HOW CFOs TAKE THE LEAD ON THIRD-PARTY RISK MANAGEMENT AND GOVERNANCE

CYBER RISK, FRAUD RISK AND SUPPLIER RISK ARE ON THE RISE

SPEAKERS

Marc Deluca
Senior Vice President
Coupa Software

Ryan Flynn
Principal
Deloitte Consulting LLP

WITH TODAY'S BOARDS OF DIRECTORS AND CEOs becoming increasingly concerned about risk management, their CFOs are being asked to step up to the plate and become more strategic on combating the issue. As a result, many CFOs with a high degree of digital maturity and data visibility are getting better outcomes, both with risk management and overall company performance.

During a recent CFO webcast, sponsored by Deloitte and Coupa, leaders discussed how CFOs have already become more forward-looking and strategic, with the driver behind the change being risk management. In fact, in a poll of the webcast audience, 47% saw cyber risks (cyber security, data privacy, GDPR, adages) as their biggest risk management worry, followed very closely by business environment risk (economic changes, trade policy, capital availability, industry dynamics), and then by operational risk, i.e., gaps in processes and data to support good decision-making and budget compliance.

Other risk challenges facing CFOs include broad risk stemming from fraud by employees and suppliers; supplier risks including supply disruption or fines from regulators for supplier actions; reputation risks, such as bribery or unethical behavior by employees or suppliers; and control risks, including financial misstatements, audit failings and compliance gaps.

Presenter Marc Deluca, senior vice president at Coupa Software, noted there are several patterns emerging when it comes how CFOs think about risk.

"The first thing is, they're all in the black. So our CFOs all see the risks going up over the next couple of years," Deluca said to start off the conference. "The other thing is that large enterprises generally are more concerned about risks than small/medium businesses. So, we see a greater degree of concern amongst large enterprises."

Deluca noted that incidences of cyber risk, fraud risk and supplier risk are getting worse. "Something to keep in mind is since these are relatively new risks to most CFOs, given their changing responsibilities, they really may not be well prepared to mitigate those risks," he said.

Talk of trade wars, recession and economic cycles is causing business environment risk concerns to grow materially over the next two years. Concerns about reputational risks are also on the rise. "This is in all likelihood driven by this endless list that we see of massive data breaches that come from fraud or information security of data privacy failures at so many companies," Deluca pointed out.

Presenter Ryan Flynn, principal with Deloitte Consulting LLP, noted that risk management has become a global concern. "There's a lot of uncertainty in the overall economic environment, and it's really impacting how companies are thinking about risk and the cost lens that they're taking towards looking at risks."

Deluca noted that most finance teams are still spending the bulk of their time on backward-looking activities — such as budgeting and financial reporting — versus forward-looking pursuits, such as partnering with business units strategically or helping to manage business risks, which is an area of grave concern among the risk committees of most boards.

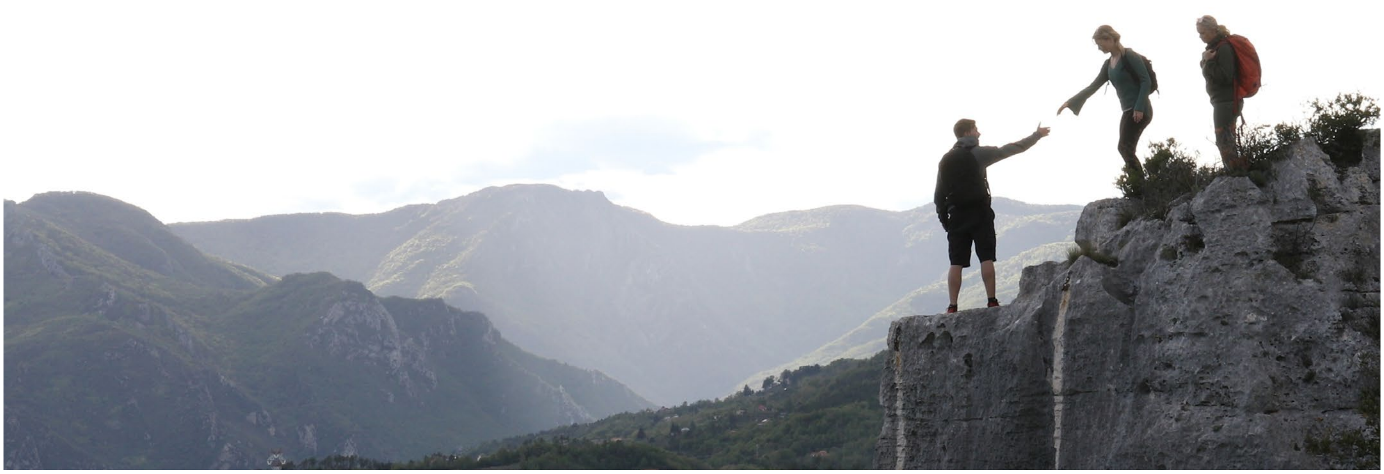
"They want and need to be strategic but they just aren't able to allocate their time accordingly, at least not yet. That's a bit of a challenge," Deluca said, adding that CFOs with visibility into transactional data flowing through their enterprises are twice as likely to be leaders in efficiency, in risk management and in business outcomes.

