Extended Enterprise Risk Management

Overview of Risks and Methodologies/Tools to Address

FEI Presentation

June 7, 2016
Our POV on Extended Enterprise Risk Management
Operational Risk Framework

Organizations are continuously exposed to a multitude of risks, emerging from within and outside of their value chains.

**Macro environment risks**
*Impact the breadth of the entire supply chain*

**Extended value chain risks**
*Originates in upstream and downstream supply chain partners*

**Operational risks**
*Relate to internal process risks*

**Functional risks**
*Exist among enabling functions that support operational processes*
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

What could go wrong?

Supply Chain Risk – Energy companies engage in highly complex projects with multiple layers of contractors and subcontractors. This complex network of contractors increases the risk of: duplicate billings, inappropriate markups, improper related party billing, failure to identify receive goods/services billed for, and overbilling relative to terms of contract. Potential overcharges on Deloitte contractor audits average of 1-5% of contract spend based on experience.

Export Controls Risk –
Energy companies utilize critical machinery and equipment, many types of which are subject to export controls regulations. In 2013, a large oil and gas company agreed to a $50 million civil penalty following allegations of exporting critical equipment to Iran, Syria, and Cuba in violation of the Export Administration Regulations (EAR) and other U.S. sanctions. In this specific case, some of the equipment transfers took place via the company’s Dubai-based subsidiary. Increasing third party administration and monitoring could prevent similar violations and ensure proper regulatory compliance.

Environmental, Health, & Safety – A super major oil & gas company was forced to pay out over $680M in settlements as a result of a catastrophic oil spill at one of its offshore rigs. This accident caused irreparable damage to the company’s reputation, significant impact to the stock price, damage to surrounding wild life and communities, lawsuits from citizens and small businesses, etc. Increasing third party administration and monitoring could prevent future accidents and increase a company’s reaction time.

Regulatory & Compliance – A large oil and gas company was forced to pay penalties and back payments on their U.S. energy leases and settled lawsuits accusing them of fraudulently underestimating the value of oil and gas to lower their royalty payments. Lack of due diligence regarding third party monitoring and risk assessments exposed the company to these costs.

With the use and complexity of the extended enterprise projected to be on the rise, stories of mis-steps in the extended enterprise continue to be prevalent.
The Extended Enterprise
Management challenges

There are several **challenges with managing the Extended Enterprise**. The findings from a recent Deloitte survey, which had representation from twenty-two industry sectors, is telling:

<table>
<thead>
<tr>
<th>How would you rate your extended enterprise management capabilities?</th>
<th>Percentage of respondents who rate themselves above average</th>
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</thead>
<tbody>
<tr>
<td>Financial and commercial management</td>
<td>49%</td>
</tr>
<tr>
<td>Contract management</td>
<td>39%</td>
</tr>
<tr>
<td>Governance</td>
<td>38%</td>
</tr>
<tr>
<td>Service performance management</td>
<td>33%</td>
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<tr>
<td>Issue and dispute management</td>
<td>33%</td>
</tr>
<tr>
<td>Transformation and transition oversight</td>
<td>31%</td>
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<tr>
<td>Service request management</td>
<td>30%</td>
</tr>
<tr>
<td>Multi-service provider integration</td>
<td>28%</td>
</tr>
<tr>
<td>Risk management and 3rd-party compliance</td>
<td>22%</td>
</tr>
<tr>
<td>Document management</td>
<td>19%</td>
</tr>
</tbody>
</table>

* Deloitte’s 2014 global outsourcing and insourcing survey
The Risk Execution Gap

While most companies have experienced supply chain risk events and aspire to better manage these risks, few have confidence in their ability to effectively do so.

87% of respondents have faced a disruptive incident with third parties in the last 2-3 years…

28% faced major disruption…

11% experienced a complete third party failure

55.1% of respondents aspire to have integrated third party risk management systems in a year or more, with 16.5% aspiring to be “best-in-class”

94.3% of respondents have only low to moderate confidence in the tools and technology used to manage third party risk and 88.6% have a similar level of confidence in the underlying risk management processes, despite significantly higher levels of confidence in organizational commitment and governance frameworks – creating the execution gap

Source: Deloitte 2016 global survey on Third Party Governance and Risk Management of 170 organizations
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 will evolving technologies, market trends, or disruptive forces present opportunities and challenges to our third party relationships?
- How do we keep up with the emerging regulatory requirements? Are our third parties keeping up?
- How do we ensure that appropriate contracts are in place with third parties, that they are meeting expectations, and complying with contractual commitments?
Established in 1997, Deloitte’s Business Intelligence Services (BIS) team is staffed with more than 240 investigators in 20 countries across the globe that are fluent in more than 85 languages.

