Extended enterprise risk management: New perspectives on a growing imperative
The Dbriefs Governance, Risk, & Compliance series

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Agenda

• 2017 EERM Survey results
• Cost and revenue recovery
• Question and answer
2017 EERM Survey results
An organization does not operate in isolation because its success is dependent upon a complex network of third-party relationships.
Organizational progress in EERM since last year appears modest although increasing awareness of risks is expected to prime 2017 and 2018 as years for accelerated maturity

• Report based on 536 responses, a significant increase from 170 last year
• Covers 11 countries across the Americas, Europe Middle East and Africa (EMEA) and Asia/Pacific across all key industry segments
• Respondents typically include those responsible for EERM:
  − Chief Finance Officers,
  − Heads of Procurement/Vendor Management,
  − Chief Risk Officers,
  − Heads of Internal Audit, and
  − Compliance and Information Technology (IT) Risk Heads
Despite increasing executive awareness of risks and some associated improvements in EERM, five key areas exist where further effort is required by most organizations.
Dependency and vulnerability

Despite high dependency on third parties, organizations are still not fully equipped to manage the risks in a holistic and coordinated manner, including those arising from external uncertainties.

53.3 percent of respondent organizations have a “high or critical level of dependence” on third parties.

40.5 percent of respondents reported “some” increase in dependence on third parties in the last one year with a further 10.1 percent experiencing “significant” increase.

However, only 20.1 percent have integrated or optimized their EERM mechanisms with others aspiring to do so within the next 1-3 years.
Dependency and vulnerability

Despite high dependency on third parties, organizations are still not fully equipped to manage the risks in a holistic and coordinated manner, including those arising from external uncertainties.

Just **11.6 percent** of respondents are “fully prepared” to deal with the increased uncertainty in the external environment while a significant majority of **72.3 percent** of respondents are only “somewhat prepared.”

**74.1 percent** of respondents have faced at least one third-party related incident in the last three years. As many as **one in five** respondents have faced a complete third-party failure or an incident with major consequences in the last three years.

**26.3 percent** of respondents have faced non-compliance with regulatory requirements (compared to 23.0 percent in 2016), while 16.7 percent have suffered reputation damage (26.2 percent last year).
Polling question #1

Do you think your organization’s level of maturity in risk management of third parties so far has been proportionate to its level of dependency and vulnerability?

a) Yes, we have a high level of maturity in EERM to address our increasing level of dependency on third parties and the related vulnerability

b) We are currently enhancing our level of maturity in EERM to match our increasing dependence on third parties

c) There is a recognized need to enhance our maturity in EERM to match our increased dependence on third parties

d) We don’t know whether our maturity in EERM is proportionate to our dependency on third parties and the related vulnerability
Relationship management

Understanding of third parties is increasing; but comprehensive, data-driven risk management and capability to predict emerging risks is still developing

55.4 percent of respondents have a reasonable to excellent understanding of third-parties, with the other 44.6 percent having only low or “some level” of understanding.

Just 13.6 percent of respondents have forward-looking vigilance capabilities to identify imminent risks and performance issues of third-parties that are well-integrated into their processes of managing their extended enterprise, while 78.9 percent are at various stages of development of such capabilities.

46.6 percent do not have any organizational initiatives to enhance maturity of contractual data to increase the understanding of their third-parties.

As many as 53.8 percent consider their level of knowledge of third-party contract terms and related data to be limited, including respondents who recognize this is inadequate.
Polling question #2

Which option most closely describes your organization’s third-party risk management capabilities?

a)  Largely dependent on real-time controls (including risk-sensing) that have been implemented

b)  Intention to evolve risk management capability based on real-time controls, but do not yet have them fully developed

c)  Largely dependent on traditional detective controls (operating with varying time-lag)

d)  Don’t know/Not sure
Governance and risk management processes

Despite executive sponsorship, there is still a long way to go to get processes and technology working effectively.

