



**CORPORATE
EXECUTIVE
BOARD**

™

WHAT THE BEST COMPANIES DO

Government Practice

Key Risks for Government Auditing in FY2012

**Presentation to the FAEC
February 16, 2011**

**Sampriti Ganguli
Managing Director, CEB
gangulis@executiveboard.com**



AGENDA FOR TODAY'S PRESENTATION

- A View from Federal CXOs – 1:00 - 1:15
- A Closer Look at Misconduct - 1:15 – 1:30
- Best Practices & Case Profiles – 1:30 – 1:45
- Question & Answer – 1:45 – 2:00

OVERVIEW OF THE CORPORATE EXECUTIVE BOARD

Practice Areas and Individual Memberships of the Corporate Executive Board

FINANCE AND STRATEGY PRACTICE	FINANCIAL SERVICES PRACTICE	HUMAN CAPITAL PRACTICE	IT PRACTICE	LEGAL PRACTICE	SALES, MARKETING, AND COMMUNICATIONS PRACTICE
CFO Executive Board	Council on Financial Competition	Corporate Leadership Council	CIO Executive Board	General Counsel Roundtable	Marketing Leadership Council
Audit Director Roundtable	Business Banking Board	Benefits Roundtable	Infrastructure Executive Council	Compliance and Ethics Leadership Council	Market Research Executive Board
Controllers' Leadership Roundtable	Insurance Advisory Board	China HR Executive Board	Applications Executive Council		Customer Contact Council
Investor Relations Roundtable	Investment Management Executive Council	Learning and Development Roundtable	Information Risk Executive Council		Integrated Sales Executive Council
Shared Services Roundtable	Operations Council	Recruiting Roundtable	PMO Executive Council		Communications Executive Council
Tax Directors Roundtable	Retirement Services Roundtable	Compensation Roundtable	Enterprise Architecture Executive Council		
Treasury Leadership Roundtable	VIP Forum				
Government Finance Roundtable					
Risk Integration Strategy Council					
Corporate Strategy Board					
Procurement Strategy Council					
Real Estate Executive Board					
Research & Technology Executive Council					

Corporate Profile

- More than 2,800 companies worldwide are represented in our member network
- More than 80% of Fortune 500 companies belong to one or more of our membership programs
- Full time staff of more than 2,500 are located in our six offices worldwide

THE VIEW ACROSS THE FEDERAL CXO SUITE

Chief Financial Officers

- Programmatic Constraints & Decision Rules for Tracking Program Performance
- Shared Services
- Putting financial systems on 'hold'
- Performance Benchmarking
- Finance IT Dependency

Chief Information Officers

- Tech Stat Reviews
- Collaboration Technologies
- Shared Services
- OMB 25 Point Plan
- Aligning Technology Cycle with Acquisitions process
- Flexible IT Budgeting and Agile Development

Chief Human Capital Officers

- Succession planning
- Hiring reform
- Performance management / productivity
- Supervisory/ manager training
- Change management/ reorganization

Chief Acquisitions Officers

- CR delay and resultant acquisitions compression
- Changing nature of contract types
- Performance Metrics
- Savings Identification
- Developing highly qualified acquisitions professionals

Even the best risk management model or process is only as strong as the people supplying the initial inputs.

- Risk management process is important but should not be fundamentally elevated above creating a risk-addressing culture that improves business decision making.
- Even as these risk management lessons are considered, the consequences and likelihood of compliance risk have increased through:
 - Greater regulatory enforcement and fining authority
 - Rising regulatory complexity and scope of doing business
 - Pressure for new revenue in slow growth economies

LESSONS FROM RECENT RISK MANAGEMENT FAILURES

1 Elevating Process Over Judgment—
Risk management often devolves into a “check-the-box exercise” that, at worst, diffuses—rather than enhances—accountability for risk.

2 Fighting the Last War—Managers tend to focus on risks that are most recent and familiar to them as opposed to looking for new, over-the-horizon risks.

3 Succumbing to Herd Behavior—
Corporate and individual incentives lead organizations to closely follow the trends and business decisions of peers.

4 Siloing Information—Managers often fail to seek or heed contrary information from a different perspective.

“With hindsight we can now see that the risk management catastrophes of the past three years were not due to insufficient investment in IT or analytic systems, but the failure to bring collective human judgment to bear on critical decisions. In fact, companies’ current focus on compliance process—in reaction to regulatory zeal—is likely to give Boards and shareholders false confidence about their risk defenses.”

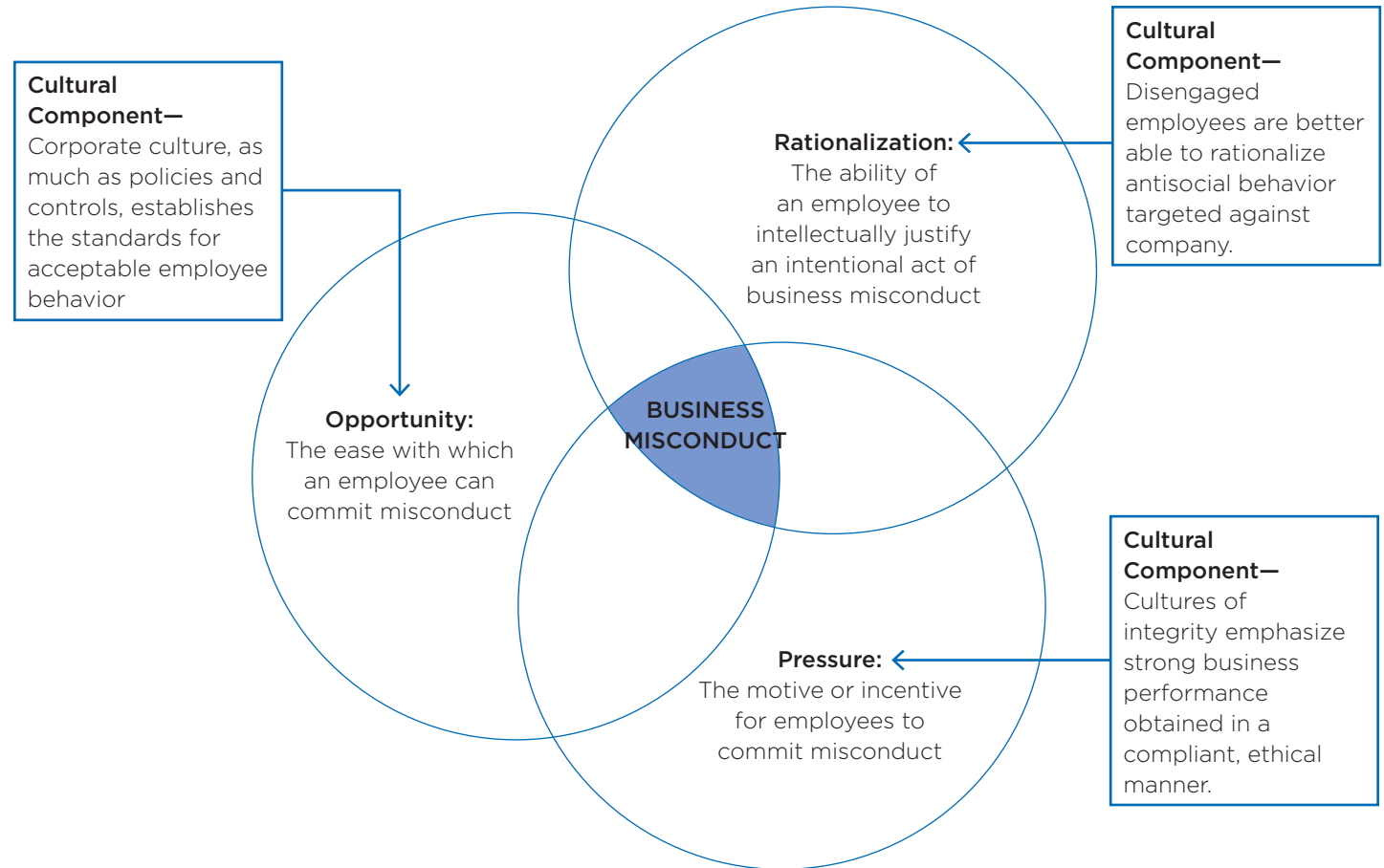
Tom Monahan
CEO, The Corporate Executive Board Company