The BIS due diligence methodology was developed to help clients identify risks within their supply chain, validate information during Mergers and Acquisitions (M&A) and provide executives with insight into their business operations and the reputation of current and potential partners.

The BIS approach to due diligence seeks to answer the following sample questions which may be of interest to a client:

- Are there FCPA allegations associated with this company or its executives?
- Are any of the company’s executives considered politically exposed persons?
- Is the company operating in countries or regions with potentially high levels of corruption?
- Is the company or its executives being investigated by local authorities?
- How financially stable is the company?
- Is the company at risk of being acquired?
- Are there lawsuits involving this company?
- Is there worrisome media about the company?
## Business Intelligence Services Methodology

Deloitte’s manual due diligence methodology follows a four-tiered approach. Marigold is currently capable of expediting a Level 1 investigation; persistently monitoring that entity; and providing the foundation to quickly get to a Level 2, 3 or 4 investigation if warranted.

<table>
<thead>
<tr>
<th>Covered by Marigold</th>
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<tbody>
<tr>
<td><strong>Level 1</strong>&lt;br&gt;• Usually conducted to rapidly determine if a company is a “bona fide” entity and to uncover any major issues of concern&lt;br&gt;• Will not give insight into many of the people associated with a company, or information contained in non-English sources</td>
</tr>
<tr>
<td><strong>Level 2</strong>&lt;br&gt;• The “standard” level of investigation needed to determine whether a company or its key officers have any significant issues of concern&lt;br&gt;• Will not give insight into non-public data, or information that can only be obtained locally</td>
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<tr>
<td><strong>Level 3</strong>&lt;br&gt;• Research is usually done after issues of concern, or ambiguities, are identified at Level 2. It is a deeper investigation into those issues and includes more intense scrutiny of individuals associated with the company or person of interest</td>
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<tr>
<td><strong>Level 4</strong>&lt;br&gt;• Research is the deepest level of research, usually in cases where the risk to our client could be significant, or when a notable absence of information exists regarding a company or individual. Therefore, Level 4 involves research into non-public information and potential site visits and/or engagement with the subject</td>
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Marigold is a force-multiplier; it enables companies to stay ahead of emergent risk and point limited resources in the direction where they are most needed.
Marigold Overview

Marigold, provides visibility into global vendor risk through automated, proactive risk assessment and monitoring at the vendor level.

Marigold Automates Risk Monitoring

- **Aggregate**
  - Gathers relevant data from disparate data sources to build a complete corporate profile

- **Automate**
  - Automates third party due diligence based on nearly 800 pre-defined rule sets that can be tailored

- **Analyze**
  - Provides a platform for an analyst to conduct further analysis on critical information that surface

- **Alert**
  - Continuously monitors and generates automatic alerts in response to critical changes

Marigold Enables Vendor Due Diligence Process

- Identifies current FCPA allegations associated with the company or its executives
- Determines company executives considered politically exposed persons
- Assesses operations in countries or regions with potentially high levels of corruption
- Uncovers current investigations by local authorities and agencies
- Evaluates financial stability of the company
- Measures company acquisition risk
- Identifies lawsuits against the company
- Discovers worrisome or negative media reporting about the company

Marigold is a web-based application that automates the identification, assessment and monitoring of vendor risk through proprietary algorithms and an automated alert system.
Marigold

Design

Marigold connects to data aggregators, manages data, and conducts thousands of due diligence, rule-based queries on a persistent basis.

- **Rules Engine**
  - Over 760 rules or algorithms divided into six categories of risk.
  - Tailorable to a client’s specific risk needs.
- **Data Aggregators**
  - Currently 10 data aggregators with access to thousands of local and international sources with information on companies, subsidiaries and executives.
  - Configurable to include proprietary databases.
- **Data Management**
  - Structured data processed through name match technology and rules engine.
  - Unstructured data is managed by key word searches, thematic clustering and timelines.

Marigold is a web-based application that automates the identification, assessment and monitoring of vendor risk through proprietary algorithms and an automated alert system.
Marigold Integration

We recommend integrating Marigold with client’s supplier relationship management solution to seamlessly share information.

Marigold was built with an open architecture designed to integrate with supplier relationship management programs

- **Screen**: Vendor will be vetted in Marigold upon registering with, and being deemed qualified by a client, to fill a sourcing need.

- **Monitor**: After negotiations and contracting is complete, Marigold will periodically monitor vendor for any emerging issues.

- **Analyze**: As a vendor’s risk assessment is completed and updated, the summary and risk score and will be fed into client’s supplier profile within the portal, allowing for a holistic and detailed view of the vendor portfolio.
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.