



SHARED SERVICES AND OUTSOURCING ADVISORY

IIA – OC CHAPTER – OCTOBER 2010 BREAKFAST EVENT

The Risks of Outsourcing: Considerations for IT and Operational Auditors

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KPMG LLP(US)

Introductions

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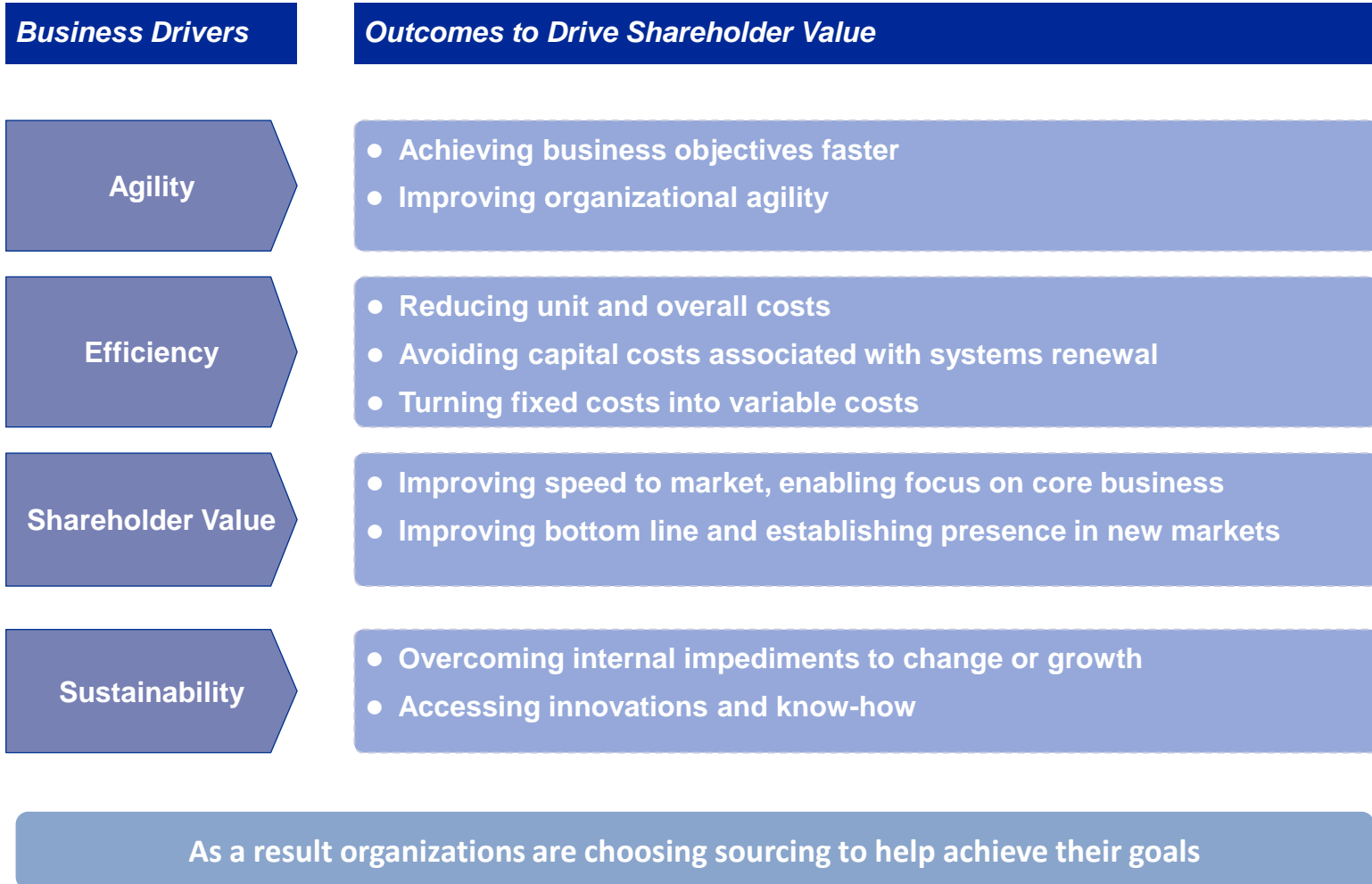