While noncompliance and misconduct stem from many factors, organizational culture, not process failure, often lies at its root.

- Pressure and rationalization can be reduced by promoting a strong sense of ethical behavior amongst employees and creating a positive work environment.
- Past CELC research found that the most significant forms of noncompliance stem from intentional employee actions, suggesting the limits of control and awareness based mitigation strategies.

CULTURE IS A ROOT CAUSE OF MISCONDUCT

Three Underlying Conditions for Business Misconduct and Their Cultural Components



Source: Based on the Fraud Triangle, developed by Donald Cressy.

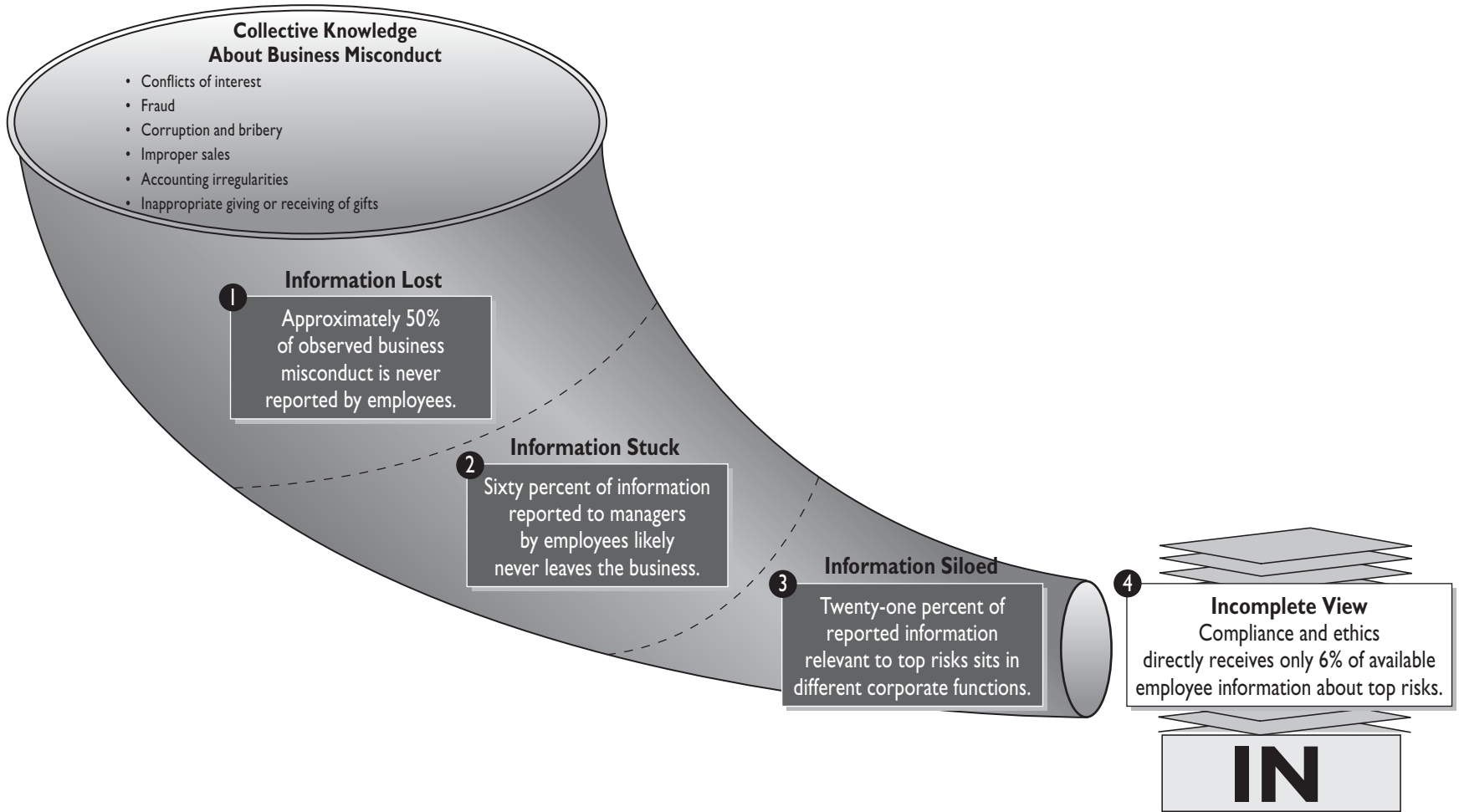
INFORMATION TRAPS: IN REVIEW

INFORMATION LOST, STUCK, AND SILOED

Relevant information about (potentially damaging) business misconduct degrades significantly as it travels across the company, reducing compliance’s ability to detect key risks

