Extended Enterprise Risk Management

Driving performance through the extended enterprise

October 2015
The Extended Enterprise is the concept that an organization does not operate in isolation, because its success is dependent upon a complex network of third-party relationships.
The Extended Enterprise

Key risks in the network

1. **Loss of reputation** – Risk to the reputation of the organization from the use of third party relationships due to a myriad of reasons including misuse of intellectual property; poor product quality; lack of compliance to human rights and environmental regulations, etc.

2. **Supply chain disruption** – Key third party business disruption due to bankruptcy, geopolitical issues, macro risks etc. can result in supply chain disruption

3. **Data risk** – Loss, misuse or mishandling of critical data of the organization or its customers by a third party relationship can result in financial loss; hefty fines and decrease in shareholder value

4. **Product recall** – Poor product quality, safety issues or faulty packaging by third parties can lead to product recalls resulting in recall costs, lawsuits from consumers, increased costs from settlements, and lost revenue from missed sales opportunities

5. **Financial impact** – Financial loss from under-reporting of revenue from licensees, royalty partners, distributors, franchisees etc. and over-payments for services from third party relationships

6. **Lack of compliance** – Third party acts corruptly to gain business advantage for organization resulting in hefty fines or is not in compliance to Environment, Conflict Minerals, Health and Safety, Labor Rights etc. regulations

7. **Poor Performance** – Lack of sustained performance from third party relationships resulting in costly mistakes, over allocation of capital to oversee relationship and defeating the purpose of outsourcing strategy

Extended Enterprise
- Sell side
- Buy side
- Infrastructure
The Extended Enterprise

Broad spectrum of third party risk

1. An outsourced vendor for transaction processing decides to exit the business and provides little notice or transitional support.

2. An important distributor does not provide the amount of prime shelf space that had been agreed upon and instead leads with a competitor’s product.

3. A contracted supplier does not deliver merchandise on-time, thus disappointing customers and damaging the company’s brand reputation.

4. A critical vendor takes on more new accounts than it can handle, degrading service levels and disrupting processes.

5. Several franchisees do not spend advertising dollars as instructed, resulting in a poor consumer response to holiday promotions.

Extended Enterprise - Example scenarios where business objectives / reputation may be impacted.
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Opposing objectives of entity and associated third parties

• **Cost** – Business entity wants to obtain the services at the least cost VS third party objective may be to maximize profitability through high price to cost ratio.

• **Service levels/Quality** – Business entity aims at aggressive service level definitions, inclusive of adequate compensation in case of failure VS Third party aims at minimal service level definitions, with least possible give back.

• **Service termination** – Business entity would prefer an agreement with ease of contractual termination VS Third party would aim at a lengthy, and relatively difficult process of service relationship termination.

Key criteria to be monitored

• Reliability

• Availability

• Operational Readiness

• Security
The Extended Enterprise
Driving performance and controlling risk

The Extended Enterprise is integral to the cost expended and revenue generated by your organization, putting it in the position to fuel or inhibit a variety of business benefits.

The Extended Enterprise is central to key cost and revenue drivers in your business

Manage these vital relationships effectively to drive performance

Leverage key benefits
- Product or service innovation
- Expand and gain entry to new markets
- Access to talent
- Access to advanced technologies
- Continue focusing on core business processes

Be aware of the risks (illustrative risks)
- Financial: Revenue leakage and increased costs
- Business continuity: Service interruption
- Reputation: Reduced brand perception
- Operational: Decreased control over operational processes/service levels
- Strategic: Misalignment to organization’s strategic objectives
- Cyber: Poor data security due to reliance on third party safeguards
- Compliance: Business interruption and hefty fines due to lack of regulatory compliance by third party

Drive performance
- Increase revenue
- Minimize costs
- Enhance value derived from third-party relationships
The Extended Enterprise
Management challenges

There are several challenges with managing the Extended Enterprise. The findings from Deloitte's 2014 outsourcing & insourcing survey, which had representation from twenty-two industry sectors is telling:

How would you rate your extended enterprise management capabilities?  
Percentage of respondents who rate themselves above average

- Financial and commercial management: 49%
- Contract management: 39%
- Governance: 38%
- Service performance management: 33%
- Issue and dispute management: 33%
- Transformation and transition oversight: 31%
- Service request management: 30%
- Multi-service provider integration: 28%
- Risk management and 3rd-party compliance: 22%
- Document management: 19%

* Deloitte’s 2014 global outsourcing and insourcing survey
The Extended Enterprise
Management challenges

Management challenges could be both internal and external. Some of the key challenges and questions we are hearing in the marketplace regarding the Extended Enterprise include:

- Where are the breakpoints in our third party relationships? How do we assess and stay ahead of them?
- How do we bridge the gap between those in the business and our compliance and risk staff?
- How can we turn this program into one that evaluates value and does so on a recurring basis?
- What tools and technologies should we leverage to make informed decisions about our third party relationships?
- What data do we already have access to? What should we be monitoring and analyzing to make real time decisions?
- How do we determine whether to outsource or insource, build or buy? What delivery models should we take advantage of?
- How do we keep up with the emerging regulatory requirements? Are our third parties keeping up?
- How will evolving technologies, market trends, or disruptive forces present opportunities and challenges to our third party relationships?
# The Extended Enterprise

## A holistic approach

The Extended Enterprise management operating model presents a holistic approach to managing third-party relationships at various life cycle stages, while considering business objectives and risk domains across your Extended Enterprise.

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<th>Business objectives</th>
<th>Growth/innovation</th>
<th>Client experience</th>
<th>Cost reduction</th>
<th>Improved time to market</th>
<th>Risk and compliance management</th>
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<th>Risk domains</th>
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<th>Operating model components</th>
<th>Governance and oversight</th>
<th>Risk culture</th>
<th>Policies and standards</th>
<th>Management processes</th>
<th>Tools and technology</th>
<th>Risk metrics and dashboard</th>
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<tr>
<td>The operating model, committees, and roles and responsibilities for managing the extended enterprise</td>
<td>Tone at the top, clarity on risk appetite, appropriate training and awareness to promote positive risk culture</td>
<td>Management’s expectations of standards and processes to be used, to manage the extended enterprise and its related risks</td>
<td>Processes to manage risks and improve performance across the third-party lifecycle</td>
<td>Use of tools and technology, predictive and risk analytics that enhance extended enterprise risk management processes</td>
<td>Use of internal and external data to measure and visualize risks and performance of extended enterprise, tailored towards multiple levels of management</td>
<td></td>
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</tbody>
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<tr>
<th>Third-party relationship lifecycle</th>
<th>Plan, evaluate and select</th>
<th>Contract and on-board</th>
<th>Manage and monitor</th>
<th>Terminate and off-board</th>
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<th>Third-party relationships</th>
<th>Sell side</th>
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The Extended Enterprise
Three lines of defense

A well-structured risk management approach incorporating the three lines of defense helps the organization achieve efficiency and enables the right level of management involvement based on the Extended Enterprise’s risk and performance impact to the organization.

First line of defense: Business unit
- Owns the third party relationship and is accountable for managing the risk in alignment with policies and procedures

Second line of defense: Centralized extended enterprise risk management governance program that
- Establishes and enforces policies/processes to ensure that third parties are managed consistently by the business
- Supports the business through provision of tools and templates to enable standard practices and reporting
- Performs independent monitoring, and evaluation of performance and compliance
- Oversees the program broadly across the enterprise to ensure that it is in line with strategy and the appropriate extended enterprise risks are being managed at an enterprise and geographic level

Board: Is aware of the sourcing strategy and risk the strategy brings, and confirms that the risk is sufficiently managed

Third line of defense: Internal Audit
Robust internal audit program aligned to the most critical extended enterprise risks and controls and performs independent assessments
The Extended Enterprise

Role of Internal Audit

• Internal Audit has a special role, since the primary customer of Internal Audit team is the “entity charged with oversight of management activities”, there is organizational Independence. The IA also being close to the day to day business can aid in drafting a Robust, Objective and Independent Audit program addressing the risks arising from Extended Enterprise.

