort payouts. That stark reality drew legislators to pass laws instituting risk management and loss prevention programs. In 2005, then-Governor Christine Gregoire signed an executive order declaring ERM to be a best management practice for state agencies to follow.

The central state agency responsible for implementing ERM began its research, finding no other state had yet undertaken the effort. While in use in private industry, ERM was practically non-existent in the government sector, leaving little opportunity to learn from government applications. That left the state and its individual agencies to find and adapt the risk model that best fit their work.

ERM also provided an additional challenge: change the cultural perspective of employees about their daily role in identifying and managing risk. For the first time, employees and leadership would be asked to not only work toward meeting traditional agency risk management goals, but also use a disciplined approach to identify and tackle the obstacles that could otherwise impede success.

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[1] Enterprise Risk Management — Integrated Framework www.coso.org/documents/COSO_ERM_ExecutiveSummary.pdf

Continuum of risk

Traditional risk models look at ways to insure against a potential loss. Consider car insurance. Individuals purchase a policy to cover themselves financially should they be involved in an accident. The risk is carried by the insurer.

A more sophisticated risk management strategy would be to purchase a vehicle with the most comprehensive package of safety features. The risk of driving remains, but the enhancements reduce the likelihood of personal injury in the event of an accident. An even more advanced approach might be considering how to avoid getting on the road in the first place, thereby eliminating any risk of loss due to an accident.

Realistically, life without driving or getting on a road would be nearly impossible. But an ERM approach forces one to examine all the opportunities to mitigate risk and still accomplish the same goal. Or at a minimum, understand the risks and then acknowledge the risk level one is willing to accept.

Good tax administration requires management to constantly test its willingness to take on risky but necessary projects. Not quite like driving a car during sleet, snow and five o'clock traffic, but pretty close to it.

Embracing ERM

Revenue began its ERM journey by evaluating divisional internal controls and taking steps to minimize identified risks and liability.

Shortly thereafter, the Governor's administration sent state agencies a self-assessment to assess their ERM maturity. As with most agencies, Revenue found itself at the intermediate level with significant opportunity for improvement.

Much of Revenue's early effort focused on human resources – mandating key training, conducting criminal history background checks on new employees and instituting an annual safety conference.

But agency leadership knew the risks faced by Revenue ran deeper than employee safety. With annual tax collections in the billions, Revenue's fiduciary responsibility was among the highest of all state agencies.

In 2006, the agency identified ERM as a strategic initiative in its Strategic Business Plan. Two years later, Revenue designated a full-time position to maturing the agency's ERM program and chartered an Enterprise Risk Management Steering Committee to provide development oversight of the risk management framework.

Unfortunately, the Great Recession interrupted Revenue's efforts, forcing the agency to cut and reallocate many non-revenue generating positions – including this one – and redirect staff to find every uncollected tax dollar to help the state fill the growing gap between declining state revenues and growing expenditures.

As critical as leadership believed ERM to be for increasing agency performance, there was no choice other than to continue integrating it at a division-by-division level for the time being.

Continuing the ERM journey

Once the recession showed signs of receding, Revenue's leadership again looked to centralize and expand its risk management program.

In 2011, the agency's organizational development manager was appointed to lead the program and brought the first risk assessment exercise to the Leadership Team. This body includes the division heads and several other key management positions.

The team used the tried-and-true approach of brainstorming the most significant risks at the strategic level. Division assistant directors first worked with their management teams to identify the primary risks they believed were faced by the agency and their division. They were asked to:

▶ Focus on risks at the strategic level of the organization

▶ Use defined risk bucket categories developed by the ERM Steering Committee to spark thoughts with their management teams

They also considered what would prevent the agency from being successful in achieving its strategic business plan goals or in carrying out its key processes. All of these risks were brought to a Leadership Team meeting for discussion and a vote.

While the first assessment provided some improvement opportunities, the value of the exercise came in bringing awareness to enterprise risks that might have otherwise been overlooked in a tax agency by continuing to look at risks in a "siloed" approach.

For example, the Leadership Team scored recruitment and retention as one of the highest risks. The exercise and its results provided a platform to establish action plans as well as a foundation for the steering committee to continue working on maturing the ERM framework.