How Information About Business Misconduct Travels*

Council Schematic of Information Flows



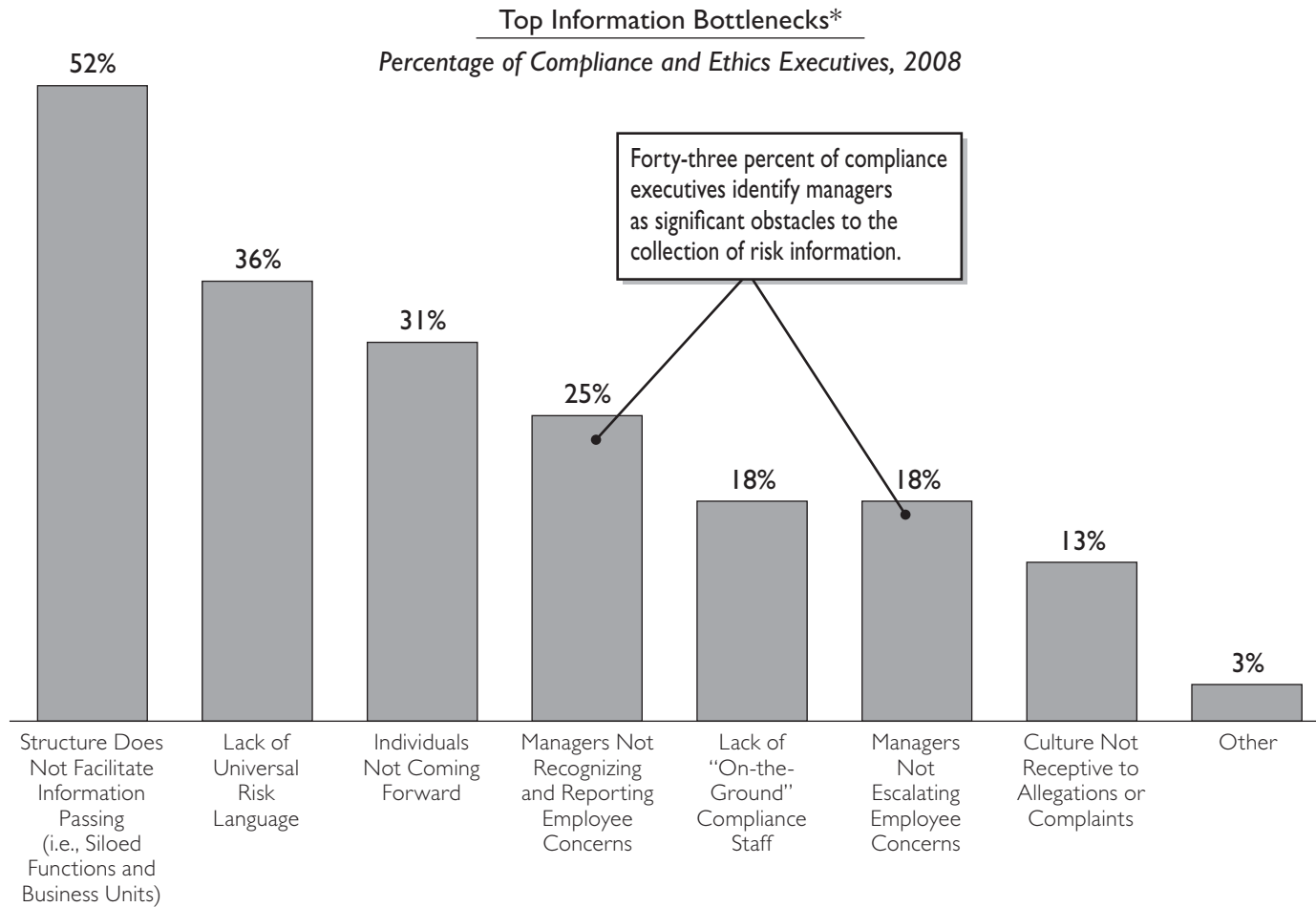
* Top risks include accounting irregularities, bribery and corruption, fraud, inappropriate giving or receiving of gifts, improper sales, and conflicts of interest.

Top Information Bottlenecks:

Effective risk management practices rely strongly on the timely flow of critical information across complex organizations, yet most companies find it difficult to remove bottlenecks that impede the travel and capture of relevant risk intelligence. More than 50% of compliance and ethics executives point out that existing organizational structures form a significant obstacle, while 43% indicate that managers don't possess the proper risk management mind-set, failing to recognize and escalate emerging issues or concerns.

WHY DIDN'T I KNOW?

Organizational structure and inconsistent language standards serve as impediments to the capture of risk information



n = 114.

* Maximum of two responses permitted.

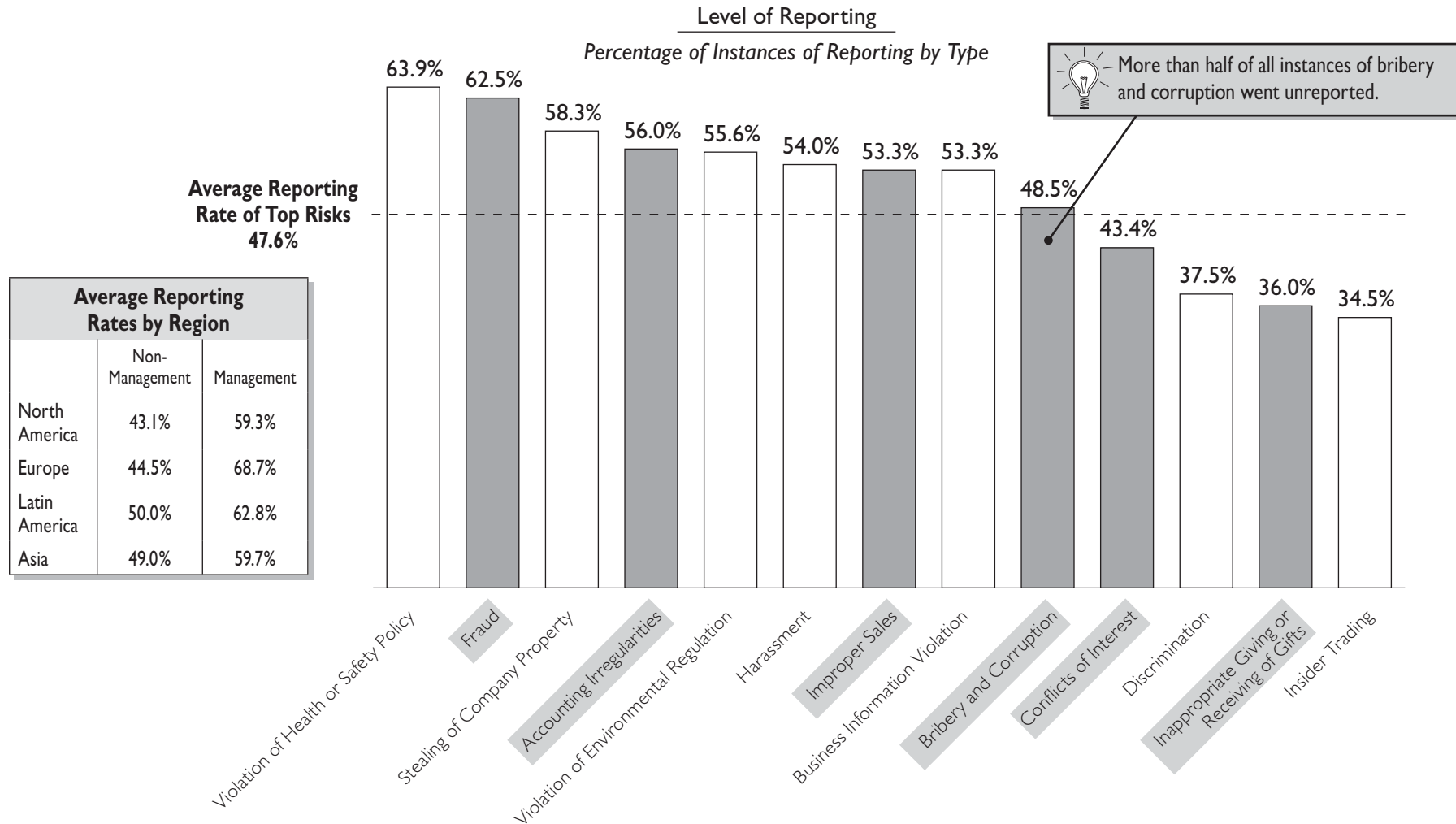
Source: Compliance and Ethics Leadership Council research.