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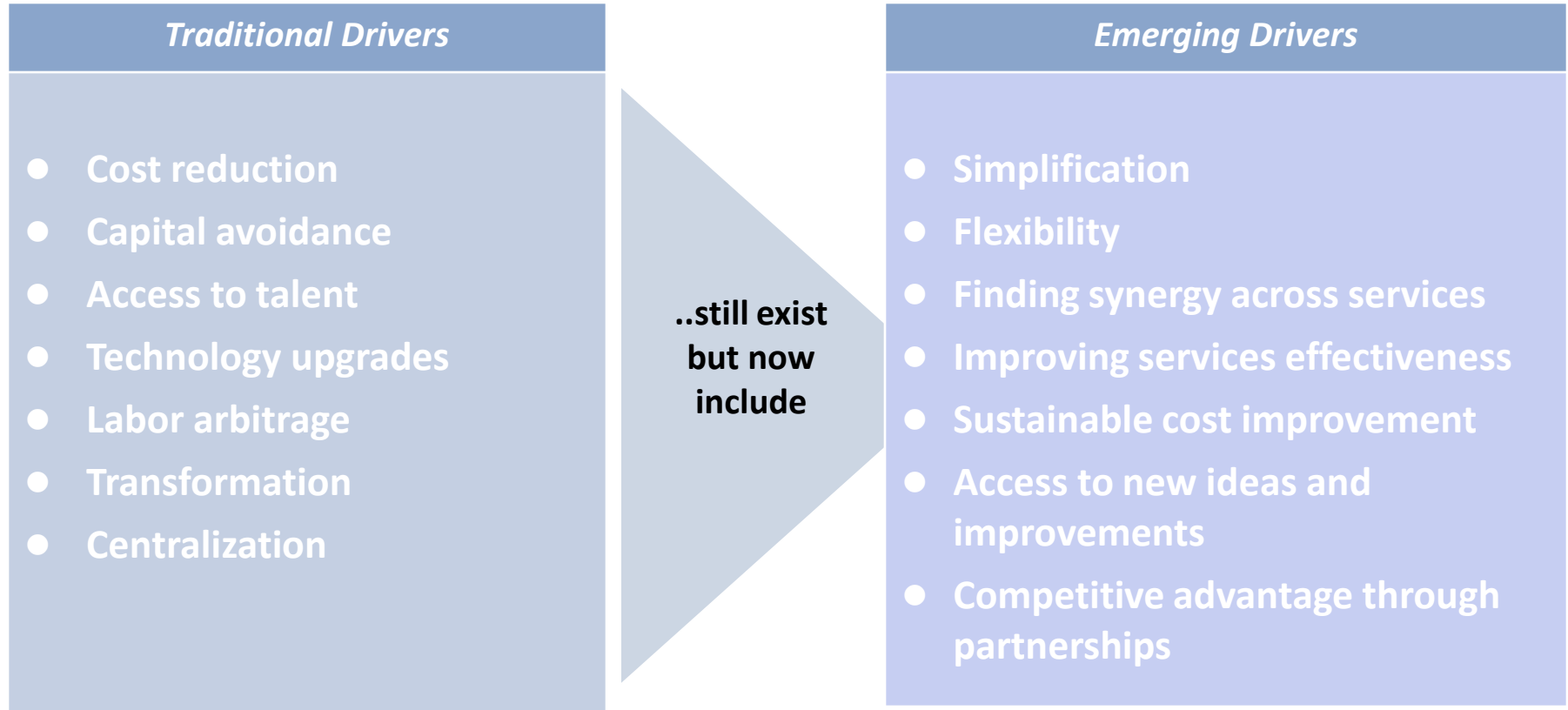
Industry Backdrop for Exploring Sourcing

Today's globally competitive business environment is forcing organizations to take a harder look at their business functions in order to compete effectively.