In 2012, the state elected a new governor who prioritized the use of Lean practices to improve state government performance. While it had been necessary to combine enterprise risk with organizational development during the economic recovery, it meant the focus was spread thin for both efforts. Given the new administration's emphasis, Revenue decided to split these functions and hire separate staff.

As the time approached for the 2013 risk assessment exercise, each Leadership Team member was asked to provide the enterprise risk officer with 10 risks.

A team analyzed the submissions, sorting through more than 100 suggestions to reduce redundancy and consolidate similar ideas. Once the list was scrubbed, they clearly defined for each the risk topic, the most likely associated risk events and the potential consequence or opportunity.

The Leadership Team evaluated the final list using a "heat map" and voting technology, resulting in the selection of three agency priorities. The heat map helped the team see how their individual assessments for the likelihood of occurrence and potential impact of each risk resulted in a team score for each risk. This approach established the beginnings of a "risk register" used by the enterprise risk officer and leadership to monitor action steps and mitigation strategies. (See examples of the heat map on page 11 and Revenue's 2015 risk register on page 12.)

Aligning with the strategic business plan

2013 also marked the year Revenue took the step of aligning its enterprise risk assessment process with its strategic business plan. Conducting these simultaneously allows for seamless integration.

This approach evolved leadership's conversation from simply naming key projects and initiatives to one that incorporates the flip side of the strategic planning coin: identifying the possible obstacles, their likelihood of occurrence and what actions needed to be taken to ensure agency success. It also makes sure the top risks identified by leadership have appropriate resources assigned in a way visible to employees and stakeholders.

It also heightened leadership's awareness of how they see risk and sparked a conversation that is ongoing today about what can be lost when you have an agency that is so diverse in nearly every area of business.

Using ERM to address new initiatives

The agency's strategic business plan and enterprise risk assessment process only happen every two years. As a result, agency leadership made the decision to be deliberate in assessing risks and opportunities that emerge mid-cycle. This philosophy allows the agency director to designate new or re-prioritize existing risks that emerge between assessment cycles.

For example, in 2012, voters approved a legal recreational marijuana marketplace in Washington. As the impact of the initiative was understood by leadership, the agency director requested the newly hired enterprise risk officer (ERO) conduct a risk assessment on cash collection activities due to banking constraints with the marijuana industry.

Based on this assessment, the director took immediate steps to re-prioritize this risk from low to high, requiring a concerted implementation project and indepth project plan. Given that the risks were imminent, new teams were assembled to focus on tax collections; how to address the likely influx of cash as tender; security; accounting systems; segregation of duties in small customer service offices; and taxpayer education.

Implementation of the initiative has proven successful. Having a maturing enterprise risk program allowed the agency to think outside the proverbial box instead of immediately accepting the most traditional approach to the issues at hand. The teams brainstormed and evaluated all possible options to mitigate the risks of increased cash collections.

While some of the implemented solutions ended up being traditional ones, the conversations had evolved to be more expansive and creative to not only assess but minimize the agency's risk.

A $70 million risk

News organizations thrive on stories about high-profile government projects failing, generating public anger about the waste of taxpayer dollars. As revenue agencies look to replace their legacy tax applications, having an ERM program can increase the project's success.

Revenue is in the midst of its own major upgrade, the Tax and Licensing System Replacement project (TLSR). The technology Revenue currently relies upon to license businesses and collect taxes is severely outdated and at great risk of failure. Basic programming changes require intensive planning and testing to ensure the systems remain operational. There is a real threat of system failure that could interrupt the collection of hundreds of millions of dollars each month.

Add to that the age of the business licensing systems and inability to be as innovative in meeting our customers' needs. In all, the agency estimates the cost of a new, integrated system will be around $70 million.

ERM plays a role not only in this risk being prioritized as the agency's top strategic initiative, but also in the procurement process and implementation of the technology solutions.

Revenue used a risk management approach during procurement as it evaluated a need to reissue the initial request for proposal. As the procurement stage of the TLSR project ended, the project team began applying ERM-inspired methodologies to implementation planning, project management processes and organizational change management – all of which consider the broader enterprise view to mitigate risks, minimize surprises and increase the elements of success.

