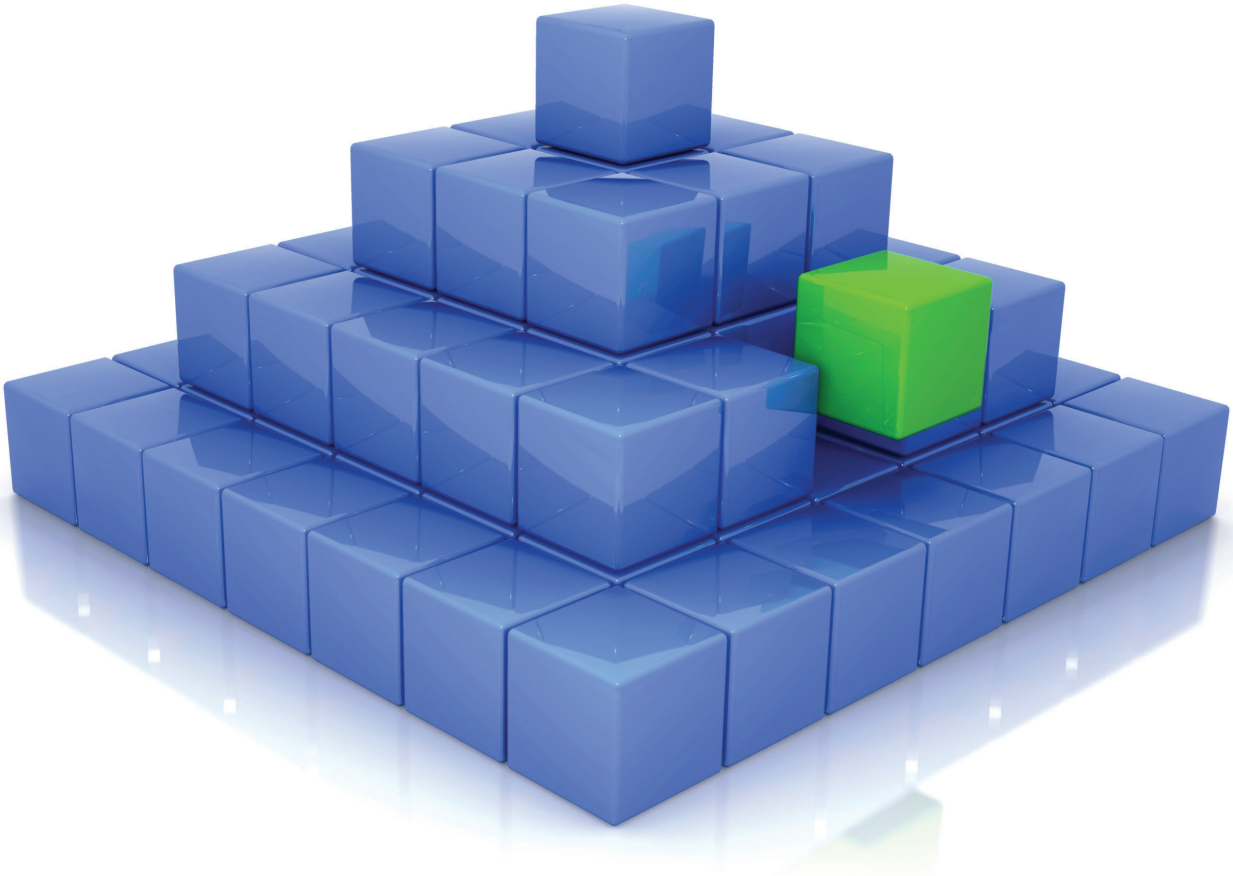
Deloitte.

Risk Management

Thriving in uncertain times by creating a Risk Intelligent Enterprise™



How do organisations ensure that they achieve their strategic objectives despite astonishing uncertainty and turbulences? What is their appetite for risk and risk tolerance? What are the best ways for boards to make certain that enterprise value and risk are being appropriately managed?

These are some of the critical questions in the minds of executives and board directors. Organisations need to survive and thrive despite increasingly volatile conditions.

Principles for building Risk Intelligent Enterprise

As a result of these conditions, there is now an urgent need for organisations to review their approach to risk management and become risk intelligent. Risk Intelligent Enterprises maintain a balance between risk (threat) and reward (opportunity), ensuring that some risks are taken to create future value and others are avoided to protect existing value.

Deloitte's Risk Intelligent Enterprise™ philosophy and proven methodology are based on nine fundamental principles of risk intelligence, as shown in the diagram below.