Drivers of Shared Services and Outsourcing

Today's shared services organizations and outsourcing arrangements are enhancing their overall capabilities through carefully planned partnerships and optimized internal and external service centers



Sourcing Lifecycle: Shared Services and Outsourcing

All sourcing initiatives can be understood and evaluated in the context of the Sourcing Lifecycle

Phase 6: Evolve

- Perform Strategic Alignment Review
- Perform cost cutting review
- Perform mid/end of deal review
- Assess pre/post merger impact
- Multi-Source strategy / Review against Business Case / Board
- Insource considerations / Strategy

Phase 5: Deliver

- Assess governance structure
- Assess service levels and customer satisfaction
- Assess contract compliance
- Assess regulatory compliance
- Assess controls
- Revisit & Refine Business Case
- Initiate Continuous Improvement Plans

Phase 4: Transition

- Implement the Delivery Strategy
- Transition processes, organization & people, governance and systems
- Develop service management processes and governance model
- Perform controls transformation
- Implement risk management plan; develop transition out plan
- Pilot Sourcing Model (if applicable)

Phase 1: Strategy

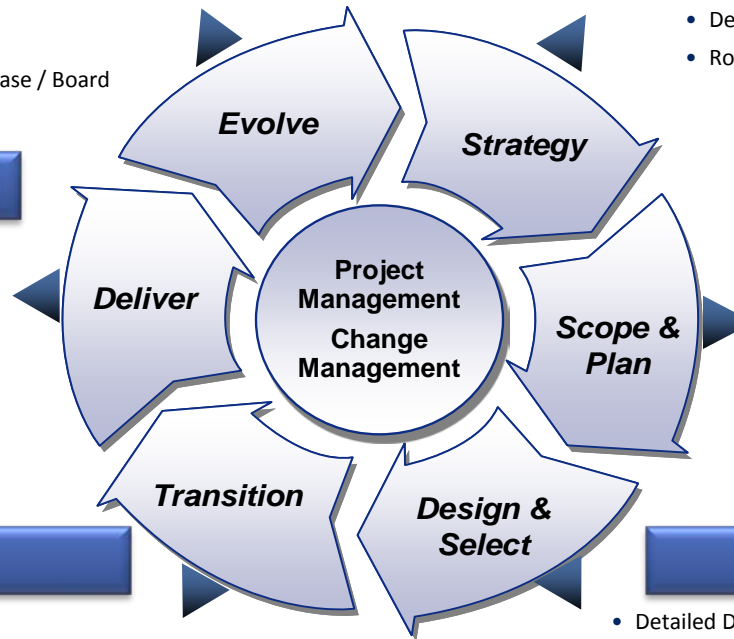
- Develop Vision
- Develop Delivery Model Strategy and Align with Business Strategy
- Develop Business Case
- Roadmap

Phase 2: Scope & Plan

- Assess current business architecture
- Design conceptual business architecture
- Assess real estate rationalisation
- Develop tax structure
- Update risk assessment
- Refine business case

Phase 3: Design & Select

- Detailed Design of Service Delivery Model
- Define Target Operating Model
- Conduct vendor selection and evaluation (if applicable)
- Provide negotiation and contracting support
- Perform Financial & Operational Due Diligence
- Conduct detailed risk assessment
- Design detailed Transition plan
- Refine & complete Business Case