On an ongoing basis, the director and other key executive management receive regular status reports that contain information on identified risks and mitigation actions. Mitigation strategies include addressing identified risks such as end-user support, business readiness, project scope "creep" and staffing needs.

Revenue leadership is confident these methodologies and approaches applied through the planning, operating and monitoring aspects of this significant project have positioned the agency for a successful rollout of its first phase in late spring 2016.

Revenue's experience with ERM to date should interest other organizations embarking on major information technology efforts to help them realize successful project implementation.

Continued improvement

Never content to rest on its laurels, Revenue has continued to keep growing its enterprise risk management program.

Even though Revenue had developed a comprehensive risk assessment in 2013, the enterprise risk management program has significantly matured since then with completing the rest of its framework.

The ERO looked for, but was unsuccessful in finding, examples of risk assessment tools by other tax agencies. As a result, the tools Revenue created were inspired in large part by the private sector, including the financial services industry, oil and gas companies and a university.

This past year, Revenue has rounded out its ERM framework. The agency:

▶ Converted its risk "buckets" initially introduced in 2011 into a risk universe. This established a better framework to align with the agency's business and organize risks strategically. (See Appendix 1)

▶ Established a risk radar that provides a dashboard type view of the severity rating of the agency's top risks, with the value of showing the concentration and magnitude of the risks in which area of the agency's risk universe. (See Appendix 1)

▶ Expanded its risk register in a way that more comprehensively identifies action steps, the chosen risk treatment and treatment strategies for identified risks above a certain "heat map" score. (See Appendix 2)

▶ Developed its risk appetite to understand the relative amount of risk the agency is willing to take in key areas in pursuit of its goals.

From this effort, not only did the top three risks make their way into the strategic business plan, but the ERM program's own goals for risk reporting and risk monitoring strategies became key performance measures in the plan itself.

Revenue is proud of the fact that knowledge of enterprise risk principles is making its way through the organization.

At a recent project chartering meeting for Revenue's upcoming headquarters move, team members discussed how to make the identified risks a regular agenda discussion to ensure the team was deliberate in managing the risks by accepting, mitigating or finding different strategies for those risks.

Through a formal risk assessment, Revenue staff also recently reconsidered its use of federal tax information, identifying the agency's appetite for managing the risks associated with maintaining and using these data and the various options that would best fit that appetite.

Additional alignment

This past summer, the agency also created a Fundamentals Map identifying its core business processes, sub-processes and process measures. The Fundamentals Map provides a single-page view of the agency's core business processes. By identifying the sub processes that support these essential business functions, the map illustrates the complexity of the agency's work in a way that is easy to understand. It also helps team members connect their work to Revenue's mission and key goals.

The map includes outcome measures and process measures to gauge how well the fundamentals are being managed in comparison to performance targets, and to identify opportunities for improvement.

Enterprise risks can now be aligned to the key processes that are impacted and the associated process measures that could be jeopardized.

We believe that Revenue's work to integrate its strategic plan and Fundamentals Map with enterprise risks and risk strategies is creating a comprehensive performance management system that is enhancing Revenue's reputation as one of the best agencies in Washington state government and a national leader in excellence.
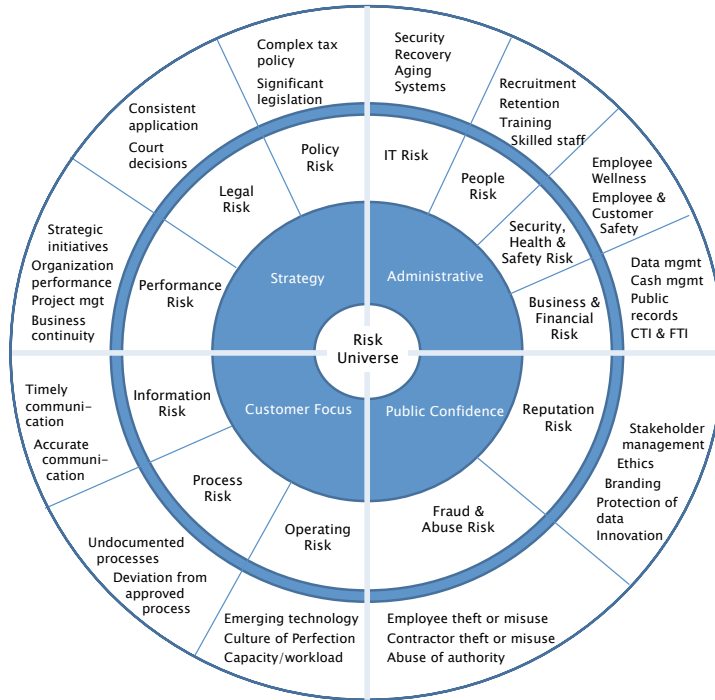
Risk universe

