

# ARE WE SPEAKING *the* SAME LANGUAGE?

*An Integrated Approach to Supply Chain Risk Management*

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# An Integrated Approach to Supply Chain Risk Management

**In early 2020, a novel virus began to dominate the news** as an increasing global threat. However, few individuals and even fewer enterprises could have anticipated the speed and extent to which COVID-19 would disrupt nearly every aspect of modern business. Suddenly, employees were working from home, meetings were held virtually, customer contact was limited, and critical supplies dwindled or disappeared for a time.

No industry went unscathed, as enterprises faced the weaknesses COVID exposed in their supply chains and they found themselves unequipped to address them in a meaningful and timely way. “COVID put supply chains through the ultimate stress test, and many did not demonstrate resiliency,” notes Yvette Connor, Enterprise Risk Management Practice Leader with Grant Thornton.

Advances in medical treatment offer the promise that COVID can become a manageable, “business as usual” risk. But what of other, post-pandemic stress tests that will inevitably arise, stretching supply chains to their limits? Will enterprises be any better prepared for those?

This whitepaper discusses the necessity of an integrated approach to supply chain risk management across an organization. In April 2021, the Internal Audit Foundation, in collaboration with Grant Thornton, conducted a survey to collect data from internal audit professionals on challenges and opportunities in supply chain risk management, and how a shared language (shared terminology) would be beneficial. The survey generated 34 responses across all levels in internal audit—from chief audit executive (CAE) to manager—with more than 70 percent of respondents reporting they are the CAE within their organization. According to Grant Thornton, the bottom line: The “swim lane” approach, in which enterprise groups—executive management, business line management, compliance, procurement, internal audit, and others—stay in their own niches, must be replaced with a coordinated, collaboration-driven knowledge pool, shared understanding of risk, and a common, shared language.

## Challenging Pandemic

**The COVID pandemic did not introduce the need** for managing supply chain risk. Organizations had been doing so for years through activities such as vetting vendors and gaining assurance over order and delivery processes. They understood what constituted business continuity and were concerned by the lack of integration between supply chain risk management and enterprise risk management, especially in large organizations engaged in manufacturing and distributing products. For them, an efficiently operating supply chain is the lifeblood of the business.

The IIA's recently revised Three Lines Model, applicable in many areas of organizations' operations, helps ensure that under normal circumstances, the supply chain would continue to meet their needs and support organizational objectives. Third line roles work with first line roles to understand the risks and assess controls and then use that understanding to review contracts with suppliers; assess controls relating to agreements, processes, and policies; and evaluate the supply chain process through its life cycle. First and second line roles handle procurement, lines of business, and the governance processes that apply to the supply chain.

When COVID entered the scene, what was previously "good enough" was no longer good enough. Jonathan Eaton, Grant Thornton Principal and National Supply Chain Practice Leader, outlines four areas in which organizations fell short early during the current pandemic:

- 1. Liquidity and solvency.** Organizations did not have adequate (or any) mathematical models of supply chain risk to quantify the financial impact to the business in the event of a "black swan" and long-duration event. In the face of supply shortages and delays, organizations encountered blind spots about supplier resiliency, including the ability of key suppliers, out to the  $n^{\text{th}}$  dependent supplier, to survive and thrive. In some cases, organizations and their suppliers had no pandemic-aligned business continuity plan and failed to understand the importance of or sensitivities around how a pandemic could impact supply chain resiliency. Eaton explains, "When lending markets tightened up, even companies with 'revolvers' couldn't draw down on them because they couldn't project cash flow. And they couldn't make that prediction because they didn't know what they needed and couldn't quantify the impact of COVID-19 to their business."
- 2. Supply and demand.** Organizations whose profits depended on sales through specific retail establishments suffered when those establishments were forced to close. Those operating under a single channel model, without e-commerce or other venues for sales, saw their profits plummet. Many organizations simply could not operate due to their inability to acquire raw materials, possibly resulting from their dependence on a single supply source.
- 3. Labor.** Employees became ill or feared going to work. They had to stay home to take care of children because the schools were closed. Unions barred employees from going to work without proper guarantees and safety measures. Or, workers were not deemed essential and, therefore, were banned from going to work, at least during the lockdown phase of the pandemic.
- 4. External factors.** These factors varied widely based on industry, type of enterprise, and geography, but they included legislation and/or other requirements that altered how businesses were required to operate in the COVID environment.