Sourcing Risks

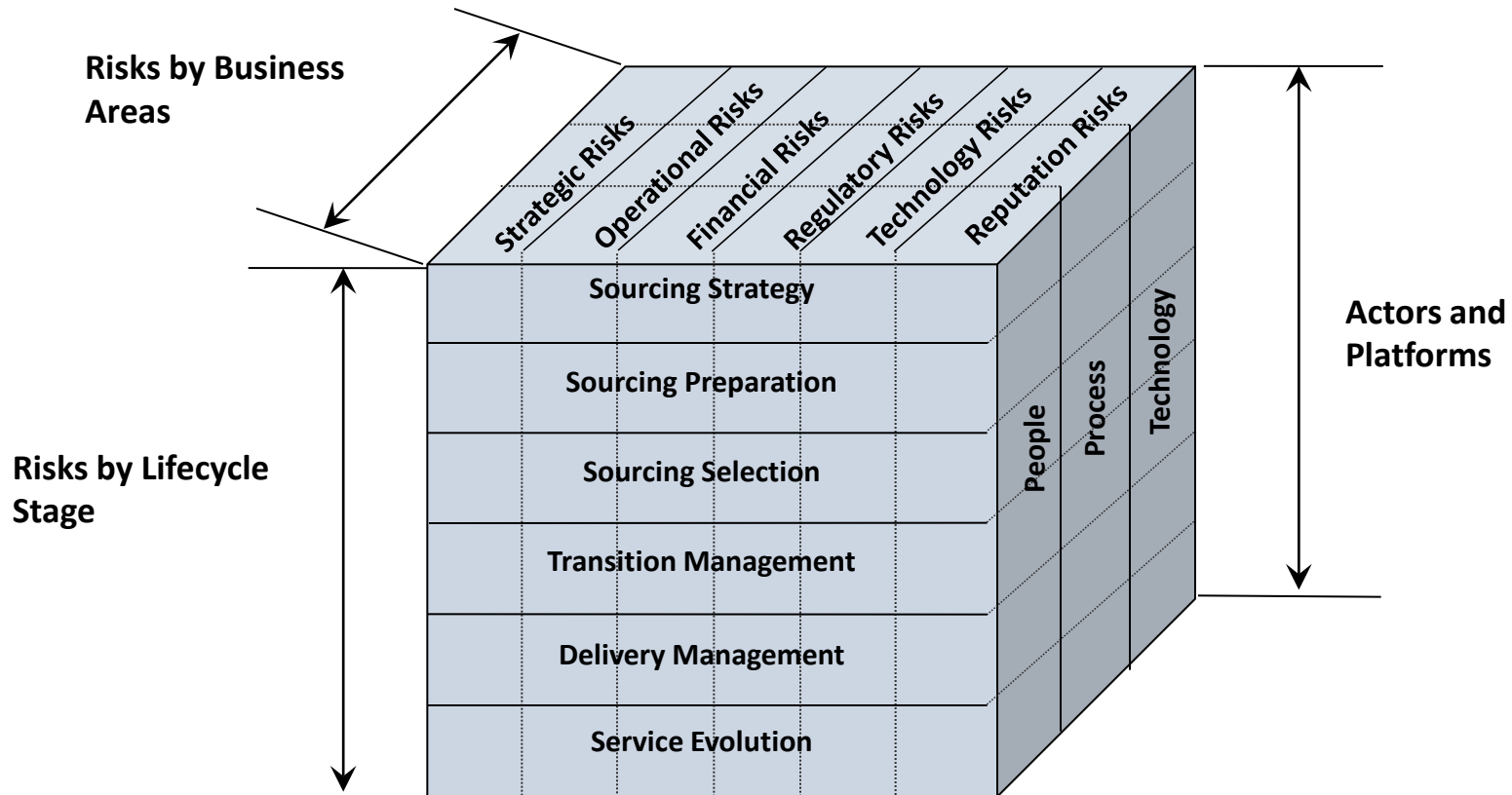
Many organizations are currently utilizing various sourcing options for their key back office functions such as HR, IT, Finance and Accounting and other similar ones.

These sourcing initiatives whether using a shared service center or an outsourcing arrangement generate a number of risks that the organization needs to assess and mitigate

KPMG has a structured approach to assist organizations in identifying sourcing risks and providing recommendations based on industry leading practices

How Can Sourcing Risks Be Managed?

There are several potential risks that are typically associated with sourcing. While some risks affect any outsourcing initiative, others may be more relevant when outsourcing offshore. KPMG has developed a “Risk Cube” to identify risks throughout the sourcing lifecycle and create a manageable framework.