The proportion of respondents skeptical about EERM technology in their organizations has only slightly reduced from 94.3 percent since our last survey to 90.6 percent of respondents.

Ultimate responsibility for third-party risk management rests with the Board, CEO, CFO, CPO or other members of the C-suite in 74.6 percent of responses.

A similar lack of confidence relating to the quality of EERM processes is also only marginally down from 88.6 percent to 82.5 percent, indicating the need for continued focus in this area.

Third-party risk features consistently or periodically on the Board agenda in 53.2 percent of respondent organizations.
Polling question #3

Which statement most accurately describes the current state of your organization’s third-party governance and management processes?

a) There is an opportunity for enhancement in the level of understanding of the Board with regard to EERM

b) The Board understands the risks associated with the extended enterprise but there hasn’t been a clear mandate yet to make significant investment in EERM

c) There is a mandate from the Board to enhance the existing EERM framework, but an execution gap in the ability to achieve intended results

d) Current EERM framework and processes are integrated and optimized

e) Don’t know/Not applicable
Technology platforms
An integrated EERM technology platform that addresses the needs of every organization has not emerged.

19.9 percent of respondents are using the TPGRM-relevant modules of broader GRC solutions, while 17.0 percent are using specific TPGRM solutions.

Using features of an existing ERP system is still the most popular solution as a technology platform for TPGRM, as outlined by 43.9 percent of respondents. 20.4 percent of respondents supported this by the use of bespoke solutions to achieve integration needs.

55 percent of survey respondents now combine more than one technology platform to address TPGRM requirements.
**Emerging delivery models**

New delivery models are emerging to bring consistency and sought-after skills, enable collaboration, and address decentralization challenges in the wider organization.

- As many as 62.4 percent of respondents are equally or more decentralized than they are centralized.
- Over 59.0 percent of respondents are moving to increasingly centralized in-house functions to support TPGM.

- 12.8 percent of respondents are moving to an external service provider-based “managed service” model for third-party management, which also reflects an emerging trend.
- One in five respondents are already utilizing information hubs (community models) on third-party risk available as market utilities or intending to do so in the near future. However, 51.3 percent of respondents are unaware of this emerging trend.
Some operational challenges

I need a turnkey, cloud-based technology solutions to automate EERM such that I don’t have to invest precious resources in configuring and maintaining the solution.
—Chief Information Officer

I need to keep up the changing regulatory and industry requirements.
—Chief Compliance Officer

I need to cut costs with managing my third-party relationships.
—Chief Procurement Officer

I need the right talent to enable my EERM center of excellence.
—Chief Risk Officer

I need a simple way to keep a pulse on my third parties, so I can react quickly to any disruptions impacting my operations. I need a centralized dashboard of emerging issues
—Supply Chain Officer

I need to make managing my third-party relationships a lean and efficient process and reduce the burden on third parties.
—Chief Operations Officer

I would like to see who our top 20 critical third parties are the risk they present to the organization
—Board

Why does it take so long to on-board a third party and why do I have to complete all this paperwork?
—Relationship owner
Managed services as a delivery model

The needs of an operating model that enables appropriate level of upstream and downstream visibility and accountability for better performance and risk management of third parties.

**Turnkey and scalability**
An established infrastructure, process and team to hit the ground running or scale up

**Informed decision-making**
Formal integration and cohesion among various functions, including Procurement, Risk functions, Compliance, IT, and others, to drive decision making supported by data and data linkages

**Efficiency**
Creates an enterprise-wide process, identifying risks faster and in a consistent manner, clarifying the required steps for up-front due diligence and reducing time to on-board

**Continuous Monitoring**
Ongoing monitoring while easing the burden on organization talent resources

**Standardized process**
Consistent application of third-party risk scoring, sensing, and monitoring by various business units across geographical location and third-party types

**Comprehensive view of risks and performance**
A broad and enterprise-wide current view of your third-party landscape, trends, executive dashboards
Polling question #4