Most organizations were affected by some, if not all, of these four areas. Many found their best efforts to respond to these challenges hampered by excessive manual processes and lack of 24/7 supplier risk data, technology tools that were inefficient and not well understood, risk and compliance processes handled differently throughout the organization, and further supplier risk data that might have proven helpful in crafting an effective mitigation approach, difficult to find and aggregate.

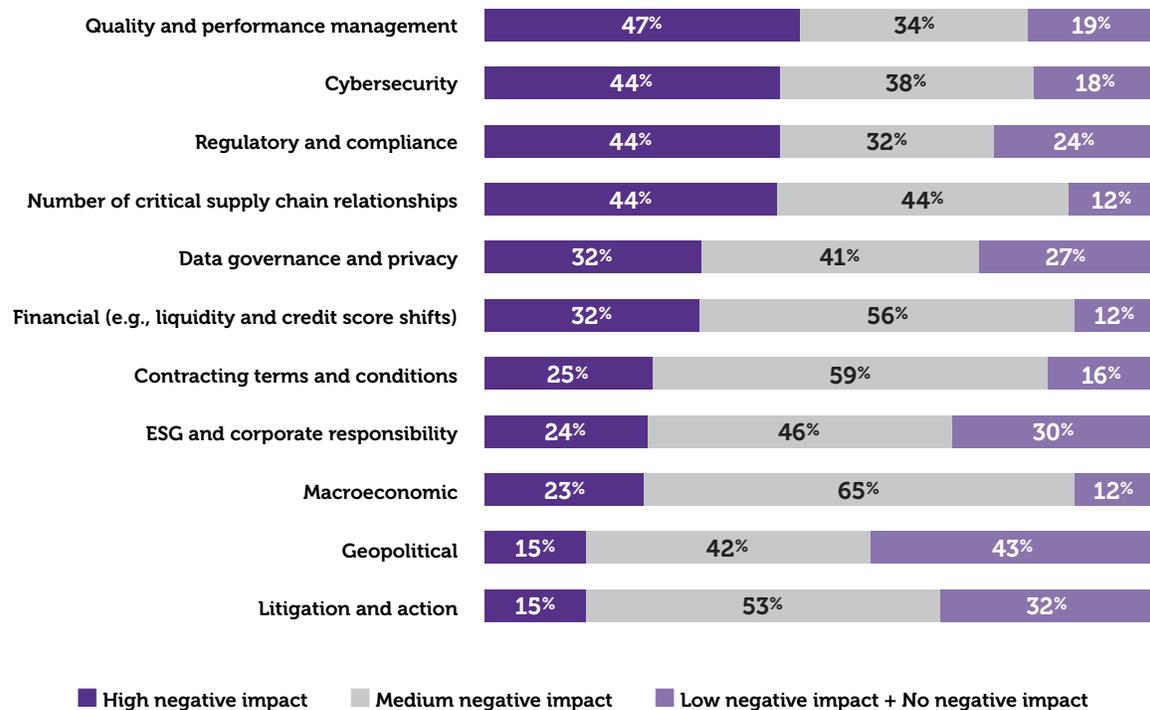
The outcomes were disheartening. Organizational objectives of financial growth, customer satisfaction, and an unblemished reputation could not be met as products could not be manufactured as promised, customer interaction was limited, and goods were not delivered on time. Executives began to question

the efficacy, efficiency, and value of corporate functions such as risk management, compliance, and internal audit, as they watched the business take a sharp downturn. Leadership in organizations has noted that those functions—and others—did not speak a common language, thus requiring considerable discussion and rework for everyone to get “on the same page.”

Take, for example, the term “cyber.” To one area of the business, cyber might relate to privacy; to another it summons the term “breach;” and to yet another it calls up thoughts of corrupted data or a lack of availability of systems. Without a common risk language, organizations that experience a cyber issue face the very real possibility that many of the people sitting around the table discussing how to address the risk are defining and solving for cyber risk mitigation strategies differently. This lack of common understanding creates significant inefficiencies when it comes to choosing optimal risk mitigation strategies and prioritizing resources, including budget dollars.

The survey examined if various risk categories negatively impact the supply chain process. Out of all areas included in the survey, the top four risk categories having a high negative impact are 1) quality and performance management, 2) cybersecurity, 3) regulatory and compliance, and 4) number of critical supply chain relationships. The perception that these categories may negatively impact the supply chain process could be due to a lack of shared understanding of the concept across the organization. It is possible that a shared language could help alleviate this impact. (See Figure 1.)