Information Trap #1: Employees Fail to Report Majority of Observed Business Misconduct

Employees, who represent the largest source of untapped information about your top risks, often do not report observed misconduct in critical risk areas, and, as a result, critical risk information gets lost. Less than half of employees decide to report misconduct in critical areas such as bribery and corruption and conflicts of interest. It is important to note that rank-and-file employees across regions are much less likely to report misconduct than management.

SOUNDS OF SILENCE

Critical information impacting key compliance risks is lost, as nearly half of all employee observations go unreported



n = 20,941 instances of observed misconduct.

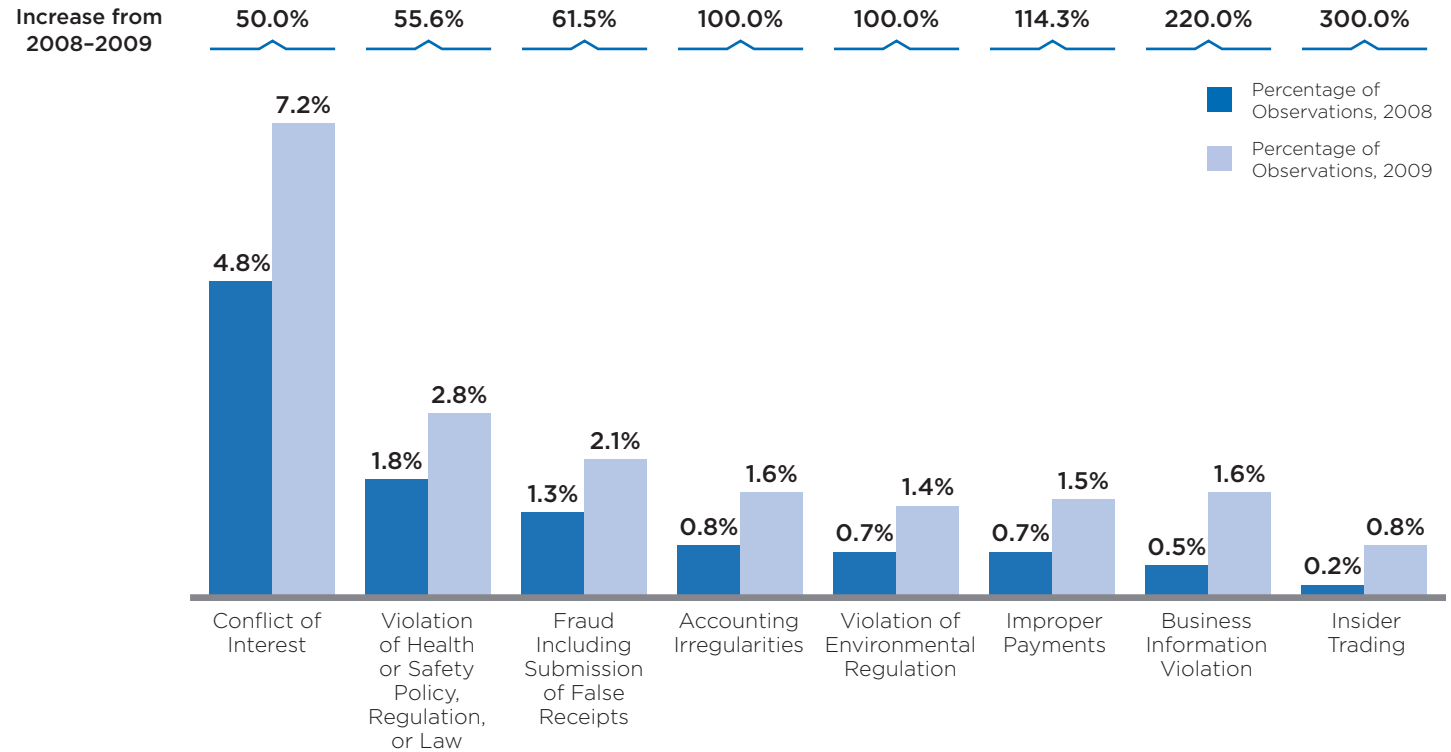
Source: Compliance and Ethics Leadership Council research.

Our 2009 data indicate that misconduct in high-risk compliance areas has increased significantly from 2008 levels.

- The disturbing trend in high risk compliance areas is hidden by the fact that overall levels of misconduct have declined from 2008-2009. This decline can be explained by a decline in HR-related types of misconduct like Inappropriate Behavior, Harassment, Discrimination, and Preferential Treatment.
- Compared to 2008, overall observed misconduct rates were down during the first half of 2009.
- In 2008, misconduct observation rates were 18.7% and 17.8% for managers and non-managers, respectively.
- During the first half of 2009, the misconduct observation rates were 16.4% and 13.3% for managers and non-managers, respectively.

TROUBLING INCREASES IN MISCONDUCT

Level of Observed Misconduct
Percentage of Respondents, by Institution



n = 65,683 Employees in 2009; 174,000 Employees in 2008.

¹ All questions were coded or recoded in such a way to directionally be on the same scale.



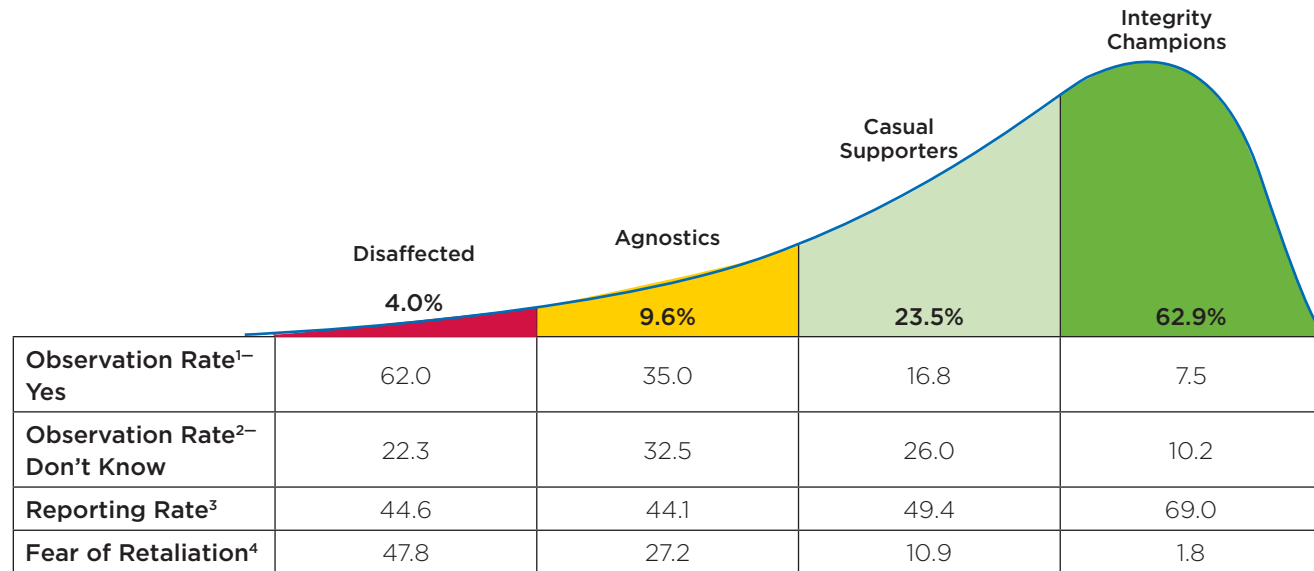
Category definitions:

- **Integrity Champions:** Employees in this group responded, on average, either Agree or Strongly Agree to all 18 questions that make up the Integrity Index.
- **Casual Supporters:** Employees in this group responded, on average, Somewhat Agree to all 18 questions that make up the Integrity Index.
- **Agnostics:** Employees in this group responded, on average, Neither Agree nor Disagree to all 18 questions that make up the Integrity Index.
- **Disaffected:** Employees in this group responded, on average, Somewhat Disagree, Disagree, or Strongly Disagree to all 18 questions that make up the Integrity Index.

INTEGRITY RISK ASSESSMENT

First Half 2009 Benchmark

Percentage of Respondents in Each Category



n = 65,683.

¹ Percentage of employees within category who observed misconduct in past year.

² Percentage of employees within category who responded "Don't Know" when asked if they had observed misconduct over the past year.

³ Percentage of employees within category who reported the misconduct they observed.

⁴ Percent of employees who stated that they would not report misconduct because they were concerned they would experience retaliation.



Disaffected employees are 10 times more likely to have concerns about reporting.

- When asked if they had concerns about reporting or raising concerns about misconduct, 76.8% of Disaffected employees had concerns about reporting or raising concerns while only 7.3% of Integrity Champions had concerns
- Disaffected employees' primary concern: **Didn't trust the people that they work with to respond appropriately**
- Integrity Champions' primary concern: **Unsure how people would respond**

DISAFFECTED VERSUS INTEGRITY CHAMPIONS

Comparison of Characteristics

Disaffected


- More likely to be non-management level employee
- Tend to be less-tenured employees (1-10 years)
- More concentrated in functions with non-manager/hourly employees like manufacturing/plant workers, technicians, quality control, and clerical/administrative

Integrity Champions

- More likely to be senior level management
- Tend to be brand-new employees (less than a year) or more tenured employees (more than 10 years)
- More concentrated in functions with larger numbers of professional employees and also those employees whose job it is to sell and market the company, i.e., Legal, Corporate Administration, Marketing, Market Research, and Sales/Commercial

Centene formally integrates its cultural assessment into risk assessments and business unit strategic plans.

- Centene integrates cultural survey results into its “Level of Control” rating.
- The Ethics and Compliance Risk champion is responsible for updating enterprise risks on a quarterly basis.

 “We were able to correlate our cultural diagnostic results with substantiated violations. Culture has indeed proven to be a leading indicator for compliance risk and is therefore an important aspect of our risk assessments.”

Robert Miromonti
Vice President
Ethics & Compliance,
Centene Corporation

From the COMPLIANCE AND ETHICS LEADERSHIP COUNCIL™ of the LEGAL AND COMPLIANCE PRACTICE
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INTEGRATING CULTURE INTO RISK ASSESSMENTS



Monthly Risk Assessments for Business Unit A

Cultural Diagnostic Survey results are one of several standard rating criteria (including policies, training, and controls testing) Centene uses to measure “Level of Control.”



Legal Risk	Risk Likelihood Scale: 10 = High Risk 1 = Low Risk	Risk Severity Scale: 10 = High Risk 1 = Low Risk	Level of Control Scale: 100% = Effective Control 0% = Ineffective Control	Remaining Risk Exposure ¹
Competition Law	4.0	10.0	60%	16
Contract Compliance	8.0	7.0	95%	3
Fraud	4.0	6.0	50%	12
Privacy Laws	8.0	5.0	40%	24

Corporate Culture:

- Serves as a mitigating control supporting integrity in business practice
- Is a forward-looking indicator of misconduct
- Improves prioritization of corrective action planning
- Identifies the root cause of underlying systemic compliance failures

¹ Remaining risk exposure is calculated as (risk severity × risk likelihood) × (1 – level of control).



NASA implemented a business process reorganization that resulted in the consolidation of a wide range of services.

- NASA successfully recuperated their \$30M investment and are currently exceeding initial savings projections of \$6-\$8 million per year and on track to recognize savings in excess of \$12 to \$16 million a year.

CONTINUOUS IMPROVEMENT: NASA'S SHARED SERVICES CENTER

Business Area	Services to Be Consolidated
Financial Management	<ul style="list-style-type: none"> Accounts Payable (Payroll, Travel, Vendors) Payment Certification Accounts Receivable (Billing, Collection) Payroll, Time, and Attendance Labor Processing and Distribution Financial Reporting (General Ledger, Treasury 224, NF-1018s) Reimbursable Accounting (Collections, Closeouts) Internal Reviews for NSSC/F Office
Human Resources	<ul style="list-style-type: none"> Personnel Program Support Employee Development and Training Support Employee Benefits and Services HR Information Systems and Report Personnel Action Processing and Record Keeping
Information Technology	<ul style="list-style-type: none"> IFM Competency Center Services NASA's Computing and Communications Services ODIN Program Management Services
Procurement	<ul style="list-style-type: none"> Transactional Services (Grants, Cooperative Agreements, and SBIR/STTR Processing) NSSC Major Contracting Operations Workforce Development and Management Operations Procurement Electronic Business Systems

Initial Estimated Annual Cost Savings for Transitioned Audit

	Total Annual Cost Savings
Financial Management	\$4.6 M
Human Resources	\$2.9 M
Information Technology	\$0
Procurement	\$1.1 M

The Department of Commerce established a Department Management Council to design a performance-based budget process.

- Program heads and CFOs ranked all of the programs in the Department using a forced distribution format.
- This process helped establish new working relationships between the CFO community and policy makers, bureau heads and program managers.

PRIORITIZING PROGRAMS: DEPARTMENT OF COMMERCE



Principles

1. Transparency
2. Accountability
3. Integration

Objective

To align resources with strategic priorities—reduce the deficit and increase investment in the highest priority programs while reducing resources in lower priority programs.