For many CFOs, operational and strategic risks are tied to third-party or supplier risks. "Given the never-ending march towards outsourcing, companies are using many more third-party suppliers than they used to in the past, and all those new suppliers bring with them risks," Deluca said, noting that raises three questions CFOs must contemplate:

1. **Who are we doing business with?**
2. **What's the nature of those supplier relationships?**
3. **What are the risks that are inherent in those relationships and what are we doing about them? How are we mitigating those risks?**

Citing a **Deloitte** extended enterprise risk management survey of more than 1,000 CFOs from 19 countries, Flynn noted that companies feel most uneasy when it comes to the types of risks they have with their subcontractors and their affiliates, with 83% of companies reporting experiencing a third-party risk incident over the past three years. More than one third of those had a moderate impact on customer service, financial position, reputation or regulatory compliance, while 11% experienced a severe impact on those same issues. "A lot of companies out there are experiencing these types of risk incidents and a good portion of them are having at least a moderate effect on their organizations and their operations, reputations, their ability to comply with regulations, etc.," Flynn said. "Experiencing one of these risk incidents, particularly if it's severe, can be quite significant both from a financial and a reputational perspective."

Risk assessments and risk management mitigation are performed in silos in many cases, which makes it more difficult to get a consistent approach and single view of risk as well as performance, Flynn said. "That's because we're talking about operational risk here, across supplier relationships across the organization."



UNDERINVESTING IN RISK MANAGEMENT

Most organizations believe they are underinvesting in risk management, with fewer than three in 10 believing that the capital expenditures, staffing and other operating costs they are making in this area is the ideal amount or more. “That’s not terribly surprising, since risk can be in many instances somewhat of a hard sell. It tends to be seen in organizations as more of an insurance policy and not something that is driving bottom-line value to an organization,” Flynn said, adding he believes that is why business are seeing an increase in cost reduction as a part of risk management being so prominent.

“Companies are starting to think about this a little bit differently, and maybe in a way that will help them get more cost reduction out of their risk management program and be able to sell that better internally to be able to get more capital expenditures for their risk management programs,” Flynn said. “The impact of this has really been that this underinvestment in risk management has weakened the ability to be, as we say, brilliant as the basics.”

Half of the respondents in Deloitte’s survey said that they do not understand the nature of individual third-party relationships, which makes those relationships hard to manage, if the CFO does not know who those relationships are with, and what kind of goods and services they are providing to the organization.