**Figure 1: Risk Categories and Negative Impact**



Note: Internal Audit Foundation/Grant Thornton Supply Chain Survey. Question: Rate the following risk categories as they pertain to a potential negative impact to your organization’s supply chain (no negative impact to high negative impact). n = 34

Departments and business leaders are also often not fully sharing or integrating tools that could otherwise accelerate efficiencies and knowledge management, helping each other better understand supply chain risk factors or risk assessment insights gained from those tools. Organizations are hindered from creating or measuring progress because they are unable to compare and contrast enterprise risk, compliance risk, and other impacts on resiliency performance in a cohesive way. They are not focused on fundamental processes in play throughout the Three Lines Model that could be more efficiently deployed to grasp the knowledge already in place and apply it quicker. They lose the opportunity to gather more risk intelligence, including missing opportunities to deploy better feedback loops to determine what is working well and recognizing new opportunities or identifying gaps that could lead to adverse results, such as supply chain delays, failures, cost overruns, or quality concerns.

This lack of a common supply chain risk language also directly impacts internal audit when it comes to audit planning and development of risk-based audits. When there are too many complexities related to scope, including misaligned vocabulary to describe risk or inability to isolate the right data and documentation in support of an audit, there is a risk to the success of the audit and, more broadly, the validity of the internal audit assessment. "Ultimately, an audit plan is developed to address risks. So, to the extent that there is inconsistent communication and siloed data, there exists an inability to have a meaningful and targeted audit," explains Meredith Murphy, Grant Thornton's Risk Analytics Practice Leader.

If the current business environment taught organizations anything (and it surely did), it taught them that agility and rapid change beyond what was previously thought possible is, in fact, possible. To avoid repeating these painful lessons in a post-pandemic environment, organizations need an integrated approach to risk assessment that is streamlined, simplified, unified, and informed.



# Taking an Integrated Approach

**As COVID-related supply chain disruptions began** to affect the operations of organizations and industries around the world, it is likely that many pointed questions were being asked behind executives' closed doors: Did we know these disruptions were going to happen? If so, what did we do to proactively mitigate the risk? Did our mitigation measures work? If they did not work, why? What have we learned about our resiliency? And how are we going to improve?

As these questions were answered and the responses analyzed, a clearer understanding and appreciation of supply chain risk management began to form among forward-thinking organizations. They recognized that supply chain risk management is not a checklist of activities; it is an ecosystem of integrated functions and roles that work together toward an objective: achieving supply chain resiliency and business performance goals.

The path to integration lies in going back to basics. Grant Thornton recommends organizations consider updated pathways to inform and operationalize governance within the supply chain risk management life cycle by:

- Identifying and defining supply chain risks and segmenting them into risk categories that represent the largest risk exposures to business objectives.
- Quantifying the probability and impact with an eye on interrelationships between risks and failure modes and effect analysis outcomes.
- Analyzing scenarios to test ranges of risk outcomes, develop response plans, and consider control effectiveness.
- Documenting the responses and distributing the resulting plans.
- Regularly revisiting the plans, testing controls, and refining program life cycle elements, as needed.

These steps may appear simple, but doing them well requires a significant investment of time, focus, and resources.

**Identify, define, and segment.** There are many areas of potential risk and opportunity for supply chain risk management—financial resiliency, financial credit, external macroeconomic factors, operational governance, and operational cybersecurity—but operational governance risk is of special note. It is important for the enterprise to know what possible scenarios or risk factors could break the supply chain, and a change of management or leadership is an area often overlooked by organizations as they consider supplier risk factors. Organizations work with many suppliers and they have likely vetted them through a supply chain risk management onboarding process; however, an organization often does not have visibility into when supplier leadership changes, or further down the supply chain, when changes occur at suppliers of suppliers—on to suppliers of the  $n^{\text{th}}$  degree.