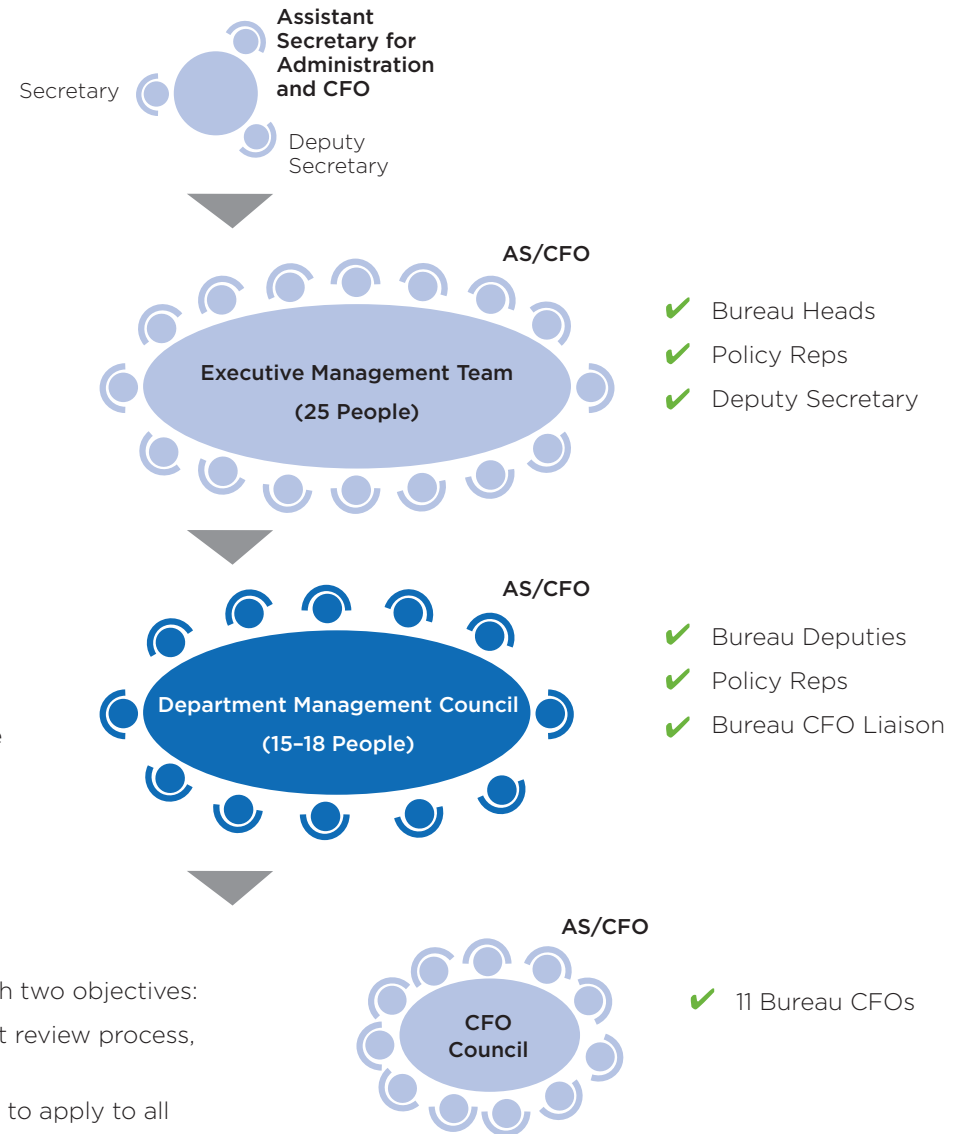
Process

The DMC charged bureau level CFOs with two objectives:

1. Recreating the program and budget review process, and
2. Developing sets of universal criteria to apply to all strategic, and another to all enabling, programs.

Timeline: Six months

Source: Department of Commerce and CEB Government Practice research.



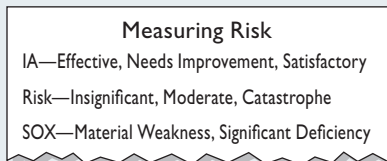
Lean-Integrated Assurance

Zurich employs an integrated assurance model that avoids high up-front costs and focuses on assurance coordination, coverage, and quality

Barriers to Successful Integrated Assurance

Zurich's Approach to Achieving Effective Integrated Assurance

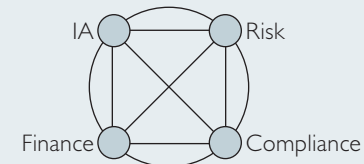
Complex Risk Language Harmonization Efforts



Companies engage in protracted risk language harmonization efforts and invest in costly technology.



Rules-Based Assurance Coordination



Assurance partners develop an integrated assurance model focusing on coordination rather than formulized risk information sharing.

Overemphasis on Assurance Redundancy

	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A
Underwriting	X	X	X	X		X		X		X	X	X	X		X	X	X	X	X	X

Companies focus only on eliminating redundant assurance work and saving costs, ignoring potential gaps in coverage.

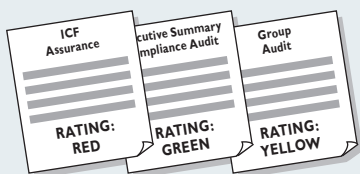


Assurance Coverage Map

5	Product Development																				X
6	Actuarial			X				X													
7	Investments																				

Assurance partners map past assurance coverage to quickly reveal coverage gaps and deliver broader coverage.

Conflicting Assurance Reports



Multiple assurance reports with conflicting findings and recommendations confuse stakeholders.



Integrated Reporting



Audit produces one report, combining the findings and recommendations of its assurance partners.

Source: Zurich Financial Services Group; Audit Director Roundtable research.

Building Guidelines, Not a Language

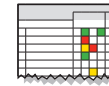
Assurance partners base their coordination on agreed-upon guidelines...

...and develop clear goals for integrated assurance activities...

ZURICH'S SHARED-ASSURANCE OPERATING PRINCIPLES

- **Respect Assurance Mandates.**
Any function can conduct assurance activity at any time and issue a report—no assurance partner holds veto power over another.
- **Rely on Assurance Partners.**
Any assurance partner can ask another function to ask questions or request documentation during the course of proposed assurance activity.
- **Hold Multilateral Assurance Meetings.**
Integrated assurance meetings should have representation from all assurance providers.

Key Assurance Goals



Review all activities in past quarter.



Highlight and review the current areas of concern for management.



Develop a common view of business risk themes.



Agree on required management action.



Agree on future assurance activity to ensure broad and efficient coverage.