To maintain alignment between risk exposures and business strategy, a Risk Intelligent Enterprise draws on the co-ordinated efforts of three levels of risk management responsibility, graphically represented as a three-layered triangle in Deloitte's Risk Intelligent Enterprise framework:

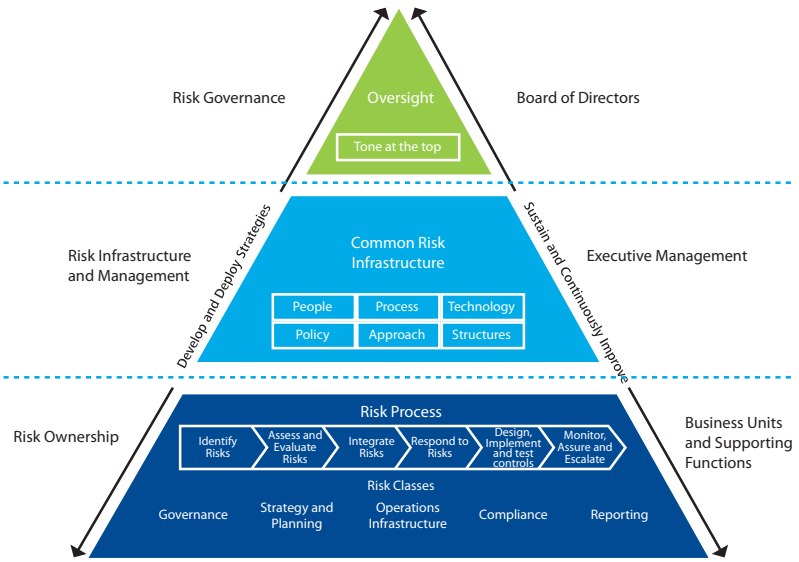
- Risk governance, including strategic decision-making and risk oversight, led by the board of directors.
- Risk infrastructure and management, including designing, implementing, and maintaining an effective risk management programme, led by executive management.
- Risk ownership, including identifying, measuring, monitoring, and reporting on specific risks, led by the business units and functions.

The top level, risk governance, directs the Risk Intelligent Enterprise. It defines the parameters of acceptable risk, monitors strategic alignment, and sets overall risk management expectations. The bottom level of risk ownership, in turn, is what risk governance relies on to execute Risk Intelligence. This includes all of the functions' and business units' responsibilities with regard to identifying, evaluating, mitigating, and responding to risks in accordance with risk governance mandates.

Nine principles for building a Risk Intelligent Enterprise

- Governing Bodies Responsibility
- Roles and Responsibilities
- Common Definition of Risk
- Common Risk Framework
- Common Risk Infrastructure
- Executive Management Responsibility
- Objective Assurance and Monitoring
- Business Unit Responsibility
- Support of Pervasive Functions

The Risk Intelligent Enterprise™



In order for organisations to continue growing their brand, improve revenue growth, operating margins and asset productivity despite uncertainty, they should embed risk management into strategy planning and monitoring.

The middle level, risk infrastructure and management, forms the essential link between risk governance and risk ownership. Composed of the three "pillars" of people, process, and technology, we believe that an effective "common" risk management infrastructure — that is, an infrastructure that supports consistent risk management approaches throughout the organisation — is essential to give executive management an enterprise-wide view of risk, particularly across four key areas:

- Strategic risks: related both to and of the organisation's strategic objectives, identified by the C-suite in agreement with the board.
- Operational risks: major risks that affect the organisation's ability to execute the strategic plan.
- Financial risks: in areas including financial reporting, valuation, market, liquidity, and credit risks.
- Compliance risks: related to legal and regulatory compliance.

Embedding risk management into strategy planning and monitoring

In order for organisations to continue growing their brand, improve revenue growth, operating margins and asset productivity despite uncertainty, they should embed risk management into strategy planning and monitoring.

One way of doing this is to ensure that the risks resulting from the adopted strategy are differentiated from the risks which may pose threats to the strategy itself. This is the crucial step in ensuring that risk management is aligned and embedded in the strategy planning. The process has to highlight shortcomings in the strategy while also pointing out those strategic objectives that may be at risk. The mitigation approaches for the strategy and strategic risks must also form part of the broad set of corporate initiatives to be implemented in order to execute the strategy and to achieve its objectives.
The appropriate way of embedding risk management into strategy planning and monitoring is to link the corporate Key Performance Indicators (KPIs) to the Key Risk Indicators (KRIs). The tracking and monitoring of the KPIs should be informed by the KRIs. This will ensure that risk management is an integral part of both the strategy planning and corporate performance tracking and elevates it to one of the critical points on both the executive and the board agendas.

Shareholder value in any commercial organisation is driven by revenue growth, operating margin, asset efficiency and expectations, but value and risk are inextricably linked and it is not possible to discuss the two concepts separately. Business thrives by taking risks but falters when risk is managed ineffectively. A Risk Intelligent Enterprise™ recognises this dual nature of risk and devotes sufficient resources both to risk taking for reward and to the protection of existing assets.