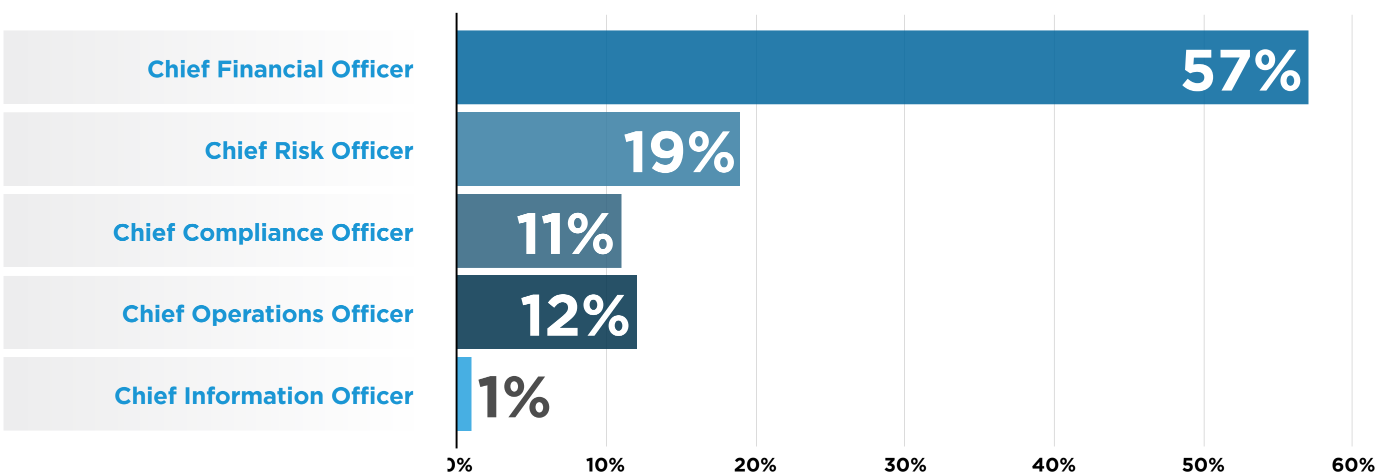
In the same survey, 43% of respondents reported that they lack enough knowledge in contract terms, while 41% mentioned that they do not monitor third parties based on their risk profile.

"This is back to singular risk profile of an organization that you can share across your organization. It is getting that visibility into third-party risks across different risk domains and understanding what that risk profile is, and what sort of actions that you need to put in place to be able to monitor and mitigate that risk on an ongoing basis," Flynn said.

"There's a real need to be able to get better visibility into who is using subcontractors and what their subcontractors are doing because, ultimately, organizations are going to be held responsible for these subcontractors and affiliates and the risks that they pose," Flynn said.

A second poll of the webcast audience found that the majority reporting at their company it is the Chief Financial Officer who drives board-level accountability for risk at their company, followed by a distant second Chief Risk Officer, and then Chief Operating Officer.

Who Drives Board-Level Accountability?



Source: live webcast audience poll conducted 8/13/19

"What we're seeing through this in terms of technology is that these organizations, because of this mandate that's coming down from the board level and the executive level in general, are really trying to get their arms around third-party risk management through the use of technologies," Flynn noted.

In the Deloitte survey, more than half of the respondents tend to use cloud-based platforms going forward to manage this risk, while 45% use or intend to use robotic process automation and just over one-third intend to use visualization techniques to create actionable intelligence with their risk management.

"We're seeing a lot of companies that are taking advantage of digital technologies as a way to be able to underpin these risk programs and be able to provide the kind of work flows as well as access to the date and visualization to be able to more effectively and efficiently, monitor and manage the risks on an ongoing basis," Flynn said.

Technology can be used to identify where risks might exist and which questions to ask. Many companies do this by looking at the supplier or third party itself, the goods and services they are providing, and even their geographic area to at least start the process of understanding what type of risk might need to be assessed.

Deluca noted that it is important for the CFO and Chief Compliance Officer to forge a close working relationship to combat risk. "When they work together, they both have a dotted line directly to the risk committee. So it's important for them to learn how to work together," he said.

CONCLUSION

Incidences of cyber risk, business environment risk, operational, third-party and other forms of risk are on the rise, and CFOs are being asked by their CEOs and boards of directors to develop ways to combat the issue.

As a result, CFO teams need to adjust their mindsets from not only dealing with backward-looking activities, such as budgeting and financial reporting, but also incorporate forward-looking activities, including partnering with business units strategically or helping to manage business risks.

CFOs are turning to technology, including cloud-based platforms, robotic process automation and visualization techniques, and working closer with their Chief Compliance Officer, to get a handle on risk issues.

Key takeaways from this webcast:

- **A wide array of risks is increasingly affecting the business community and CFOs are being tasked with tackling the growing threat.**
- **In addition to backward-looking activities, such as budgeting and financial reporting, CFOs need to devote time to forward-looking activities, including helping to manage business risks.**
- **Many risks arise from suppliers and third parties, with that threat is increasing as companies continually look to outsource to curtail expenses and boost profitability.**

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