

CFO *Agenda*

Linking risk and performance



CFO Agenda

How do you turn risk management into a competitive advantage that drives performance? CFOs are increasingly tasked with this mandate as their role evolves to strategic partner of the CEO.

In the past, risk management was performed in silos, separate from the overall performance management function. CFOs now need to take a holistic approach and integrate the two to create a competitive advantage and differentiator for their organizations.

Moving from a reactive, compliance-centric approach to a proactive strategic driver of performance is a significant paradigm shift and a necessary one in this very competitive and tough global economic climate where organizations must do more with less. It's a transformational initiative critical to move organizations to the next level of growth. While there's no cookie cutter, one-size-fits-all solution it's a direction that organizations regardless of industry, sector and maturity of their business should be striving towards.

More and more CFOs who are effective and successful are playing strategic roles in their organizations and getting involved in wide-ranging initiatives, such as helping address new operational challenges, implementing new technologies and enhancing brand image, all with an eye to risk. In other words, CFOs are rolling up their sleeves and helping integrate risk management with strategic planning, financial management and performance.

The challenges

In many ways, the evolution of the role of the CFO mirrors that of the evolution of the role of technology. For example, 15 years ago enterprise resource planning (ERP) business management software was largely focused on accounting and financial reporting as was the CFO. Now ERP programs touch on continuity planning, controls design, health, safety and environmental sustainability; the full spectrum of the business is represented by the software. The challenge is getting each of those elements to work together to create more efficiency as opposed to creating more processes. That challenge falls to the CFO who must close the loop between people, process, technology and strategy. To be successful, CFOs need to address many stakeholder requirements, create a common language around risk and make the link to performance in order to bring risk management into the day-to-day operations of the organization.

Creating those linkages is critical in today's globally interconnected marketplace where the speed of communication and increasing regulations add to the complexity and magnitude of risk. The landscape of the risk assessment that needs to be performed has been extended, not only in individual organizations but in dealings with business partners and further still to brand image and reputational risk. Everyone in an organization has to take responsibility for managing risk—it can no longer be left to the audit or compliance functions. That was made clear by the excessive risk taking that led to the financial and economic crisis of 2008. Companies have to disclose a lot more information and they have to demonstrate transparency. Risk is now a boardroom issue and accountability has to cascade throughout the organization to ensure that there is the right balance between risk and performance. The CFO plays a critical role in making this happen. Today a CFO's job description entails finding the right level of control to manage risk while enhancing performance and making those critical linkages.



CFOs need to manage risks throughout the organization to drive performance

Many organizations encounter difficulties with integrating performance and risk management. CFOs and senior management sometimes miss important signals of threats to driving a risk resilient business. For many organizations, risk management practices must evolve from a silo design and separate processes to one that's embedded uniformly in all strategic and performance management processes. Key performance reports used to run the business need to be enhanced to include risk factors in addition to financial and non-financial indicators. There's a need to strive for reliable risk information to more clearly understand the sources of and linkages between risks. Collaborative risk mitigation among independent business units of a single organization as well as with supply chain partners need to be designed and embedded in the standard operating model.

At a more tactical level, some of the recurring challenges reported include the lack of explicitly appointed executive ownership leading to slow or no progress on linking risk and performance; the disparate systems in existence at many organizations with multiple systems being maintained for financial and risk reporting; and more specifically, inconsistent data residing in multiple systems that prohibit linking performance and risk indicators.

CFO Agenda



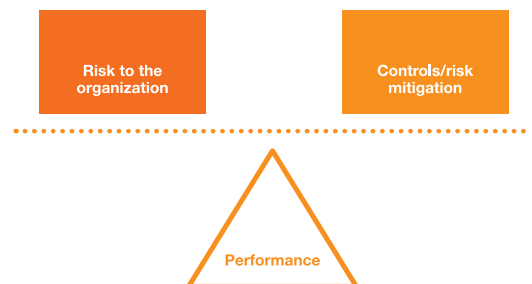
Striking the right balance

Striking the right balance comes down to having a clear understanding of how risk is perceived in the organization. What's the risk appetite within your organization? That's the starting point for any discussion about risk. Only with this knowledge is it possible to comprehensively define the risks that need to be managed and design the controls and performance expectations around those risks. Organizations can then take the next step of balancing risk with the cost of mitigating that risk in a way that helps the organization achieve its strategic objectives.