The Deloitte Risk Intelligence Map™ (refer to diagram below) provides a unique view on the pervasive, evolving and interconnected nature of risk that executives and managers may find useful in identifying risks that apply to their organisations. The Risk Intelligence Map™ is intended to serve as guides on the journey towards Risk Intelligence, by helping personnel in all functions of an organisation broaden their perspective on risk and improve their ability to execute their risk-related responsibilities. The Risk Intelligence Map™ can be used to:

- Spur discussions about risk management topics, including risk identification, prioritisation, measurement and mitigation.
- Facilitate the connection of risk management silos.
- Identify redundant efforts in place to manage risk.
- Improve efficiency in compliance and risk management efforts.
- Develop risk event scenarios that require integrated responses.

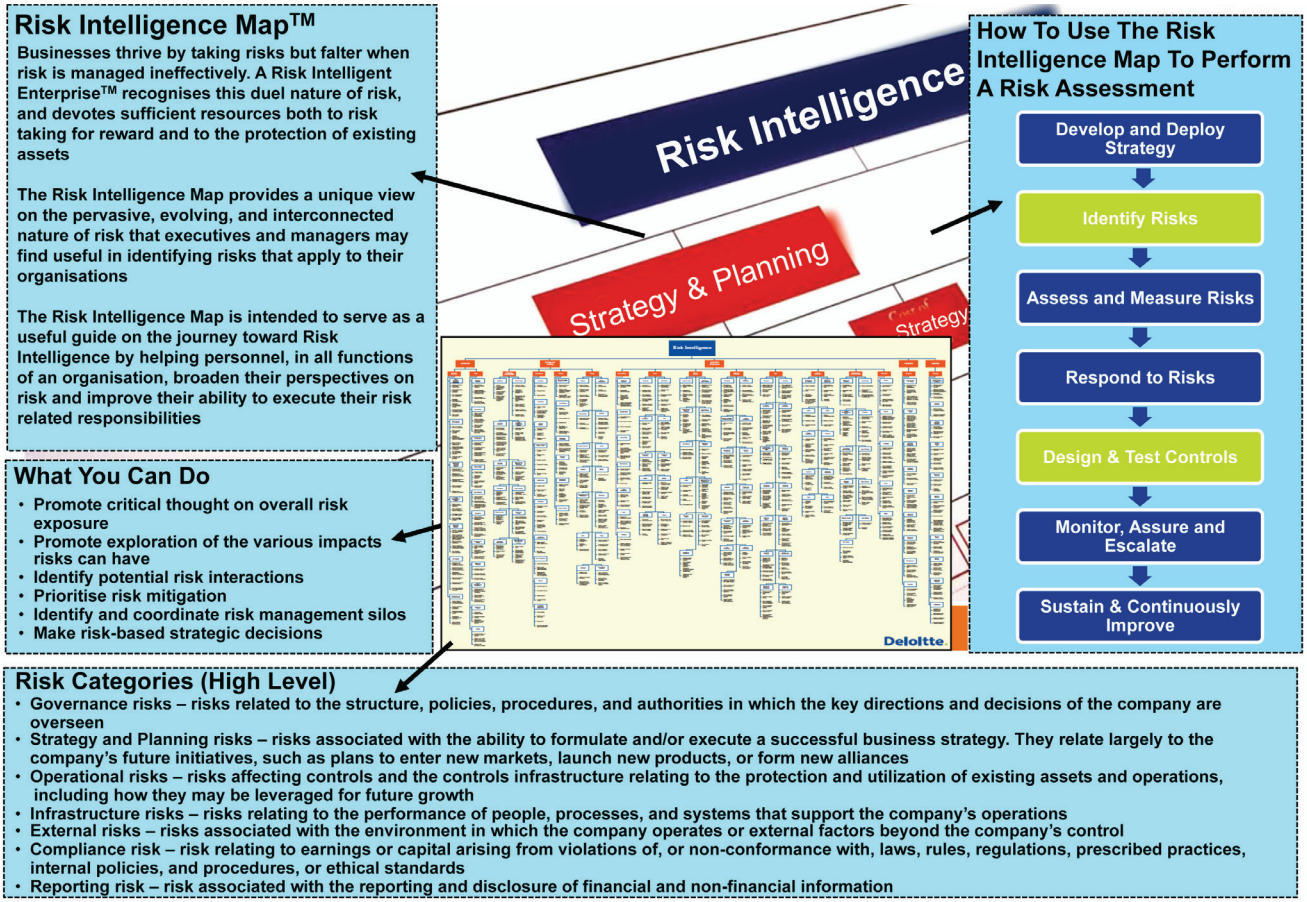
The Risk Intelligence Map™ should be used as part of an overall risk management programme that is based on the fundamental principles of the Risk Intelligent Enterprise™. These principles define and integrate risk-related responsibilities at every level of the organisation, and address issues around governance, infrastructure, management and ownership.