The inner circle shows the four areas that most closely represent Revenue's way of strategically categorizing its risks, further breaking it down with the associated types of risks in the middle ring. Finally, the outer ring shows a sampling of specific enterprise risk areas the agency identified and rated that correspond to those categories.
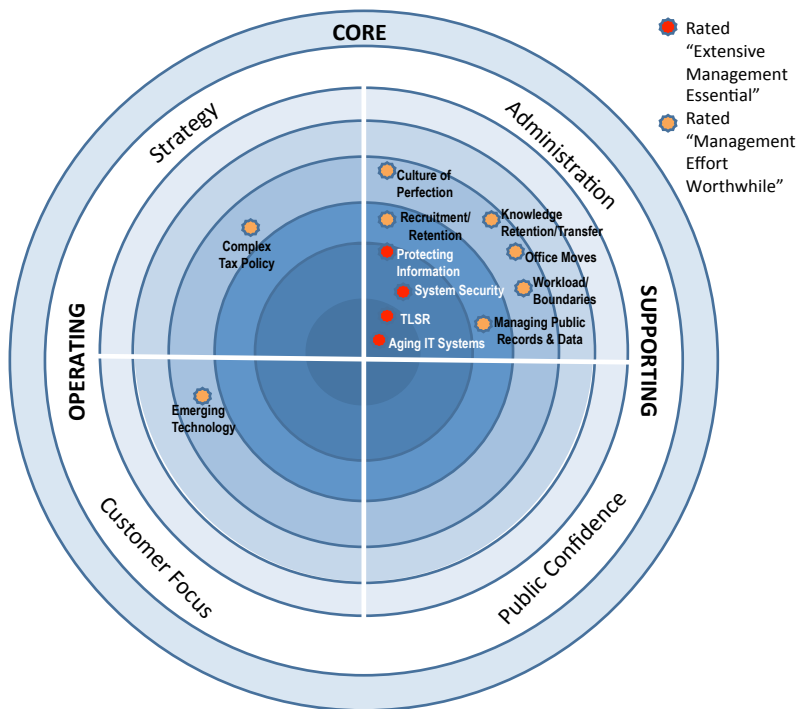
Risk radar

This risk "radar" was created by Revenue to show the highest rated risks by quadrant, helping show where the most resources and attention are needed.

HEAT MAP

A **heat map** is a tool to help evaluate risks across the organization and determine their relative value. Using numeric descriptors for each level of likelihood and impact ensure a consistent risk evaluation process throughout the agency.

			Risk Matrix		
			Impact		
Likelihood	**Insignificant (1)**	**Minor (2)**	**Moderate (3)**	**Major (4)**	**Catastrophic (5)**
Almost certain (5)	(5)	(10)	(15)	(20)	(25)
Likely (4)	(4)	(8)	(12)	(16)	(20)
Possible (3)	(3)	(6)	(9)	(12)	(15)
Unlikely (2)	(2)	(4)	(6)	(8)	(10)
Rare (1)	(1)	(2)	(3)	(4)	(5)

LIKELIHOOD SCALE

Descriptor	Likelihood of Risk Event
1 – Rare	The event will almost certainly **not** occur within the next two years.
2 – Unlikely	The event probably will **not** occur within the next two years.
3 – Possible	It is possible the event will occur within the next two years.
4 – Likely	The event probably **will** occur within the next two years.
5 – Almost Certain	The event will almost certainly occur within the next two years (it has happened before, happens frequently, or is expected).