Those  $n^{\text{th}}$  degree suppliers may experience a change that results in poor cyber hygiene, financial distress, or a lack of aligned environmental, social, and corporate governance (ESG) principles. They may be overly exposed to geopolitical issues, or they may be subject to shifting regulatory requirements

involving trade with nation-states such as China. Those factors may be invisible to the organization, but they represent very real risks to supply chain continuity and performance. So significant is supplier risk that nearly 90 percent of the CAEs polled by The IIA agreed that increased knowledge about suppliers is one of the benefits of an integrated approach. Nearly one-third claimed that the number and location of n<sup>th</sup> degree suppliers associated with critical suppliers (including nation-state or other ownership) would be the risk category—if added or elevated to the same level as other categories—that would add the most benefit to their organization's supply chain risk management program.

Supplier risk is not the only operational risk of concern to the supply chain, however. For example, manufacturing plants must have a clear understanding of the sorts of events that could shut them down, such as power outages, strikes, and natural disasters—anything that disables or takes their production capacity offline. Unless a plant can transition its manufacturing activity to other locations, productivity will suffer. Another manufacturing risk is maintaining a too-tight margin on inventory, which may cause the organization to run out of product or impair services, thus losing sales, damaging its reputation, and angering customers.

The number and type of operational risks—transportation, financial, regulatory, compliance—can be significant, often accruing specifically to an organization, a geography, or an industry. Yet, less than half of those responding to the survey (46 percent) were satisfied with their organization's current supply chain risk management's ability to identify and define supply chain risks and segment them by risk type to better understand which risk types are most prevalent in their supply chain. (See Figure 2.)

**Quantify.** In this step, the organization develops an understanding of how much opportunity or harm an identified risk can do if it materializes over a specific time line. What will it cost the organization in terms of decreased revenue, increased expenses, and customer impact? This knowledge helps clarify what the organization should prioritize relative to supply chain risk management efforts and responsive risk mitigation strategies. Loss trending, evaluation of compliance exposures, aggregation of supplier risk scores, and other techniques can be used to help inform the quantification view. Artificial intelligence and machine learning can be used effectively in this step to create and deploy mathematical algorithms to inform models that can provide insights and information, on a recurring basis, regarding unwanted risk and compliance impacts. Once these models are created, they should be examined and updated at least quarterly.

**Analyze.** Scenario planning and situational analysis are effective ways to analyze a risk and determine a proactive action plan to either avoid, minimize, or transfer (via insurance) potential risk impacts. For example, transportation risk can have far-reaching implications if the organization cannot get what it needs when it needs it and sales and customer experience are negatively impacted. Any organization that identifies that risk is a high-probability, high-impact concern should ensure that its scenario planning and situational analysis include consideration of the amount of lead time to build into the supply chain and the amount of safety stock to keep on hand. According to the survey, less than half of respondents (46 percent) are satisfied with their organization's ability to analyze supply chain risks to develop risk mitigation plans and control effectiveness response plans. (See Figure 2.)

**Document and distribute.** The action plans created in the analysis phase must be incorporated into business continuity plans, which should be supported by a full communication campaign to ensure that the plans are distributed throughout the organization and all employees know what to do if a risk becomes a reality. Ongoing staff reminders, formal training, and even games or contests should be used to reinforce employee understanding and commitment.

Despite the importance of this step, only 33 percent of survey respondents were satisfied with their organization's supply chain risk management's capability to distribute risk information, document risk responses, and monitor the resulting plans for tracking and mitigating risk. (See Figure 2.)

**Revisit and test.** The business continuity plans should be tested from time to time, especially those that address the risks of the highest impact to the business—an exercise that may require more rigor than expected. In the current survey, only 21 percent of respondents were satisfied with the ease with which their organizations can regularly revisit the plans, test/retest them, and refine them as needed. (See Figure 2.) Wargaming and situational awareness exercises can be used to create simulations that can generate discussion of the ongoing sufficiency of the plans and the organization’s ability to carry out the plans in the event of a variety of disruptions. The organization should look for gaps in the plans, learn from them, and use them to refine and improve the plans.

The overall lack of satisfaction with supply chain risk management capabilities suggests there is much room for growth and improvement. That improvement (in addition to the ideas mentioned here) should start with a common, shared language for supply chain risk management processes across the entire organization.