By implementing these principles, a company can transform itself into a Risk Intelligent Organisation where:

- Leaders adopt a broad outlook on risk and integrate risk considerations into strategic decision-making.
- The Board executes fiduciary responsibilities to ensure that appropriate risk management controls and procedures are in place.
- Capable processes, systems and trained personnel exist to act on both risks and opportunities in a timely and co-ordinated manner.
- A consistent approach is used across the organisation to manage all classes of risk in an effective and efficient manner.

The Risk Intelligence Map™ is not a definitive or comprehensive representation of risks that may be encountered by an organisation. Organisations may consider customising the Risk Intelligence Map™ based on specific risks relevant to their circumstances. For example, the risk areas significant to a particular organisation may include regulatory, geographic, industry and company-specific issues.

The diagram below depicts the Risk Map.



10 Essential Risk Intelligence Skills:

Enterprise risk intelligence comprises ten skills essential to the art and discipline of robust enterprise management.

These skills form the core of enterprise risk intelligence. While events may be mildly random, they can also be "widely" random. Risk Intelligence generates awareness of risk at all levels within an integrated framework to obtain the best intelligence available under the circumstances.

The goal is to achieve decision superiority and competitive success, by considering these essential practices:

1. **Check your assumptions about the "knowns"**
   Organisations should challenge "life and death" assumptions they have concerning their business model and competitive environment. A focus on experience can be misleading as this can amount to counting on false assumptions which is often at the root of business crisis, loss and failure. By challenging conventional wisdom and changing the rules of the game, organisations might find a considerable source of opportunity. For a risk intelligent approach to strategy, organisations should consider identifying their "white swans", or the current "life and death" and their "black swans".
2. **Maintain constant vigilance**
   Organisations need to maintain constant vigilance for both the expected and the unexpected. Signal detection systems need to be established to provide effective early warning of key shifts in the environment.
3. **Factor in velocity and momentum**
   Factoring in velocity and momentum is a critical skill that can help management understand whether a potential or unfolding event is a crisis or simply an incident. When factoring in velocity and momentum, organisations should improve preparation, so that speed of risk response equals or exceeds speed of risk onset, and improve planning and crisis management to increase the quality and speed of response.
4. **Make key connections to manage complexity**
   Businesses are usually linear systems operating in a nonlinear environment. It is therefore crucial for leaders to identify, understand and manage the key connections and dependencies that touch their enterprise's ability to operate. Managing key connections in a complex, nonlinear environment requires an in-depth understanding of the critical dependencies of the enterprise.
5. **Anticipate potential causes of failure**
   If failure is defined as an unacceptable difference between actual and expected performance, it becomes clear that risk management is really about performance management – because risk, including the risk of inaction, is simply the potential for failure in terms of loss, harm or missed opportunity. It is important for leaders to systematically consider the possibility of failure – strategic, operational, financial and compliance in order to anticipate and, if possible, prevent its potential causes.
6. **Verify sources and corroborate information**
   An essential risk intelligence skill is that of having credible sources and accurate information for making a judgement. Credible, historically reliable sources should be corroborated/verified when the situation warrants it.
7. **Maintain a margin of safety**
   People and organisations do have limitations. Resilience requires knowing those limits and maintaining an acceptable margin of safety. "No margin of safety means: no margin for error".
8. **Set your enterprise time horizons**
   A common mistake is focusing on the present or short term. Failing to think long-term is highly destructive for a company, therefore, organisations need to establish longer, strategically appropriate time horizons in order to support better decision making.
9. **Take enough of the right risks**
   Instead of focusing on risk aversion, companies should follow the approach of taking risks in order to create value. Innovation demands a willingness to experiment, but also to tolerate a certain level of failure. In preparation, organisations should manage scenario planning, critical dependencies, and connections in a manner consistent with their risk appetite. They should promote the understanding and management of rewarded risk taking. Long-term success requires bold moves.
10. **Maintain operational discipline**
    Operational discipline is imperative for a company's success: it's the way a company runs its business. This can be achieved by ensuring that people understand the mission and values of the organisation and have committed themselves to supporting that mission and those values. Management can assist by enacting these values and exerting effort to ensure that the operation achieves the organisation's mission.

For more information contact

Dave Kennedy *Service Line Leader - Risk Advisory*	dkennedy@deloitte.co.za	+27 (0)82 780 9812
Mark Victor *Director Risk Advisory*	mvictor@deloitte.co.za	+27 (0) 82 772 3003
Thabile Nyaba *Associate Director Risk Advisory*	tnyaba@deloitte.co.za	+27 (0)83 376 1826

Designed and produced by the Studio at Deloitte, Johannesburg. (801931/les)