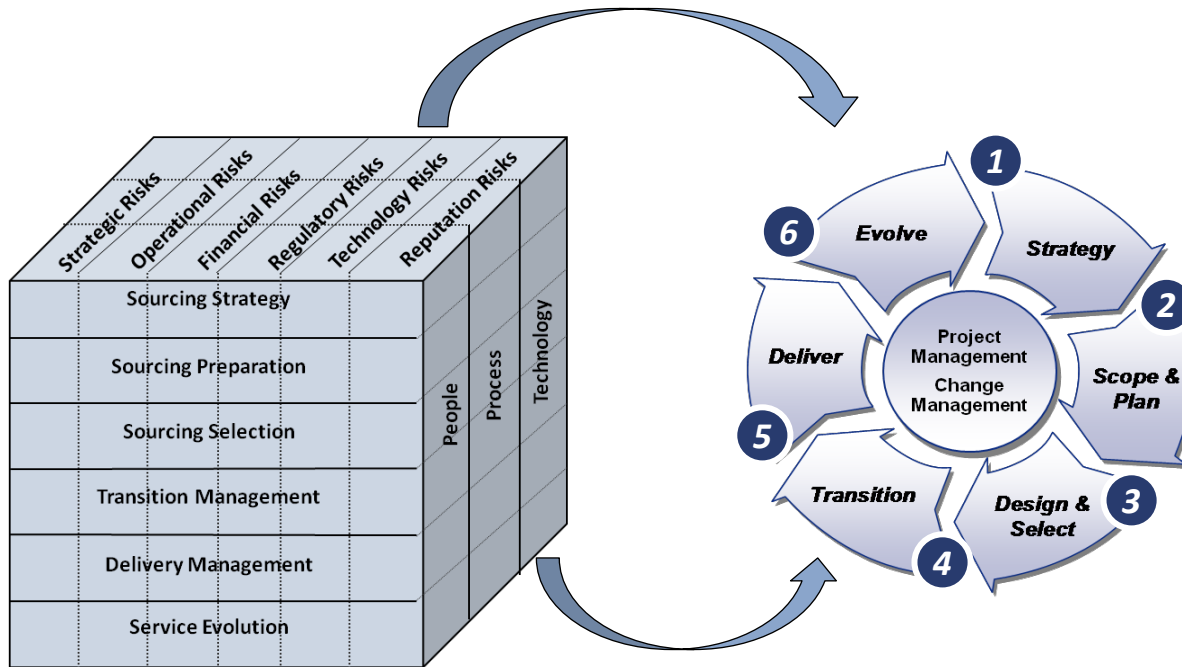
Sourcing Risks by Business Areas

- As organizations setup Shared Services Centers or Outsourcing arrangements with vendors there are a number of risks that arise that need to be effectively mitigated
- Some of these key sources of risks are highlighted below

Strategic Risks	<ul style="list-style-type: none">• Risks associated with adverse business decisions or failure to implement decisions
Operational Risks	<ul style="list-style-type: none">• Risks attributable to operational problems with service or product delivery or inability of an entity to recover fully and timely from unforeseen events
Financial Risks	<ul style="list-style-type: none">• Risks attributable to financial aspects such as insurance, tax, interest rate movements or movement in foreign exchange rates that impact cross-border contracts and operating activities
Regulatory Risks	<ul style="list-style-type: none">• Risks caused by violation of laws, rules, regulations, prescribed practices and ethical standards
Technology Risk	<ul style="list-style-type: none">• Risks relating to the failure of the outsourced entity's IT environment to effectively process and deliver products to its/your customers on a fully secure basis
Reputation Risk	<ul style="list-style-type: none">• Risk of negative publicity regarding business practices associated with the outsourced operation

Managing, Mitigating and Eliminating Risks

A useful approach that IT / Operational Auditors may wish to adopt that will help to identify, mitigate, and/or eliminate risk is understanding leading practices in each Sourcing Lifecycle phase (across the Risk Areas) that the business should adopt. Internal Audit can then determine how and when to assist and thus help enable the process.



