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Risk Angles
Five questions on risk-adjusted forecasting and planning

An interview with Nick Pope, director, Deloitte UK and a closer look by Charles Alsdorf, director, Deloitte Financial Advisory Services LLP in the United States.

Companies today face a dizzying array of risks, from regulatory pressures and competitor actions to talent shortages and cost volatility — and everything in between. These risks can have a significant impact on financial performance. Yet most financial forecasts and plans still revolve around single-point estimates and metrics that do not objectively consider a company's unique combination of key risks.

In this issue of Risk Angles, Nick Pope discusses an approach to forecasting and planning that analyzes and tests multiple risk variables to help executives present forward-looking numbers with greater confidence — and manage key business risks more effectively. Then, Charles Alsdorf shares his perspective on how CFOs can benefit by taking an investor's view when preparing forecasts and plans.

Question	Nick's take
What drawbacks are there to traditional forecasts and plans?	Most decision-makers recognize the limitations of the traditional approach, which produces single-point plans and forecasts using broad-brush safety cushions that often don't reflect the real-world risks a company is facing. A risk-adjusted approach enables executives and other key stakeholders to have much greater confidence in the numbers. It also helps a company manage its business risks more effectively.
How can a risk-adjusted approach to forecasting and planning be beneficial?	Risk-adjusted forecasting and planning is an approach to forecasting that generates a range of possible outcomes and probabilities based on an analysis of multiple risk variables. Key measures such as cash-flow-at-risk and earnings-at-risk are generated by "shocking" financial forecasts against major risk drivers to create a probability distribution for each period. This rigorous method provides a unique and illuminating perspective on a company's overall risk profile and individual risk components.
Is risk-adjusted forecasting and planning just a concept, or are companies actually using it today?	Companies in highly volatile industries such as energy and resources are increasingly adopting a risk-adjusted approach as an essential part of their standard forecasting and planning processes. However, the basic methods and tools are applicable to every industry, and we expect to see widespread adoption as more and more companies come under scrutiny because their traditional plans and forecasts are not robust enough to handle the ups and downs of today's complex business environment.
Will analysts and board members be able to understand the results?	Absolutely. In fact, much of the demand for this new approach is coming from outside the C-Suite. Analysts, boards, investors, and ratings agencies all recognize the limitations of traditional forecasting and planning and are demanding deeper insights about risk. A risk-adjusted approach provides insights that are more detailed and nuanced, yet delivers them in a more digestible medium with charts and graphs that make risk easy to visualize.
How do we get started?	A good way to start is with a pilot or proof-of-concept that focuses on group-level forecasts, or on a particular business unit or product profit and loss statement. Input to the model should be a balanced mix of quantitative data and qualitative insights from subject matter experts. Over time, the pilot can evolve and expand in response to future business needs.

A closer look: Taking the next step

Charles Alsdorf

When it comes to forecasting and planning, it's useful to think like an investor or analyst. A risk-adjusted approach provides deep insights into the risks and assumptions behind a company's forward-looking numbers. This typically gives those involved — both internally and externally — much greater confidence that the forecasts and plans are realistic and achievable.

Capturing risks and planning assumptions in a quantitative model supplements existing estimates and intuition with systematized rules that can be analyzed and improved. The result? Greater transparency, repeatability and rigor.

Plus, improved integration with the risk management and strategic planning processes enables the forecasting and budgeting process to tap into existing organizational knowledge about key business risks — without having to reinvent the wheel. In fact, risk-adjusted forecasting and planning doesn't just produce more accurate and reliable numbers; it can actually boost business performance by improving a company's understanding of key risks — and their likely impact — so leaders and managers can take action to avoid or mitigate problems before they occur as well as take advantage of opportunities to enhance value by leveraging the upside of risks. This can also support investment decision-making and capital allocation processes.

Given the growing complexity and uncertainty in today's global business environment, we believe companies that adopt risk-adjusted forecasting and planning will be better positioned to gain a competitive edge. Conversely, those that don't may be stifled and be exposing themselves to unacceptable levels of risk.

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