



THE YELLOW AND GREEN BOOKS: STILL MISSING THE MARK ON RISK ASSESSMENT

SIR ISAAC NEWTON KNOWS WHY!

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The Yellow Book, which references the Green Book collectively, provides wonderfully rigorous, well-thought-out, but not nearly comprehensive enough guidance for consideration of risk. In their attempt to address risk assessment and the risk environment through the multilayered and multidimensional approach of Enterprise Risk Management (ERM), they are missing consideration of some of the most obvious and influential factors of risk.

The concentration of this risk assessment is entirely on internal controls — assessing, holistically, the ugly underside of the tapestry threads woven throughout the organizational structure and processes.

The assumption is that, by definition, controls and risks are controllable! Everything will be just fine if we have the right ones in the right places — they are working to promote efficient and effective direction and performance of the organization's mission objectives while preventing loss of resources and performance.

But what about all of the external things that influence the performance and success of an organization? The big things that we can't control, but that may ultimately have a greater impact on the success of an organization? This is where both the Yellow Book and Green Book fall drastically short.



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They assume a static world in which the organization and the stakeholders it serves are isolated and independent of external forces. But in relative proportion, the external factors render greater risk than do internal factors.

External Risk Assessment, the kind that is often used in strategic planning, needs to be integrated into the total organizational risk assessment. Even an assessment of the organization's own consideration of external risks must — at a minimum — be done to provide a more complete assessments of ever evolving risks. The present and future are not linear extensions of the past.

Just because organizations cannot control factors of risk, does not mean they can pretend that they don't exist. Not to recognize external influences, changes, and opportunities for the purpose of adapting is to helplessly yield to the risk of future viability, sustainability, relevance, and survival.

Commercial enterprise is littered with more organizational failures and losses in numbers and magnitude due to ignorance or even defiance of external factors than with losses due to internal factors. Only about 14% of the companies that were part of the original Fortune 500, are even still in business today. Why? Because they failed to adequately control their reaction and the subsequent response to the external risk forces. Why should government entities be any different, or exempt from the forces of external risks just because there is not a profit? They are not exempt. The reaction is just hidden by resource loss, inefficiencies, and poor performance otherwise not addressed by internal control assessments or Enterprise Risk Management.

Without consideration of external risks, organizations render themselves extremely vulnerable and at risk to the whims of a rapidly changing world. Without external risk assessment, organizations are unwitting victims of external forces, unable or unprepared to control their responses to reactions to those forces. They can't control the external risk factors, but they can control their responses. Would an internal risk assessment, using ERM alone have prevented the *Titanic's* fate?



This is where the roles of Sir Isaac Newton’s Laws of Motion and **PESTLE** assessment apply!

What is PESTLE Analysis?

The External Factors of force we can’t control — but which control us!

PESTLE is the acronym for: **Political, Economic, Social, Technological, Legal, and Environmental**. I have taken minor liberty in listing a variation of **PESTLE** external factors of a changing world. Below is a **PESTLE** Chart with examples of the specific force factors of each **PESTLE** element.

NEWTON’S LAWS OF MOTION:

“Every object persists in its state of rest, or of uniform motion in a straight line, unless it is compelled to change that state by forces impressed on it.”

“Force is equal to the change in momentum (mv) per change in time. For constant mass, force equals mass times acceleration.” $F = m a$

“For every action, there is an equal and opposite re-action.”

<i>Economic</i>	<i>Political/Legal</i>	<i>Science/Technology</i>
<ul style="list-style-type: none"> • Interest Rates • Tax Rates • Employment Rate • Labor Rates • Inflation • Growth Patterns • Exchange Rates • Financial Markets • Gov’t Grants/Contracts 	<ul style="list-style-type: none"> • Fiscal Policy • Trade Tariffs • Change in Gov’t/Laws • Local Gov’t Policy • Health/Safety • Labor/Commerce Laws • Law Enforcement • Global Threats/Wars • Security/Cyber 	<ul style="list-style-type: none"> • Automation • Research and Development • Technology Transfer • Communications • Engineering Techniques/Technology • Transportation/Infrastructure • Medical Treatment/Pharmaceuticals • Artificial Intelligence • Robotics
<i>Demographic</i>	<i>Social/Cultural</i>	<i>Environmental/Natural Resources</i>
<ul style="list-style-type: none"> • Education • Age Distribution • Location Patterns • Immigration • Income Distribution • Public Health • Mortality/Birth Rates • Family Size • Retirement Rate/Age 	<ul style="list-style-type: none"> • Ethnic Homogenization • Public Safety • Access to Health Care • Cultural/Ethical Norms • Generational Differences/Preferences • Employment Expectations • Mobility/Gentrification • Saving/Buying Patterns 	<ul style="list-style-type: none"> • Resource Management • Energy Availability • Air/Water/Air Quality • Weather Patterns • Climate Change • Availability/Demand for Water • Disaster Quotient • Waste/Carbon Management • Water and Land Use