A well-designed and executed risk program applies the appropriate level of human resources and capital in order to reduce the risk and remove the barriers that would prevent the organization from achieving its desired performance. Every organization has finite resources and prioritizing in order to achieve the greatest benefit is critical. The key is to prioritize risks for impact and likelihood. This will lead to the controls necessary to advance strategic objectives and that reflect the organization's risk tolerance. There are times when the probability of risk turning into a reality is so low, there's no value in directing resources to manage that risk. That's why it's important to understand how you define risk in your organization and what level of risk you are willing to tolerate.

This is where the CFO as a strategic partner of the CEO, has a better appreciation of what the organization needs to do to move forward. In the past, CFOs concentrated on financial statements and controls that would allow them to get their numbers in on a timely basis. To drive real value out of comprehensive risk management and drive the most benefit from controls, the CFO needs to be proactive and ensure risk management, controls reporting and transparency initiatives are aligned with overall performance and brand image in the marketplace.

Figure 1:
Striking the right balance



Today, there's a growing recognition that risk management needs to be part of a comprehensive strategic plan in which the risks that could prevent the organization from achieving its objectives are identified and addressed.

Building risk mitigation into the strategic plan

For a long time, the strategic plan was separate from the risk mitigation plan. Whereas the strategic plan outlined specific objectives, action steps to achieve goals, benchmarks to measure progress and a clear picture of what success looks like, the risk mitigation plan was often not as well defined, with no clear vision of success or targets to measure. The result: the strategic plan was in effect the to-do list while the risk mitigation plan was often left aside and referred to only when it was necessary to respond to a problem.

Today, there's a growing recognition that risk management needs to be part of a comprehensive strategic plan in which the risks that could prevent the organization from achieving its objectives are identified and addressed. Financial institutions have moved the furthest on this front and have developed robust programs that address organizational risk well beyond financial reporting and compliance.

One of the greatest shortcomings in the risk management process is not the ability to identify or assess risk or create risk mitigation plans but the fact that typically people are not held accountable to those plans. In order to fully bring risk management into the strategic plan and hold people accountable, it is necessary to build a formal set of measures and targets around risk mitigation initiatives. This ensures the initiatives are owned by stakeholders in the organization and offers a practical way to link risk back to objectives.

People, process and technology

People, process and technology are all part of defining risk and ensuring everyone has the same understanding of what risk means in a given organization. From a people perspective for example, the finance department may view risk as it relates to managing bank covenants but the marketing department may view risk with respect to brand and reputation in the market. Consistent processes and technology offer the opportunity to reduce redundancies within risk mitigation practices and to make sure everyone is talking the same language around risk.

Critical steps for CFOs to build risk mitigation into the strategic plan

- **Define** the organization's risk tolerance.
- **Prioritize** risk by impact and probability and allocate resources accordingly.
- **Include** risk management in the strategic plan. Identify the objectives to be achieved. Agree on what success looks like from a risk perspective and develop initiatives and action steps to get there.
- **Establish** a formalized process to track financial targets through a risk lens to see how people are managing risks. Set targets and metrics to measure progress and outcomes.
- **Build** accountability into the process by putting risk management in the annual goals. That's how you can get risk management into people's day-to-day activities.



Well-designed and aligned ERP systems can help connect people and processes to strategic objectives.

Technology in particular can aid in both people and processes being aligned to the organization's strategic priorities. It can help link risk to objectives and cascade that information throughout the organization. In fact, ERP implementations that have been customized to suit the needs of a specific organization can help ensure everyone is speaking the same language when it comes to risk and performance measures. ERP systems are able to share information such as key performance indicators and monitor how one part of the business is doing compared to another. That's when a holistic picture of operations starts to emerge.