Sourcing Strategy



Phase 1: Strategy

- Develop Vision
- Develop Delivery Model Strategy and Align with Business Strategy
- Develop Business Case
- Roadmap

Departments /Divisions

Challenges

Sponsorship

Program Leadership

Better practices to overcome challenges

- *Understand and document the business case for sourcing; "why we need to do this"*
 - *Ensure that the sourcing program should have visibility at an executive level*
 - *Ensure that an executive who has the budget owns the mandate to source*
- *Nominate an experienced leader to provide day to day program management*
 - *Ensure that project plans are developed and resources to fulfil tasks are deployed*
 - *Ensure that resources who are held accountable for tasks have the bandwidth to devote time to the sourcing program*

How IA Can Help

- *Work with executives and check to see if they have visibility and support initiatives*
- *Discuss with project teams if a vision / guiding principles have been agreed to and/or documented*
- *Discuss budgets and whether resources have been assigned*
- *Look for high level project objectives*

Scope and Plan



Phase 2: Scope & Plan

- Assess current business architecture
- Design conceptual business architecture
- Assess real estate rationalization
- Develop tax structure
- Update risk assessment
- Refine business case

Departments / Divisions

Challenges

Better practices to overcome challenges

Tactical Ownership

- *Conceptualize and roll out a change and communication program to obtain buy in*
- *Tie the performance goals of process leads to key milestones and deliverables in the source program*
- *Equip each process owner with tools, templates and resources so that they can take a lead role*
- *Build a nimble retained organization that seeks to manage processes and outcomes rather than individuals and their activities*

How IA Can Help

- *Work with project teams to see if a high level project plans exist and that teams are tracking them*
- *Stakeholders such as HR and Corp Communications should be involved and kept informed by the project teams*

Design and Select



Phase 3: Design & Select

- Detailed Design of Service Delivery Model
- Define Target Operating Model
- Conduct vendor selection and evaluation (if applicable)
- Provide negotiation and contracting support
- Perform Financial & Operational Due Diligence
- Conduct detailed risk assessment
- Design detailed Transition plan
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Departments /Divisions

Challenges

Better practices to overcome challenges

Robust Solution Design

- *Operating model design aligns with business objectives and takes into consideration all business and operating risks*
- *Comprehensive financial and operational due diligence is performed for both the vendor and/or the proposed service location*
- *Vendor evaluation process involves inputs from all key stakeholders*
- *Contract negotiation focuses on getting the right solution instead of getting a lower price*

How IA Can Help

- *Review operating model design to identify key risk areas and design appropriate controls to mitigate these risks*
- *Participate in vendor site visit or location visits and identify any business/operational risks*
- *Evaluate vendor solutions from a risk and controls standpoint*
- *Review contract terms to ensure it meets audit requirements*

Transition



Phase 4: Transition

- Implement the Delivery Strategy
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Departments /Divisions

Challenges

Better practices to overcome challenges

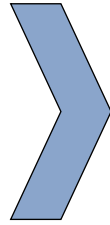
Tracking and Smooth Execution

- Detailed project plan that tracks training, communication timelines infrastructure and technology setup timelines, ramp-up timelines, and go-live timelines
- Setup escalation process that ensure all issues are escalated in a timely manner
- Communications and change management plans have been adequately drawn up to ensure employee engagement and timely release of communications

How IA Can Help

- Review governance processes to identify any risks and design appropriate controls to mitigate these risks
- Review performance metric measurement process to ensure accuracy of reporting
- Support transition teams with timely reviews of user ID creation process for segregation and other similar issues

Deliver and Evolve

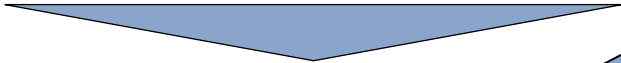


Phase 5: Deliver

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Departments / Divisions

Challenges

Better practices to overcome challenges

Continuous Improvement

- Evaluate performance metrics on a periodic basis and realign them to changing business objectives
- Conduct annual or bi-annual benchmarking of vendors
- Review scope of services and re-evaluate sourcing strategy for the updated scope