PESTLE risk assessment of the organization and its stakeholders (because an organization only exists to serve its stakeholders) = force vulnerability, significance, and probability impact.

Management is responsible for deciding on the actions in response to the reactions of the factors of force. But auditors, as part of risk assessment, add value by also assessing external risks and vulnerabilities. The chart below demonstrates a simplified way of assessing the implications of risk force factors by their significance and probability. This assessment process could require a complex analysis of data and trends based upon different scenarios of force significance and probabilities.

Applicable External Risk Force Factors	Assessment of Implications/Reactions on the Organization and/or its Stakeholders (consider near-and long-term). Reactions can be risk of mission/resource loss and/or opportunities?	
	Significance/Reaction Implication of Each Factor	Probability
Economic		
Political/Legal		
Scientific/Technology		
Demographic		
Social/Cultural		
Environmental/ Natural Resources		

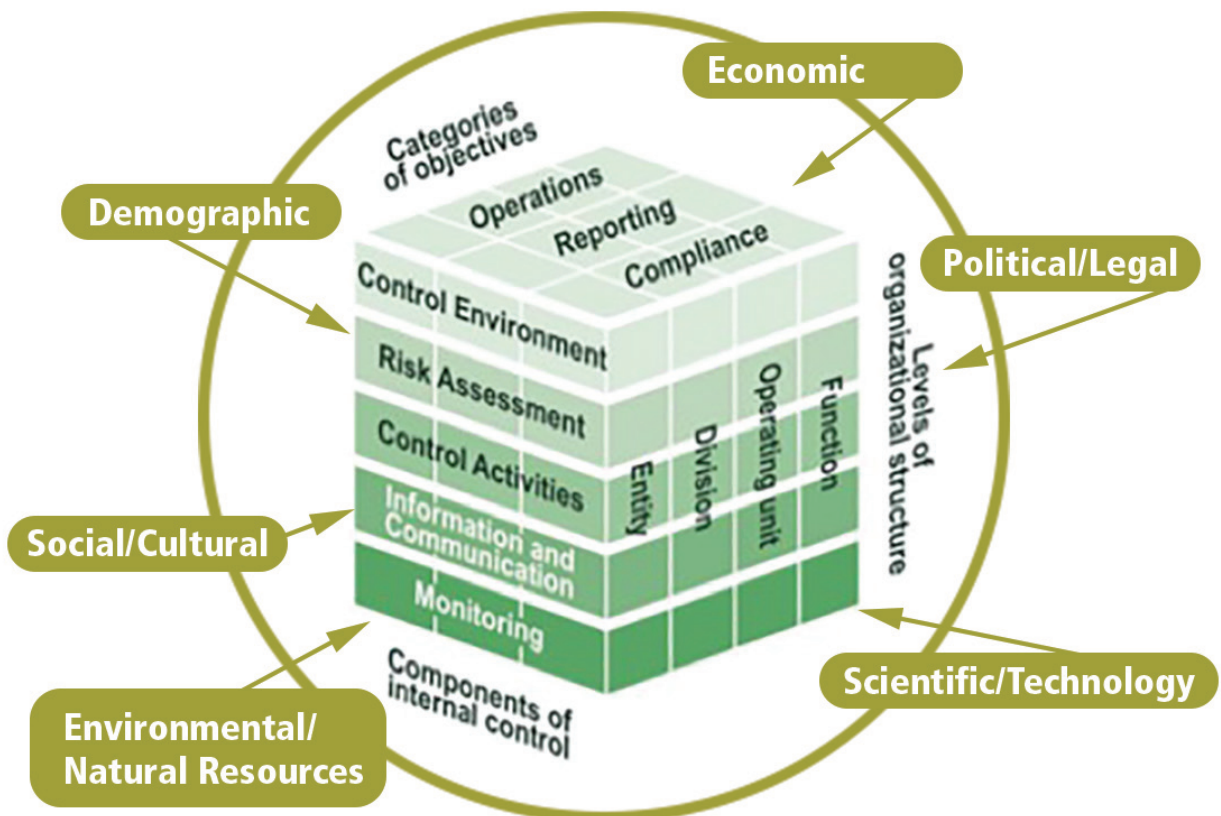
Instructions: Try filling in a few of the applicable factors for your organization listed in the previous PESTLE chart along with the significance, impact, and likelihood. Some of these factors may be retrospective, now rendering the organization vulnerable in fulfilling its mission, suffering loss, or not seizing an opportunity – because it did not adequately anticipate or respond to the external risk force factors. External risk force analysis may also reveal the root cause of conditions necessary for meaningful findings and recommendations, not otherwise detected by ERM assessment. Think icebergs!