This is only possible however, when controls, in addition to performance reporting requirements, are integrated into the ERP implementation, and the system itself is configured to avoid redundancies and drive the most value from risk mitigation practices and a balanced and efficient internal controls process. The technology needs to be customized to align risk and business objectives within the unique business model of the organization.

Companies are at different stages of maturity when it comes to their risk management programs and the integration of ERP systems. Many are not taking advantage of quick wins that could be achieved by using technology to its full advantage. Rather, as the complexity around regulations and compliance has increased, the trend has been to add on as-needed approaches and solutions to risk mitigation. Those organizations that are willing to reexamine processes around risk and create a common platform approach are also able to develop programs that allow them to be in continuous compliance and continuous controls mode. This then frees up more resources to focus on change drivers and performance initiatives. Well-designed and aligned ERP systems can help connect people and processes to objectives.

A good way to approach the management of enterprise risk is to build on existing systems and processes. The goal is to incrementally augment existing ERP systems, templates or dashboards as opposed to creating a new distinct process. In this way, managing risk becomes part of the day-to-day systems already being used and user buy-in is guaranteed. At the same time, incremental change across the whole process can have profound effects.



Our CFO Agenda articles provide our perspectives on the issues that keep Canada's senior finance executives awake at night, as their roles within the enterprise continue to evolve with changing market dynamics.

Key benefits of integrating risk and performance management

By integrating risk management with performance, CFOs can help add value for various stakeholder groups.

Benefits for the board

- Enhanced understanding of risk appetite and risk tolerance in the context of the business strategy, which allows the organization to be more nimble while maintaining quality.

Benefits for the C-suite

- A vehicle for systematic identification of risks that are key to strategy across the business portfolio and address their impacts on financial and operational performance.
- Cost savings and market differentiator resulting from clearer articulation of where resources need to be applied in order to achieve objectives.

Benefits for shareholders

- Drives increased alignment of the financial incentives for risk taking with defined and calculated results.
- Allows for explicitly assessing specific risks when creating and evaluating performance goals of new projects or investments at the business unit level and in the context of the company's overall business portfolio.
- Confidence within the market that the organization is competitive, which in turn will minimize the variability in share prices.

Benefits for staff

- Focuses resources, financial and operational, to initiatives where the risk-reward proposition is clearly defined and better meets basic conditions for success, driving related recognition and compensation.

Benefits for customers

- Efficiencies which translate into leaner processes, improving customer experience through
 - o competitive products
 - o better pricing
 - o enhanced customer service

Benefits for regulators

- More assurance that the organization is risk resilient, transparent and responsible.

Benefits for strategic partners

- An integrated risk and performance management plan with an operational and technology environment, which breaks down legal and process barriers, facilitating the ability to go to market with partners. This is essential in today's business environment to stay competitive.

Aligning risk management and performance measurement helps organizations stay on track and get ahead. With the increasingly strategic role that CFOs play in driving organizational performance, they can help their organization be better positioned for future success.

Who to contact

National Finance Effectiveness Leader

Samir Bishara

416 814 5730

samir.bishara@ca.pwc.com

National Risk & Controls Leader

Arturo Lopez

416 941 8219

arturo.j.lopez@ca.pwc.com

Vancouver

Jeff Wong

604 806 7105

jeff.c.wong@ca.pwc.com

Calgary

Todd Dixon

403 509 6388

todd.dixon@ca.pwc.com

Toronto

Peter Hargitai

416 941 8464

peter.hargitai@ca.pwc.com

Paul Ingram

416 815 5230

paul.r.ingram@ca.pwc.com

Montreal

Sebastien Doyon

514 205 5382

sebastien.doyon@ca.pwc.com

Our CFO Agenda articles provide our perspectives on the issues that keep Canada's senior finance executives awake at night, as their roles within the enterprise continue to evolve with changing market dynamics.