What is the extent of your management’s appetite to explore alternative delivery models for EERM while retaining overall accountability for risk management in-house?

a) Appetite to explore managed services (outsourced) models on an end-to-end basis for third parties, consortiums and market utilities

b) Appetite to explore managed services models for certain aspects of EERM such as due diligence and risk assessments but not consortiums or market utilities

c) Appetite to explore consortiums and market utilities only but not outsourced managed services models

d) No appetite to explore any of the above

e) Don’t know/Undecided
Cost and revenue recovery
**Cost and revenue recovery—Overview**

The recent dramatic rise in data analytics capabilities, predictive learning, and optical document scanning has increased the ability for companies to monitor and identify significant financial recovery and cost saving opportunities.

<table>
<thead>
<tr>
<th>Third parties</th>
<th>Transaction types</th>
<th>Application tools</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Vendors</td>
<td>• Cost sharing agreements</td>
<td>• Contract automation tools</td>
</tr>
<tr>
<td>• Licensees</td>
<td>• Purchase agreements</td>
<td>• Data analytics and algorithms</td>
</tr>
<tr>
<td>• Customers</td>
<td>• Invoicing and related surcharges</td>
<td>• Royalty agreement and cost sharing agreement compliance tools</td>
</tr>
<tr>
<td>• Channel partners</td>
<td>• Lease agreements</td>
<td>• Software deployment inventorying tools</td>
</tr>
<tr>
<td>• Landlords</td>
<td>• Software License Agreements</td>
<td></td>
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<tr>
<td>• Distributors</td>
<td></td>
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<tr>
<td>• Advertisers</td>
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**Cost and revenue recovery**

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**Application tools**
- Contract automation tools
- Data analytics and algorithms
- Royalty agreement and cost sharing agreement compliance tools
- Software deployment inventorying tools
Example risks and opportunities
Illustrative examples of compliance risks underlying various types of third-parties and the opportunities it presents for cost and revenue recovery

### Direct suppliers

<table>
<thead>
<tr>
<th>Contract manufacturers</th>
<th>Suppliers of raw materials</th>
<th>Equipment suppliers</th>
<th>Dealers</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Over-reported/ non-contractual pass-through costs charged</td>
<td>• Lack of clarity over pricing of key chemical inputs</td>
<td>• Non-adherence to contractual pricing structure</td>
<td>• Under reported revenue</td>
</tr>
<tr>
<td>• Reputational impact of inadequate quality control procedures</td>
<td>• Incorrect benchmarking of raw material costs</td>
<td>• Mis-calculation of individual and volume discounts</td>
<td>• Compliance with regulatory requirements</td>
</tr>
<tr>
<td>• IP security and infringement concerns</td>
<td>• Non-contractual exchange rates applied</td>
<td>• Under-reporting or non-payment of volume rebates</td>
<td>• Special pricing promotion incentives</td>
</tr>
</tbody>
</table>

### Indirect suppliers

<table>
<thead>
<tr>
<th>IT suppliers</th>
<th>Marketing services</th>
<th>Travel agents</th>
<th>Outsourced business functions</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Over-reported charges for hardware and software products</td>
<td>• Acting in an unethical manner, leading to reputational damage for client</td>
<td>• Use of non-contractual rates</td>
<td>• Incorrect timesheets provided to client or used for cost reporting</td>
</tr>
<tr>
<td>• Incorrect charging of rates and hours for consultants, overtime and expenses</td>
<td>• Breach of regulations in relation to provision of gifts or hospitality</td>
<td>• Under-reporting or non-payment of airline rebates</td>
<td>• Duties not performed to required service levels</td>
</tr>
<tr>
<td>• Lack of understanding over software licensing terms and conditions</td>
<td>• Over-reporting of costs or mis-allocation of costs</td>
<td>• Incorrect charging of point of sales fees</td>
<td>• Over-reporting of costs or mis-allocation of costs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Uplifted hotel rates charged</td>
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</tbody>
</table>
Cost and revenue recovery—Getting started
Effective monitoring and data analytics of business partner relationships can often lead to significant cost reduction and revenue recoveries