**Figure 2: Satisfaction with Supply Chain Risk Management Capabilities**



Note: Internal Audit Foundation/Grant Thornton Supply Chain Survey. Question: How satisfied are you with your organization’s current supply chain risk management capabilities for the following areas (very satisfied to very dissatisfied)? n = 33

# Building the Team

**Assembling the right people for the supply chain** risk management life cycle development process is as critical to its success as the activities themselves. Involving a broad array of roles across the organization helps promote the enterprisewide adoption and use of shared terminology (shared language) to discuss risk topics and scenarios. It also supports an enhanced understanding of supply chain risk and risk impacts applicable to the entire supply chain and enables enhanced risk planning and solution development. Every organization is different, and the individuals to be involved will vary according to its culture and structure. Ideally, the chief risk officer and his/her team will champion and own the risk strategy. Other roles to involve might include the chief operating officer; procurement; analysts; and leaders from first, second, and third line roles, including the CAE. Once the analysis has been done, it is useful to loop in the leaders of lines of business in those areas that may be disrupted if supply chain problems occur. They have day-to-day knowledge of their areas and can provide valuable intelligence about the options for mitigation that are available and most likely to be effective.

Creating this integrated approach does not require the organization to undergo an organizational restructure or demand that its employees acquire entirely new skill sets. It depends more on adapting current supply chain risk management approaches in order to garner improved risk intelligence about suppliers and to dynamically, versus statically, monitor changes across deeper supplier ecosystems and related key supplier risks. This aligns with what already exists in the Committee of Sponsoring Organizations of the Treadway Commission (COSO) models, which guide both audit and risk to create an integrated approach first line functions can adopt as needed. The Three Lines Model is well positioned to support organizations in establishing an integrated approach in that it acknowledges that risk-based decision-making is as much about seizing opportunities as it is about defensive moves. The model places first line roles (provision of products/services to clients, managing risk) and second line roles (expertise, support, monitoring, and challenge on risk-related matters) under management, while third line roles (independent and objective assurance and advice on all matters related to the achievement of objectives) remains under internal audit. The model even allows for first and second line roles to be blended, if needed, to support assignment of some second line roles to pertinent specialists. Ultimately, the model places responsibility for managing risk on the first line roles and within the scope of management. See [Three Lines Model](#).



# Benefits of an Integrated Approach

**The benefits of an integrated approach are plentiful and impactful**, each contributing in diverse ways to the achievement of organizational objectives, such as protecting the organization's brand, supporting growth, meeting financial targets, protecting customer relationships, and maintaining shareholder value.

**Increased flow of knowledge.** If the adage “knowledge is power” is valid, then the integrated approach, which enables creation and sharing of more knowledge, is a substantial source of power for the organization. It leverages risk insights through a dynamic risk assessment approach (constant monitoring) used by the first and second lines simultaneously and shared across the enterprise. This knowledge flow makes for quicker, more resource-appropriate responses, resulting in enhanced productivity and careful management of expenses.

Connor compares the dynamic knowledge flow and information sharing to water running through pipes continuously, rather than having to be turned on and off. “The water represents the insights about risk the organization needs to manage,” she explains. “Those insights, along with alerting and adjudication of issues, are needed continuously, not just when manually summoned. The constant flow enables organizations to make sense of their risk holistically which, in turn, increases resiliency and decreases the likelihood of unwanted surprises. It’s a way of unclogging the pipes to avoid water damage.”

**Resilience.** Integrated supply chain risk management creates a more resilient organization—one that can rebound after setbacks and apply lessons learned. This quality directly aligns with competitive advantage over other organizations that are not as adept at managing expenses and delays that affect customer service.



**Efficiency and focus.** The improved understanding of risk and mitigation actions created by the integrated approach is based on an agreed language to discuss risk. With a shared terminology, fewer problems must be revisited multiple times simply to reach an agreement on meaning and responses. Instead, the organization can focus its time, talent, and resources on the things that matter the most to its operations and strategy. These may include issues that could be material/severe to the business, or they could be incidents that, while not terribly severe, occur frequently and are upsetting to customers. A focus on what matters most allows internal audit to concentrate on trouble spots, assessing their impact and recommending mitigation actions.