• Corporate governance (as it drives policies, processes and structures used by organization to direct activities, achieve organizational objectives and stakeholder interest protection) is a key aspect in addressing / mitigating/controlling risks arising from the extended enterprise. Internal Audit is one of the 4 pillars of Corporate governance, the other 3 being “Board of Directors”, “Management” and “External Auditors”.

• Chief Audit Executive (CAE) as part of the Senior management, may participate in reporting on any significant risks the organization faces to the Audit Committee, or ensure management reporting is effective for that purpose – inclusive of any risks / potential issues pertaining to third parties.

• Participating & contributing in conversations such as – a) Does the entity have a complete inventory of all existing relationships and agreements?  b) has risk assessment been performed for each relationship?  c) ownership and accountability of compliance for existing relationships?  d) Entity controls to ensure reporting related to / from third parties is accurate?  e) do existing SLAs address the key risks associated with relationships?
Role of Internal Audit – Repeatable audit program

Step - 1
Establish an audit program to evaluate third party relationships. Defining the objective and scope of the audit.

Step - 2
Third Party Management – Interview key mgmt. personnel to identify high-risk third party relationships.

Step – 3
Risk assessment and planning - For the key third party relationships identified in step #2, assess mgmt.'s level of planning & risk assessment.

Step – 4
Vendor due Diligence – For key third party relationship identified in step #2, assess mgmt.'s level of due diligence. Did mgmt. perform an investigation of third party vendor prior to entering into the relationship?

Step - 5
Risk Measurement, Monitoring and control – Document mgmt.'s processes in place for ongoing monitoring of third party. Mgmt. should establish ongoing expectations and limitations, compare program performance to expectations and ensure all parties to the arrangement are fulfilling their responsibilities.
Role of Internal Audit – Repeatable audit program

Business Expectations – What needs of the business is the third party expected to fill?

Importance of the relationship – how critical is the relationship of the third party to the business entity?

Staff expertise – are there individuals within the business entity who can perform the services, in case the risk of working with the third party proves greater than the business would like? Is staff trained to monitor the third party service delivery?

Cost Benefit Relationship – Does the potential benefits from the relation outweigh the risks or associated costs?

Exit Strategy – If the relationship goes poorly, can the business entity withdraw from the relation, with minimal impact?
Vendor Due Diligence

Background Checks – References, prior performance, licensing and certification, Key individuals, legal proceedings, business model?

Cash Flow – can management clearly establish how cash flows (both incoming and outgoing) between third party, the business entity and any stakeholders / members of business?

Financial and Operational control review – SSAE16’s, independent audit results and/or regulatory reports.

Contractual Provisions and Legal Review.

Accounting considerations – Have potential accounting complexities been adequately considered by qualified personnel, such as a CPA?
Role of Internal Audit – Repeatable audit program

Evaluate the service provider’s financial condition periodically, periodically review audit/security reports and evaluate the adequacy of the service provider’s systems and controls – security, availability, integrity, confidentiality.

Monitor changes in key service provider project personnel allocated to the institution. Determine adequacy of training provided to its employees.

Regularly review reports documenting the service provider’s performance. Determine if the reports are complete and accurate. Evaluate the provider’s ability to support & enhance the institution’s strategic objectives.

Periodically meet with the contract parties to discuss performance / operational issues. Review invoices to assure adequate charges for services rendered. Review service provider performance against SLA.

Maintain records regarding contract compliance, revision and dispute resolution. Periodically review the service provider’s contingency plan, to ensure mission critical services can be restored within an acceptable timeframe.
Managing the extended enterprise risk with a robust, secure and integrated technology platform provides the appropriate level of upstream and downstream visibility and accountability that is critical to better performance and risk management.