Below are some initial steps that can help identify potential opportunities:

1. Take inventory of significant external revenue streams, key contracts, and areas of potential leakage

2. Identify repeatable use cases where revenue enhancement or cost reduction steps can be undertaken across common sets of third parties

3. Evaluate vendor, agent, and alliance partner areas for recovery opportunities

4. Identify high-value business cases to pilot and establish a granular project plan and roadmap for broad/global implementation
## Estimated savings by recovery area

Listed below are third-party cost recovery areas and average savings we have seen based on our experience.

<table>
<thead>
<tr>
<th>Recovery area</th>
<th>Savings levers</th>
<th>Average savings %*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Accounts Payable Review</strong></td>
<td>• Cost recovery driven from payables spend&lt;br&gt;• Typical levers are duplicate payments, missed volume discounts, etc.</td>
<td>• 2–10% of AP spend</td>
</tr>
<tr>
<td><strong>Contract Compliance</strong></td>
<td>• Cost recovery based on post contracting audits on large spends. Cost savings areas might include: duplicate incorrect rate billings, non-reimbursable items, payroll variances, etc.</td>
<td>• 1%–5% of contract spend</td>
</tr>
<tr>
<td><strong>Joint Venture Review</strong></td>
<td>• Cost savings/recovery driven from claims against operator of a JV&lt;br&gt;• Typical claims include: incorrect allocation rates and expenses, unsupported overhead charges, etc.</td>
<td>• 10%–15% on expenses side</td>
</tr>
<tr>
<td><strong>Tax Recovery</strong></td>
<td>• Cost recovery drivers from various indirect taxes: Sales/use, VAT, Excise and Severance.</td>
<td>• 15%–20% of indirect tax paid</td>
</tr>
<tr>
<td><strong>Construction Cost Audit</strong></td>
<td>• Cost recovery driven from review of project spend&lt;br&gt;• Typical levers are unsubstantiated change orders, incorrect labor charges, and allowances</td>
<td>• 1%–5% of contract spend</td>
</tr>
<tr>
<td><strong>Software Asset Management</strong></td>
<td>• Cost savings driven from reduction in software expenses and minimized service risk which can be directed toward value-added IT projects.</td>
<td>• 15%–20% of software spend</td>
</tr>
<tr>
<td><strong>Other-Telecom, Advertising, Most Favored Customer Reviews</strong></td>
<td>• Cost savings/recovery driven from other high risk areas&lt;br&gt;• Typical claims include; telecom billing errors, media credit errors, not receiving MFC rates</td>
<td>• 1%–5% of telecom and advertising spend&lt;br&gt;• 5%–10% of MFC spend</td>
</tr>
</tbody>
</table>

* Actual savings will vary based on size of company, third-party spend, industry etc.
Some benefits

Cost and revenue recovery strategies can lead to larger benefits across the universe of the third-party risk management program and could include...

1. Leakage prevention
2. Better contract negotiation
3. Stronger third-party relationships
4. Robust governance and controls over third-parties
5. Self-funding of EERM program
Polling question #5

Our current EERM program optimizes cost and reduces revenue leakage with our third-party relationships:

a) Hardly any focus on cost optimization or revenue leakage in our current EERM program

b) Limited focus on cost optimization and reduction of revenue leakages (e.g., due to reliance on upfront controls on initiation of a contract only)

c) Some focus on cost optimization and reduction of revenue leakages (e.g., contract renegotiations resulting from periodic rate benchmarking and assessments of third parties)

d) Significant ongoing focus through regular cost and revenue recovery assessments of third parties

e) Don’t know/Not applicable
Question and answer
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