...while avoiding the difficulties of a formal risk language

CONVERSANT IN RISK, FLUENT IN COMMON SENSE

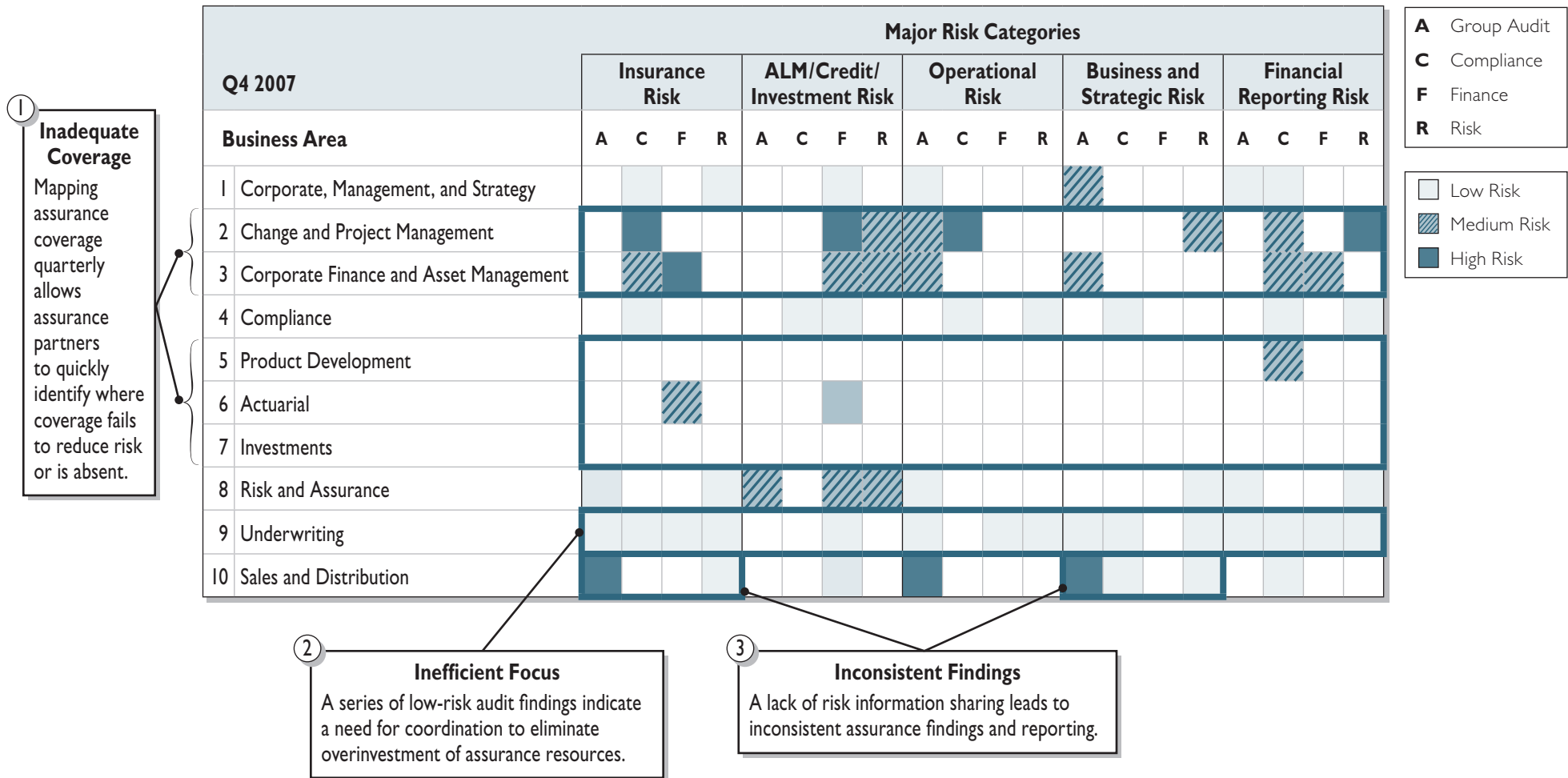
“By simply asking what keeps you up at night, we realized that everyone at the table had the same understanding of a top risk, whether it was explicitly defined or not. By focusing on that commonality of understanding, we were able to share information effectively without getting buried under a risk language harmonization effort.”

Mike Taylor
Group Audit COO
Zurich Financial Services Group

Mind the Gap

Assurance partners map concluded assurance activity across risk and business areas, quickly identifying coverage gaps

Zurich's Assurance-Mapping Framework



Source: Zurich Financial Services Group; Audit Director Roundtable research.

The Common Thread

Internal Audit links findings to ERM risk and control deficiency categories...

...and performs an analysis to determine trends in control breakdowns

Compilation of Audit Findings

Illustrative

Snapshots of Internal Audit's Preliminary Trend Analysis

Illustrative

Audit Number	Process Covered	Finding Description	Finding Risk Rating	ERM Risk Category	Control Deficiency Category
101	Process A	This finding...	low	Ethics	Fraud
101	Process A	This finding...	medium	Financial Reporting	Authorization
101	Process A	This finding...	high	IT Systems	Application Controls
102	Process B	This finding...	high	People and Culture	Evidence or Documentation
102	Process B	This finding...	medium	IT Systems	Application Controls
103	Process C	This finding...	low	Physical Assets	Authorization
103	Process C	This finding...	high	People and Culture	Business Resumption

ERM Risk Categories

- People and culture
- Strategy
- Ethics
- Legal regulation
- Financial reporting
- Customer activities
- Procurement
- Physical assets
- Environment, health, and safety
- IT and systems
- Capital structure

Control Deficiency Categories

- Application controls
- Asset verification
- Authorization
- Business resumption
- Change management
- Compliance
- Contracts and agreements
- Evidence or documentation
- Financial statements
- Fraud
- Measurement
- Monitoring

①

ERM Risk Category	High Risk Findings 2007	High Risk Findings 2008	Change
• People and culture	25	42	↑
• Strategy	10	10	↔
• Ethics	15	22	↑
• Legal regulation	22	19	↓
• Financial reporting	45	53	↑

Risk category trends provide Internal Audit with a quick snapshot of risk management performance across the organization.

②

Control Deficiency Category	High Risk Findings 2007	High Risk Findings 2008	Change
• Application controls	21	36	↑
• Asset verification	52	54	↑
• Authorization	46	35	↓
• Business resumption	34	32	↓
• Change management	79	25	↓

Control deficiency trends provide the ability to identify red flags and problem areas worthy of further investigation.

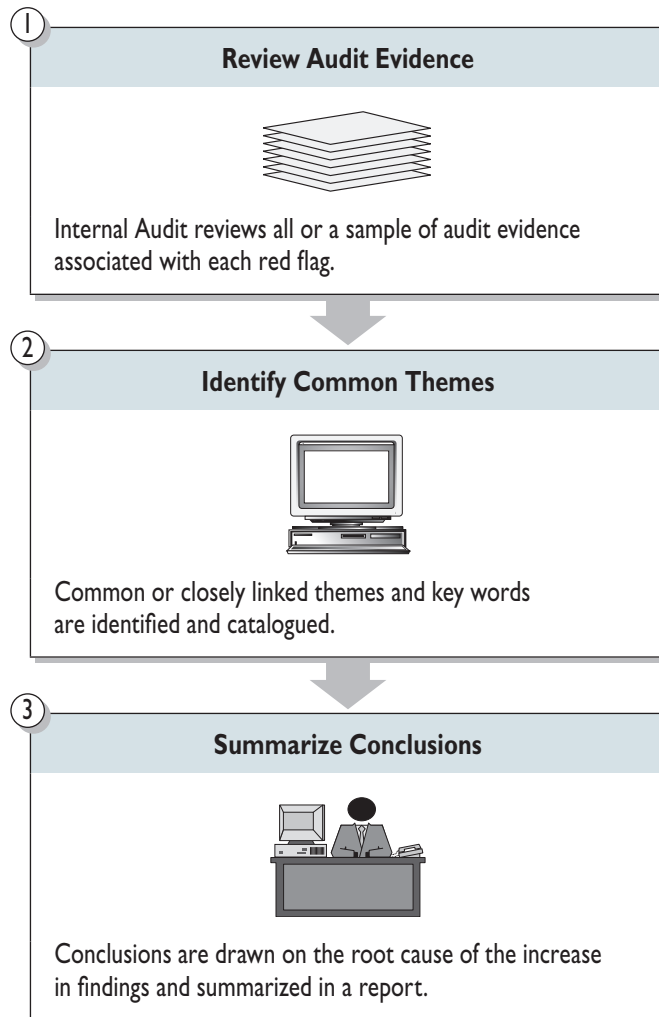
Source: Marathon Oil Corporation; Audit Director Roundtable research.