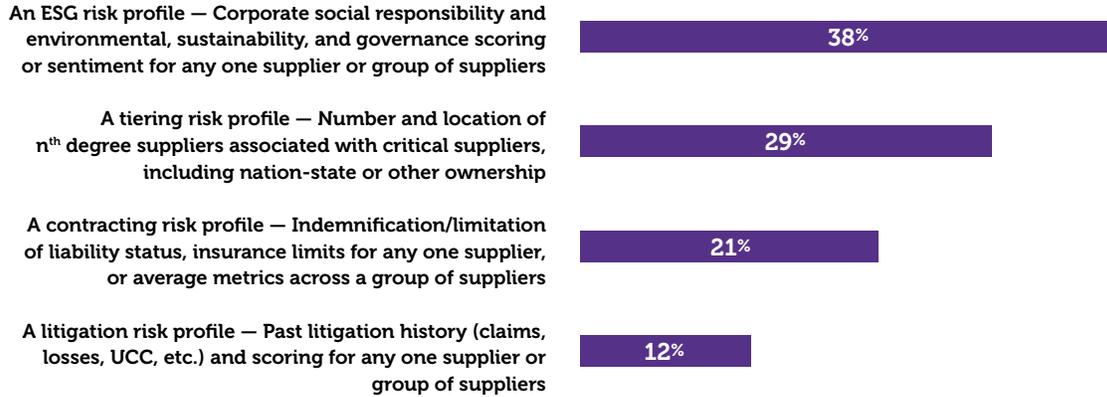
**Enhancement of internal audit's contribution.** The value of compliance and internal audit is sometimes viewed within the organization, especially by CEOs and other C-suite members, as obscure or necessary only because of a regulatory mandate. The integrated approach negates that perception by enabling internal audit to perform at its highest capability based on robust first and second line functions and data. It positions auditors to go beyond simple compliance activities—checking on whether contracts were followed or SOC 1 and SOC 2 reports were received—to take a broader, more forward-looking advisory role (a benefit of integrated supply chain risk management recognized by 85 percent of survey respondents). (See Figure 4.)

For example, supplier resiliency, especially financial resiliency, is a critical facet of supply chain risk management. Supply chain and procurement teams often seek insights into a supplier's financial resiliency, and risk management has ideas about the type/degree of resiliency the supplier or vendor must maintain to comply with minimum standards required by the organization (and financial resiliency scores and target measures are developed as a result). Based on this information, internal audit can examine supplier nonperformance and/or failures and, instead of simply reporting on results, provide valuable counsel on opportunities to improve ratings, measures, and thresholds.

The integrated approach's increased access to a broader universe of data supports audit processes such as continuous auditing, continuous monitoring, key performance indicator (KPI) reporting, and key risk indicator (KRI) reporting. It enables auditors to address more effectively the current shifts being reflected in audits, such as a focus on ESG, and considerations of diversity, equity, and inclusion. This focus on ESG was noted in the survey, with 38 percent of respondents indicating the addition of an ESG risk profile for all suppliers would be more beneficial to the organization's supply chain risk management program. (See Figure 3.) It supports the use of market-leading practices and positions internal auditors for evolving risk and technologies.

Some internal auditors may be concerned that the integrated approach's emphasis on collaboration across first, second, and third line functions will affect their independence, but that is not the case. Of course, it will remain necessary to maintain attention to handoffs and delivery, scope, and how the work is performed. But the Three Lines Model's Principle 5 notes the necessity of internal audit's unfettered access to people, resources, and data needed to complete the work. In other words, independence is not synonymous with working alone.

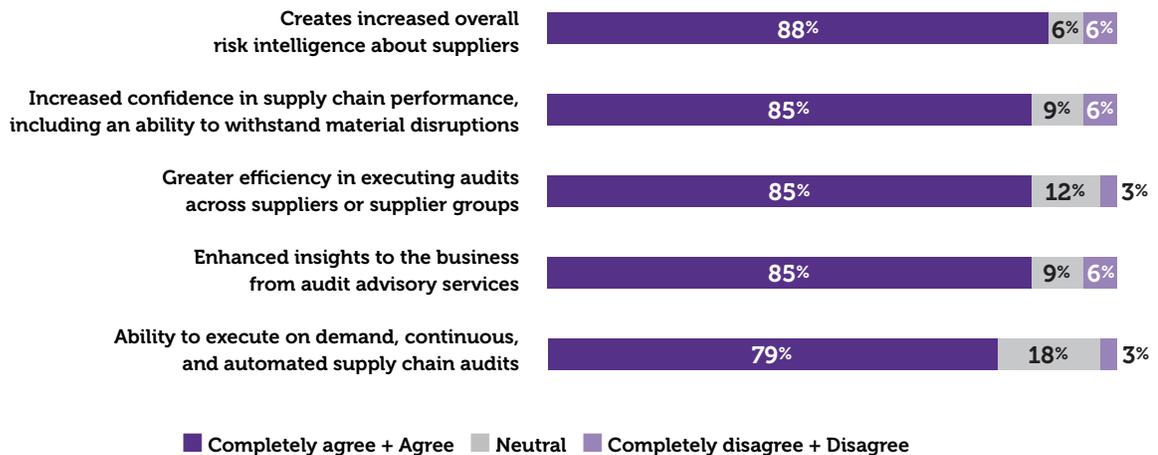
**Figure 3: Risk Category Providing Additional Benefit**