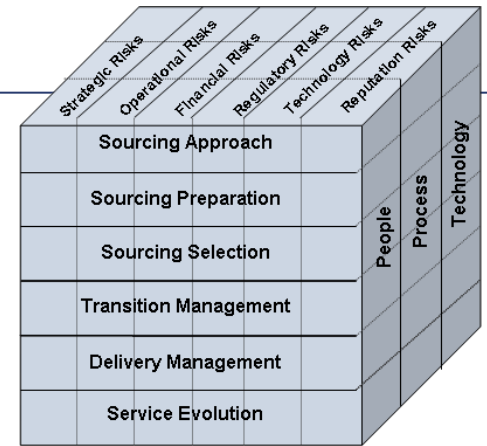
How IA Can Help

- Audit vendors to ensure compliance to contract requirements
- Review and audit performance reports to ensure compliance to performance reporting processes as well as service level agreements

Managing Sourcing Risks

Strategic Risks

- Risks associated with the scenarios, plans, directives and decisions that dynamically define and integrate the internal and external resources and services required to fulfill the enterprise's business objective.



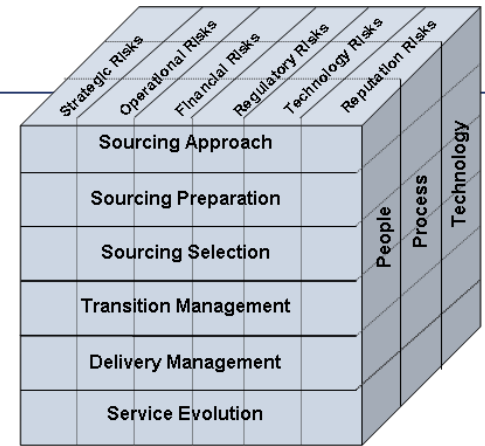
Strategic risks typically arise on account of the following scenarios:

- Lack of “visible” Executive Sponsorship
- Outsourcing strategy may not align with overall business strategy and priorities
- Strategy does not consider long-term goals for outsourcing other processes
- Strategic objectives are not clearly defined and/or effectively communicated to outsourcing partner
- Failure to identify and involve key stakeholders, both internal and external, in the strategic planning process
- Failure to identify components of the organization that need to be retained, taking the wrong processes offshore, especially broken processes with multiple hand-offs
- Lack of local market knowledge impacting areas such as location selection, local regulatory compliance, local government monopolies and delivery quality
- Failure to perform a consumer impact analysis of outsourcing

Managing Sourcing Risks

Operational Risks

- Risks attributable to operational problems with service or product delivery or inability of an entity to recover fully and timely from unforeseen events.



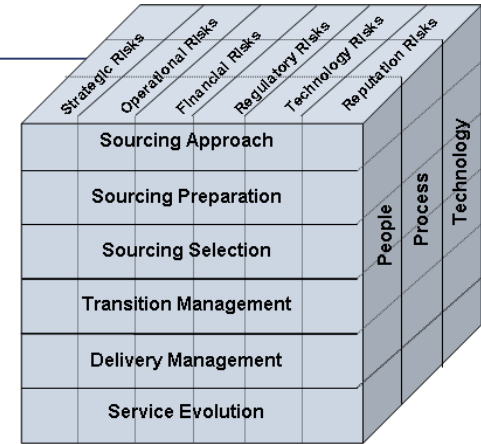
Operational risks typically arise on account of the following scenarios:

- Significant geographical differences between service delivery location and client locations
- In ability to clearly defined or track performance metrics
- Inability to “operationalize” strategy
- Inadequate attention to recruiting, training, learning curve and retention at delivery site
- Project charters not clearly defined or prioritized
- Scope and service levels not regularly reviewed
- Skill and knowledge transfer may be difficult and costly to recover
- Operational capacity requirements not clearly defined or understood
- Informal processes may not be documented or their impact to operations clearly understood
- Unrealistic reliance on contracts and service level agreements to ensure success
- Proper oversight of outsourced processes not maintained, inadequate resources allocated to relationship management

Managing Sourcing Risks

Financial Risks

- Risks attributable to interest rate and foreign exchange rate movements or the entity's inability to meet payment obligations as and when they fall due.