IMPACT SCALE

Descriptor	Impact of Risk Event
1 – Insignificant	Very little effect seen on daily operations or meeting agency objectives.
2 – Minor	Effect(s) will cause minor disruptions in daily operations or meeting agency objectives.
3 – Moderate	Effect(s) will disrupt daily operations or impede the agency from meeting its objectives.
4 – Major	Effects(s) will significantly disrupt mission-critical operations or prevent the agency from meetings its objectives.
5 – Catastrophic	Effect(s) will cause mission-critical operations to cease or immediately stop the agency from meetings its objectives.

Risk register sample

Risk Title	Heat Map Score	Brief Description of Risk (Risk Event)	Risks to Manage/Mitigate (Consequence/Opportunity)	Treatment Chosen	Major Actions Taken (2013-2015)	Risk Owner	Support Staff	Status
Aging IT Systems	20 - Severe	Agency systems are old, complex and fragile; starting to fail; difficult to maintain; and hard to use.	- Inability to maintain (system failure, system errors) - Inability to implement changes - Inability to find programming staff - Inability to improve usability and expand online services	Reduce	- Began HP Nonstop upgrade - Began Windows 2012 server upgrade - Completed CAPS rewrite - Initiated legacy system replacement project (see #5) - Developed technology roadmap	David Sorrell	IT staff	Managing
Managing Public Records and Data	16 - Severe	Lack of consistency in search methods and guidance to staff on records retention could lead to inappropriate release of CTI or incomplete content.	- Inappropriate release of CTI - Incomplete records provided - Inappropriate content - Missed deadlines	Reduce	- Hired additional resources - Conducted Lean event - New records retention policy - New records retention Intranet site - Interviewed other agencies	Janet Shimabukuro	Public Records Unit Division Public Records Coordinators	Managing
Recruitment and Retention	16 - Severe	Inadequate compensation and an aging workforce could lead to high turnover rates and the inability to attract good candidates.	- Inability to hire good and diverse candidates - Inability to meet expectations of five generations in workplace simultaneously - Employees leaving DOR at higher than expected rates	Reduce	- Implemented recruitment/ retention plan strategies: - Enhanced Recognition Learning Ctr - Reinstated Tuition Assistance policy - Implemented veteran hiring program - Held Ops Team meeting/training - Lean event on recruitment - Enhanced NEO and Agency Overview training	Katie Gerard	HR staff ADs	Stable
Protecting sensitive and confidential information	12 - High	Inappropriate/ inadvertent release of personal or sensitive information about employees or taxpayers.	- Lawsuits - Damaged credibility - Employee investigations - Penalties (FTI) - Identity theft	Reduce	Related to #2 - Required training for all employees - Specialized training for employees working directly with CTI/FTI.	Janetta Taylor/Marcus Glasper		Managing
Tax distributions and allocations	12 - High	Erroneous or inaccurate tax distributions to local governments or allocations to dedicated accounts.	- Damaged credibility - Potential loss of $ if entity spends an over-distribution - Bad publicity - Increased workload from error corrections	Accept & Monitor	- Completed 6-year reconciliation for 17 of 18 dedicated taxes. - Began producing monthly detailed reports for majority 13 of the dedicated taxes.	Debra Conn/ Dan Contris		Managing
Knowledge retention and transfer	12 - High	Large percentage of experienced staff eligible for retirement in the next 5 years.	- Loss of institutional knowledge - Delays in fulfilling external requests - Impact on revenue, fairness, consistency - Decrease in customer service	Reduce	Related to #3 - Offer job shadowing - Encourage internal promotion - Increased documentation of processes	Katie Gerard		Managing

Fundamentals Map

MISSION
To fairly and efficiently collect revenues and administer programs to fund public services and advocate sound tax policy

VISION
To achieve the highest level of voluntary compliance and customer service through collaboration and innovation

VALUES
- Open Communication
- Integrity
- Cooperation
- Professionalism
- Respect
- Accountability
- Excellence

GOALS

Customer-Focused Service | Simple and Efficient Tax Collection and Program Administration | High-Quality Diverse Workforce | Correct and Timely Reporting and Payment of Taxes | Fair and Consistent Tax Policy Administration