Getting to the Bottom of It

Internal Audit investigates risk or control deficiency category red flags...

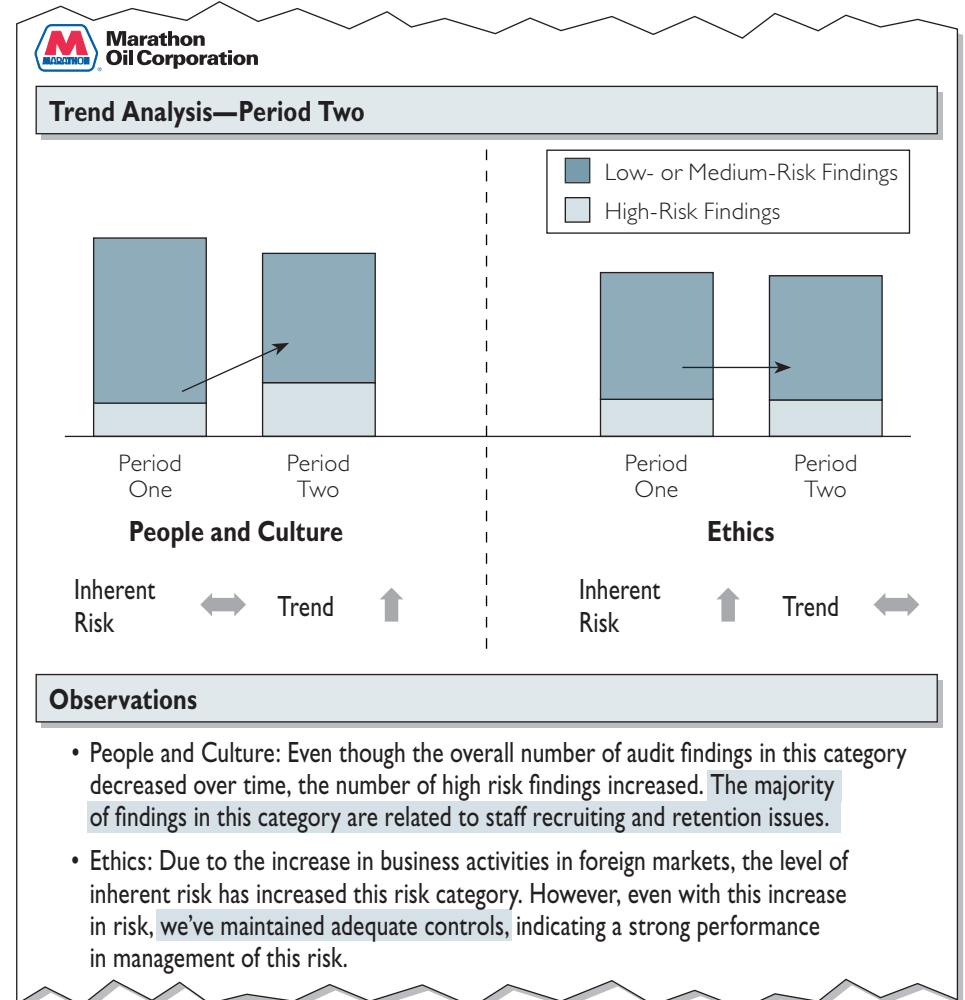
...to highlight fundamental causes of control themes

Red-Flag Investigation Process



Excerpt of Audit Committee Report

Illustrative



Source: Marathon Oil Corporation; Audit Director Roundtable research

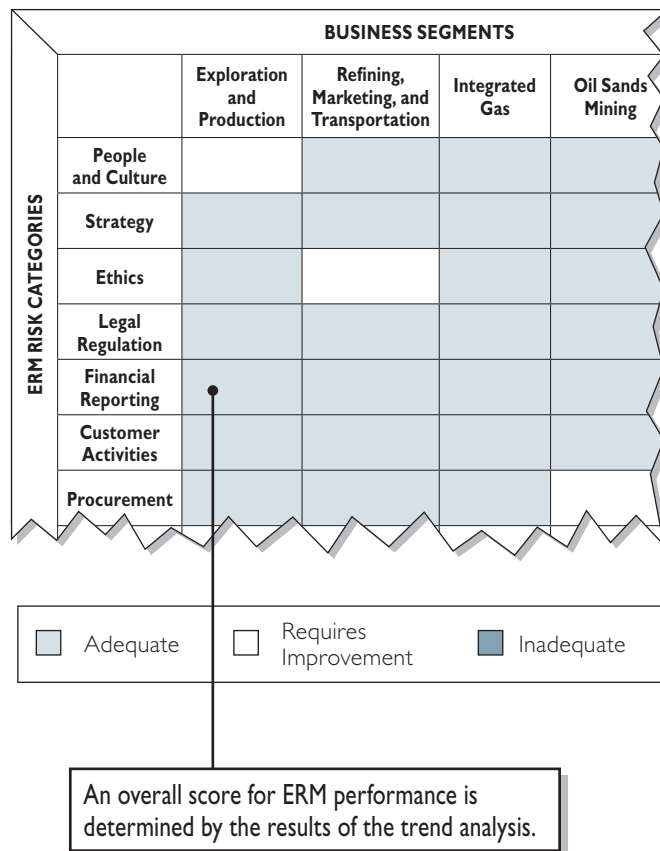
Evaluating Performance

Audit finding trend analysis provides an essential window into risk management performance...

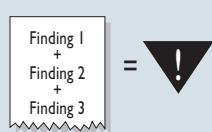
...and enables auditors to generate enterprise-level insights on the control environment

Enterprise Risk Management Performance Scorecard


Illustrative




Benefits of Trend Analysis and Reporting



1 Understand Aggregate Impact of Findings
By cataloging and analyzing findings, the audit team is able to lift up beyond the results of individual audits to understand and identify the compound effect of findings on the risk universe.



2 Identify Systemic Issues and Solutions
Investigating red flags allows audit to identify the true sources of control breakdowns and recommend centralized solutions for control issues occurring across processes and business units.



3 Proactively Fix Issues Across the Organization
By identifying control issues that are isolated but could have a broader potential impact, management can take a proactive approach to fixing problems before they materialize.



For further information, contact

Anthony Williams
Executive Director, Government Practice
twilliams@executiveboard.com

Sampriti Ganguli
Managing Director
Corporate Executive Board
(571) 303-6250
gangulis@executiveboard.com