Newton's Laws + PESTLE + ERM

Integrating Newton's Laws with **PESTLE**, and Internal Risk Assessment provides the necessary risk assessment view of the organization from the inside out using existing Enterprise Risk Management, and maybe more importantly, the risk force factors from the outside in!

The following diagram shows how Newton's Laws of force works with **PESTLE** and ERM to address risks.





Organizations that can anticipate and adapt to external risks are well suited to control their reaction to their advantage or to minimize loss.

Conclusion:

External risk forces on an organization, (and its stakeholders) are often more influential in terms of both probability and significance than internal control forces. Thus combined with Newton's Laws, the external factors of risk, which are not controllable, cause equal force reactions on an organization and/or its stakeholders as challenges or opportunities, independent of the internal risks and controls.

Organizations that can anticipate and adapt to external risks are well suited to control their reaction to their advantage or to minimize loss. Conversely, organizations which cannot or do not anticipate or prepare for, and which are unable to control their reactions and adapt to these factors of risk are likely to become obsolete, ineffective, or sustain significant or fatal losses. As the world changes, the gap between external conditions and internal reactions represents an external control gap.

Organizations cannot control the external factors, but must be prepared to acknowledge and react to them internally. Internal enterprise risk assessment and management, without rigorous external risk assessment to include preparation for reaction and adaptation, is myopically incomplete. The reaction and implications of external force factors can be disproportionately greater than internal vulnerabilities. The Standards should be expanded to address the need for assessment of external risk force factors.



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About the Author

Michael J. Binder, CIA, CFE is the Director of Graduate School USA's Financial Management Programs and the Government Auditing Training Institute. For over 42 years, he has served in federal audit, management and executive positions in the U.S. Government Accountability Office, the Inspector General community, and as Acting Inspector General of the National Endowment for the Arts.

He has held key roles with the U.S. Environmental Protection Agency (EPA) Office of Inspector General (OIG), where he directed internal risk assessment, audit follow-up, audit and investigative planning, budget development and execution, legislative analysis, policy review, performance measurement, financial reporting, and other key functions.

He led the application of logic models and SWOT Analysis for audit planning and performance measurement in the OIG, for EPA and the federal IG community. He created the President's Council for Integrity and Efficiency (PCIE) — now CIGIE — Environmental Consortium, and chaired the PCIE Government Performance and Results Act Committee.

Michael has BBA and MBA degrees in Finance and Economics from the George Washington University. He also attended Harvard University, the Federal Law Enforcement Training Center, and the Federal Executive Institute, and is a former national officer of the Association of Government Accountants.

Michael has been an adjunct professor of management, finance, white collar crime, and auditing since 1975 at institutions including at the University of Maryland, George Mason University, University of Michigan, Florida Atlantic University, the Federal Air Marshall Academy, Federal Law Enforcement Training Center, the Council of Inspectors General Training Academy, and Graduate School USA. He was a principal contributor to the development of the University of Maryland's White Collar Crime Certification curriculum.