- **Higher Quality Information**: Integrating the right information gives management visibility into quality data and allows them to make better risk informed decisions, in a timely fashion.
- **Process Optimization**: With structured process flows, redundant/ non-value add activities are eliminated, activities are streamlined to reduce lag time and inconsistency, responsibilities are correctly allocated.
- **Intelligent Risk Management**: Processes can be tailored to address risks inherent to the product/service being outsourced with consistent application for same type of relationships for intelligent risk management.
- **Effective Capital Allocation**: Identifying areas where there are redundancies or inefficiencies allows financial and human capital to be allocated more effectively.
- **Reduced Costs**: Proactive decision making, visibility into performance and compliance of extended enterprise and optimized processes result in cost reduction, providing return on investments in technology.
**The Extended Enterprise**

**How does your approach stack up?**

The Extended Enterprise maturity model below is designed to help you understand where you are today, your ideal future state, the value the future state can bring to your organization.

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<th>People</th>
<th>Strategy and Governance</th>
<th>Technology</th>
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| Initial | - No formal governance  
- Risk taking for quick fix benefits | - Off the shelf tools used for problem solving  
- Limited access to third-party data |
| Managed | - Individual effort  
- Little management input  
- Lack of training | - Defined processes in siloes  
- Functional, reactive problem solving  
- Minimal effort in reducing risk  
- Risk taking for short term benefits |
| Defined | - Few activities defined  
- Fire fighting mode | - Coordinated processes across the business  
- Monitoring and alerting leveraging dashboards, with some proactive issue resolution  
- Dedicated roles  
- Invested executives within each silo  
- Some training offered |
| Integrated | - Simple and least expensive tools used ad-hoc | - Adapted tools used for reporting and monitoring  
- Customized tools, used for tactical decision making  
- Value additive tools  
- Internal data centralized and easily accessible |
| Optimized | - State of the art practices, linked to value drivers  
- Extended enterprise embedded in strategic planning and decision making | - Focus on preventing issues  
- Intelligent risk taking, aligned with enterprise strategy  
- Awareness of value of extended enterprise across the organization  
- Enterprise wide roles  
- Executive ownership at the enterprise level |
|         | - Trained professionals with defined roles throughout the lifecycle  
- Executive champions on both sides, aligning service delivery to strategic objectives | - Full standardized processes, integrated with tools and data  
- Proactive decision making using analytics, improving bottom-line and performance  
- Leveraging predictive and sensing analytics, tools and dashboards |
|         | - Processes aligned with strategy, integrated into third parties  
- Continuous improvement and proactive responsiveness | - Highly - customized decision support tools  
- Integrated external data sources that enhance insights  
- Tools and analytics are key value driver and differentiator |

Progress through the levels of maturity increases extended enterprise performance through both (i) controlled risks, and (ii) enhanced benefits.

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The Extended Enterprise
Risk management solutions

Deloitte brings together the full breadth of its capabilities into a comprehensive suite of solutions designed to increase the performance of the extended enterprise and help your organization achieve your strategic business objectives.

- **Strategy and program development**
  - Solutions to assess, design and implement strategically aligned extended enterprise program
  - Governance and operating model design
  - Strategic risk assessment, tiering, and segmentation
  - Crisis management and simulation modeling
  - Regulatory compliance

- **Evaluation and continuous monitoring**
  - Solutions to assess third parties and proactively sense and respond to extended enterprise risks and opportunities
  - Third party due diligence
  - Third party assessments
  - Risk sensing
  - Third party assurance

- **Technology enablement**
  - Solutions to transform and continuously enhance extended enterprise risk management by designing, implementing and deploying technology solutions
  - Intelligence
  - Visualization and analytics
  - Governance/program management
  - Risk and compliance
  - Knowledge management

*The solutions range from those that can be integrated across the organization and/or to specific risk domains and specific third party relationships.*
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