OPERATING PROCESSES

CORE PROCESSES	Develop Tax Policy OP1	Assist Customers OP2	Maintain Customer Records OP3	Collect and Distribute Funds OP4	Administer and Enforce Tax Policy OP5	Manage Litigation OP6
PROCESS CHAMPION	Sr. AD Tax Policy	AD Taxpayer Services	AD Taxpayer Account Administration	Sr. AD Administrative Services	Sr. AD Operations	AD Appeals
SUB PROCESSES	• Coordinate policy development • Prepare fiscal notes and estimates • Perform economic, policy, and legal analysis • Analyze and draft legislation • Develop legislative proposals • Review, draft, and issue public guidance • Publish select determinations • Provide technical advice	• Provide education to customers • Provide information and assistance to customers and stakeholders • Develop and maintain customer relationships • Provide one-stop business licensing and registration • Administer unclaimed property	• Maintain customer information • Provide document imaging and data capture • Safeguard records	• Receive, deposit and record tax revenues, business licensing fees, and unclaimed property • Create and manage receivables • Track and reconcile tax funds • Create financial reports • Account for write-offs and adjustments • Distribute tax and licensing revenues	• Examine and process tax returns and business licensing applications • Enforce tax collections • Conduct business audits • Investigate underreporting • Negotiate and execute closing agreements • Conduct Rule 100 reviews • Issue permits • Review local administration • Conduct property appraisals • Equalize central assessments • Determine state levy • Administer exemptions and deferrals • Provide guidance and direction to local officials	• Conduct APA appeals • Issue decisions • Present cases during informal proceedings • Provide litigation support
PROCESS MEASURES	• Timely action on rules/interpretive statements • Timely analysis of legislation • Timely response to technicial asststance requests • Timely fiscal notes	• Timely application processing • Calls answered timely • Answer ruling requests • Taxpayers receiving assistance	• Timely public records response • Timely data capture • Records retention	• Accurate distributions • Timely refunds • Timely reporting • Cash payments	• Completed/timely audits • Mainstream appeals cleared • Small claims appeals cleared • Businesses involuntarily registered	• APA appeals cleared • Number of lawsuits

SUPPORTING PROCESSES

CORE PROCESSES	Manage Organizational Performance SP1	Support Employees SP2	Provide Information Technology SP3	Listen and Inform SP4	Provide Business and Financial Support SP5	Provide Organizational Assurance SP6
PROCESS CHAMPION	Director	AD Human Resources	Chief Information Officer	Communications Director	AD Business and Financial Services	Deputy Director
SUB PROCESSES	• Set goals and prioritize • Select strategic initiatives • Connect employees to goals • Manage operations • Manage strategic initiatives • Review organizational performance • Improve agency performance	• Recruit and retain employees • Onboard employees • Manage performance • Recognize accomplishments • Maintain employee/position information • Manage labor relations • Promote safety and wellness • Provide training and career development • Manage classification and compensation • Enhance culture through employee engagement	• Set IT direction and standards • Manage data/information • Ensure security • Provide business systems analysis • Conduct IT operations • Provide technology solutions • Oversee new system implementation • Provide for IT disaster recovery/business continuity	• Manage DOR reputation/brand • Build and manage external relations • Develop communication strategies • Create informational content • Deliver information • Manage communication channels	• Manage contracts • Manage purchase of goods and services • Manage inventory • Equip employees • Manage facilities • Oversee budget • Administer payroll • Manage mail services	• Formalize decisions (policies and procedures) • Identify and manage risk • Conduct internal control assessments • Provide advisory services • Conduct internal audits/reviews • Manage external audits
PROCESS MEASURES	• Performance contracts reviewed • Strategic initiatives completed • Lean projects	• New supervisor orientation • Timely evaluations • Timely development plans	• Percent uptime • Hours to resolution • IT risk assessments • Project completion	• Intranet articles • Ease of use • Timely media responses	• Timely document processing • Timely service request response • Inventory accuracy • Timely reporting	• Risks addressed • Findings addressed timely • Mitigation plans completed

OUTCOMES

Customer Satisfaction
- Overall satisfaction rating
- Timely customer service

Employee Satisfaction
- Turnover rate
- Employee satisfaction

Voluntary Compliance
- Voluntary compliance rate

Effective Enforcement
- Total enforcement collections

Sound Tax Policy
- Legislative changes adopted
- Decisions upheld

Operational Health
- Fiscal health
- Annual certifications
- External audit findings

Cost Effectiveness
- Cost of collections

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