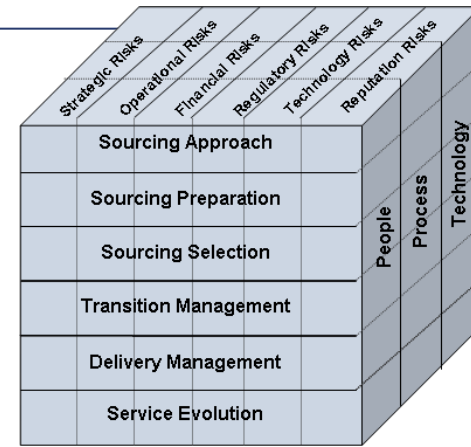
Financial risks typically arise on account of the following scenarios:

- Financial consequences of an operational failure not identified and/or mitigated
- Economic benefits and cost levers are not properly defined
- Short-term cost reduction does not justify long-term costs
- Cost reductions not achieved due to inability to reduce workforce and related resources
- Business disruption insurance may not cover outsourcing relationships
- Exchange rate fluctuation can impact cross-border contracts
- Insufficient attention to tax related issues thus impeding ability to achieve tax incentives available at offshore locations

Managing Sourcing Risks

Regulatory Risks

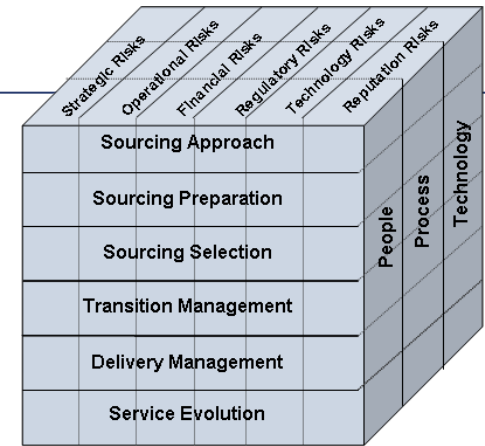
- Risks caused by violation of laws, rules, regulations, prescribed practices and ethical standards.



Regulatory risks typically arise on account of the following scenarios:

- Improper compliance with laws and regulations such as:
 - Patriot Act
 - Sarbanes-Oxley
 - ICD 10 CM
- Regulatory scrutiny over international offshore sourcing, if applicable
- Compliance with local tax and labor laws at offshore location

Managing Sourcing Risks



Technology Risks

- Risks relating to the failure of the outsourced entity's IT environment to effectively process and deliver products.

Technology risks typically arise on account of the following scenarios:

- Failure to exercise greater levels of due diligence in the evaluation and selection of a vendor's technology capabilities
- Comprehensive evaluation is not performed to identify the appropriate technical solution
- Complexity grows exponentially when sourcing internationally: Network latency, security, disaster recovery become significant risk considerations
- Existing business continuity plans that may not adapt well to international recovery requirements
- Protection of intellectual capital
- Migration and Transition strategy not clearly defined
- End-user, operations and infrastructure support requirements not clearly defined or understood
- Technology obsolescence not considered in contractual agreements

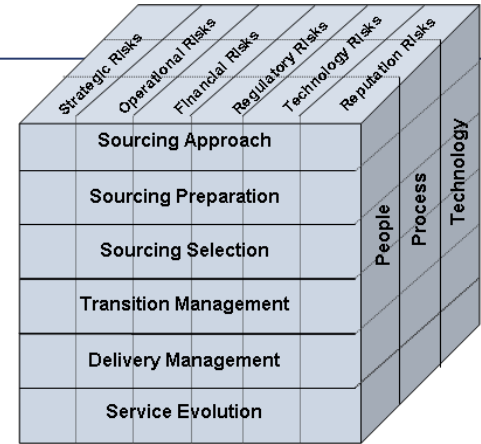
Managing Sourcing Risks

Reputation Risks

- Risk of negative publicity regarding business practices associated with the outsourced operation.

Reputation risks typically arise on account of the following scenarios:

- Backlash against moving jobs offshore
- Language and dialect issues negatively affecting end user perception



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