Viewing Performance Management through a Risk Lens

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This essay is part of a series, *Controllers' Corner: Two-Minute Essays on Financial Management and Control*, which asks industry thought leaders for their opinions on critical issues facing today's finance organizations.

The importance of risk management is growing. But many organizations are not satisfied that they are addressing risk effectively.

Q **Could finance organizations close this gap by incorporating risk management capabilities into their performance management processes?**

Risk management is top of mind for many finance organizations today. In fact, in the recently published IBM 2010 Global CFO Study, CFOs were asked how important risk management was to their organization, and how effective they were at managing risk. The results paint a challenging picture. While 77% indicated that risk was very important, only 55% felt they were addressing it effectively.[1]

Unfortunately for many finance organizations, their day-to-day activities focus mostly on processes to support transaction management, culminating in measuring and reporting on financial and operational performance. Risk management is often a secondary activity, performed by risk management specialists. But now CFOs and finance teams are quite rightly looking to address the gap between importance and effectiveness. One place for them to start is in an evaluation of where performance management processes impact risk measurement and control.

Most companies are already establishing or improving their performance management processes and systems across areas such as planning and forecasting, reporting and analytics, financial consolidation and corporate reporting. Connections between performance management and risk can easily be embodied within these systems.

Let's take a look at three specific areas where companies can quickly introduce risk management capabilities.

Planning as an early warning system. Planning, budgeting and forecasting all have a common element – they offer a forward looking view into performance through the financial and operational data of an organization. Whether it's a cost center budgeting and control plan or a sophisticated revenue plan by customer or product, the information can be evaluated through a risk lens. Are there new or increased variances relative to the original plan? Are those variances material and can we measure their impact by comparing historical trends? Are there changes in customer or channel behavior that should cause us concern – perhaps a sudden increase in the volume of closed business, which might point to

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risks on contracts? Companies should review their plans and include metrics and measures that will help them track risk factors. They should consider new ratios and data that would highlight the potential for extreme, unexpected costs or sudden swings in revenue. Planning is one of the few times that organizations look forward across the business. Let's include risk in the planning process.

Reporting as a detection and measuring system. Reporting fluency in most organizations is very high. In fact, many organizations have more reports than they know what to do with. The critical question as to risk management is – do the reporting systems offer metrics that can help organizations assess and understand risk? While many reporting systems reflect financial and operational performance – and their associated variances – including risk as part of performance management reporting will help expose important risk insights. And creating the right reporting environment is fairly straightforward today. The breadth of functionality available in modern business intelligence systems enables an organization to maintain: 1) a framework to support and deliver data from virtually any source or combinations of sources, 2) a full suite of reporting, charting, and information delivery capabilities, 3) connections to the fast pace of business by delivering information over smart phones and through e-mail alerts. In short, companies have at their disposal the tools to include information in reports that can be extended to incorporate risk exposures. One example is measuring forecast quality by comparing forecasts over time, and identifying which forecasts show enough variability to expose the company to risk. The opportunity to establish regular reporting processes to understand risk is tremendous.

Performance management as a controls evaluation system. The advent of Sarbanes-Oxley in the United States and internal control mandates elsewhere have led to vastly improved internal control structures in most companies. The risk management view enables us to monitor and measure the effectiveness of those controls in the context of business data flowing through the organization. Not only can we map actual financial and operational details against internal controls, we can also include history to evaluate trends and plans to identify the effectiveness of existing controls.

Performance management processes and systems are intertwined with sensitive and critical company data. In many cases simply adding a risk lens will increase the visibility and understanding of risk factors throughout the organization. The important message here is that, with a minimum of effort, risk management can be an integral part of your planning, reporting and consolidation processes.

[1] IBM Institute for Business Value, *The New Value Integrator: Insights from the Global Chief Financial Officer Study,* March 2010

About Delbert Krause

Delbert Krause is the Business Unit Executive, Financial Performance Management Solutions, for Cognos Software in the Business Analytics division of IBM. In addition to his formal training in finance, Mr. Krause has more than 20 years of experience in consulting, selling, and marketing performance management software solutions for finance, business and IT users. Mr. Krause can be reached at delbert.krause@ca.ibm.com.

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