Note: Internal Audit Foundation/Grant Thornton Supply Chain Survey. Question: What risk category, if added or elevated to the same level as the other categories, would add the most additional benefit to your supply chain risk management program? n = 34

**Unity of purpose.** Every area of the business is affected by supply chain risk management. While each department or function understands the need for robust risk management, each area also has its own objectives, priorities, and needs. For example, employees in the various lines of business often want to move quickly; their objective is to get out in front of customers and sell products. Employees in risk management want to support that activity, but they also want to maintain clear eyes on vendor and risk governance. In an integrated approach, these objectives are not at cross-purposes. Both are possible. Internal audit’s role is to ensure congruence and integration; they advise how clear those eyes were and recommend lens adjustments if needed.

**Figure 4: Potential Benefits of Integrated Supply Chain Risk Management**



Note: Internal Audit Foundation/Grant Thornton Supply Chain Survey. Question: Integrated supply chain risk management likely provides many benefits to an organization. Please indicate your level of agreement for these statements about benefits of an integrated supply chain risk management process (completely agree to completely disagree). n = 33

# Conclusion

An integrated supply chain risk management approach can deliver significant financial benefits to the organization, support organizational goals and objectives, and provide ongoing assurance about overall resiliency and compliance to stakeholders across multiple areas. “Increasing the efficiency and performance of the Three Lines Model will help drive shareholder/stakeholder value and deliver improved risk insights to the business. Integrating supply chain risk management is an area where businesses can start to practice this integration process—looking for immediate results across the business, risk management, and audit,” says Connor.

In this back-to-basics approach to establish this common language, before beginning the work of identifying, defining, and segmenting risks; quantifying them; analyzing them and documenting mitigation activities; then regularly testing and refining the plans, there are a few “level-setting” considerations that will help establish a firm foundation for the project:

- Consider carefully who will be involved in developing the integrated approach, based on their role in the business and the culture and organizational structure of the organization. Secure a project sponsor, ideally at the C-suite level—someone who provides the tone at the top and understands what the project is intended to do and how it delivers value. Consider also who will be doing the hands-on work to make it happen. Think about bringing in line-of-business leaders, even suppliers. Be sure to have geographic and functional representation. Finally, ensure that first, second, and third line roles are prepared to work in collaboration.
- Develop a shared vision for the project. Define it. Identify the goals on which to focus. Create a collective road map, noting milestones and/or time frames.
- Collaboratively identify probable challenges for the project. Determine where they may arise and anticipate solutions.
- The process of creating a collaborative, integrated approach can be complex, time-consuming, and costly. Identify and focus on the areas where the organization can gain the quickest and most impactful returns on its investment of time and resources. Quick wins can boost ongoing support for the project.
- Remember that an integrated supply chain risk management approach must not hinder the organization’s ability to achieve its strategic objectives. Risk taking is necessary for growth, so any efforts identified to address risk must align with the organization’s risk appetite and enable, not hamper, the organization’s progress.

When these pieces are in place, the organization can focus on the activities of working collaboratively on their integrated approach. “The basics are a governance protocol that involves identification of risk factors, determining how they can hurt the business, and developing a plan to proactively manage them. What makes them different and effective for each organization is in the technology used, the way the analysis is undertaken, and the processes designed to make it work,” Eaton points out.

Among internal audit’s contributions to the project is its arm’s-length view of managing relationships with vendors, suppliers, and partners. Auditors know the pain points; they can assess strengths and weaknesses in supply chain processes, and they know where there are areas of criticality and vulnerability across the supply chain. They can look through a broad, yet unique, lens, explains Murphy. “Internal auditors have the opportunity to see a variety of perspectives. Because of their unique view across the organization, they can provide valuable insights into the art of the possible, as it relates to maintaining and enhancing the supply chain. They know what excellence looks like.”

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