

Third Party Assurance: Can You Outsource Controls?

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Introduction



Has outsourcing gone too far?

Apr 27, 2010

The government is outsourcing an unprecedented amount of work, and the Obama administration wants more work in federal employees' hands, Gordon says.

“The government’s current outsourcing issues are not on a pendulum that has swung far to one side and is coming back, the president’s procurement policy administrator has said.

Never before have agencies outsourced as much of their work to the private sector as they are now, said Daniel Gordon, administrator of the Office of Federal Procurement Policy, arguing that the current circumstances aren’t simply the far end of usual cycle.....

Gordon wants federal employees to handle more of their agencies' work, particularly jobs that are central to an agency accomplishing its duties.... Overall, Gordon is trying to “rebalance” the workforce so fewer contractors are working so closely to the intimate decision-making.

Source: www.washingtontechnology.com, Matthew Weigeit

Course Overview



- **In these challenging economic times, many organizations are turning to third parties for critical business process and information management services. However, there are several key questions that need to be answered regarding these arrangements:**
 - ◆ Why consider outsourcing?
 - ◆ What are the true costs and benefits of outsourcing ?
 - ◆ What risk factors are involved with outsourcing?
 - ◆ Which outsource model is right for your organization?
 - ◆ By outsourcing, has the user organization relinquished their responsibility for controls?
 - ◆ How can organizations gain comfort that proper controls are in place over outsourced processes or operations?

Why Outsourcing?

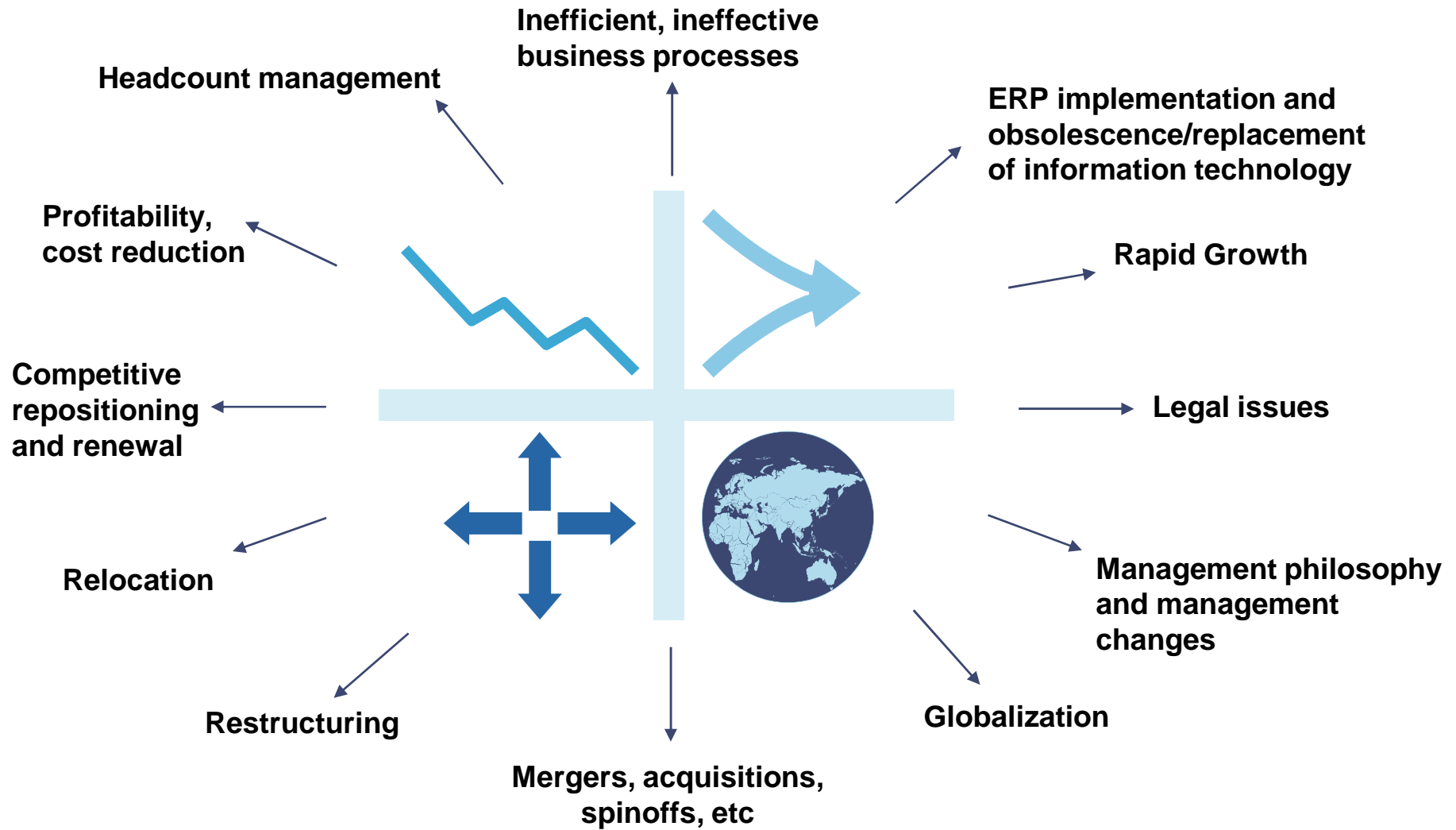


■ Exercise

- ◆ At your tables, take 5-10 minutes to discuss:
 - 1) Broad strategic reasons why an organization considers outsourcing
 - 2) Specific examples of people, process, or technology factors that influence outsourcing decisions



Why Outsourcing?



Why Outsourcing - People?



■ People

- ◆ Undesired turnover or incompetent workforce due to:
 - ◆ Company or departmental image or economic outlook
 - ◆ Lack of career path
 - ◆ Salaries not competitive with market demand
 - ◆ Nature of the work and/or lack of challenge
 - ◆ Aging workforce
 - ◆ “War for qualified talent”
 - ◆ What are other people-related reasons?

Why Outsourcing - Process?



■ Process

- ◆ Reduce and/or control operating costs
- ◆ Reduction of management oversight in the process
- ◆ Free up internal resources for other purposes
- ◆ Department/ function is not seen as core business function
- ◆ Inability to address high risk areas due to staff size and/or incompetency
- ◆ Inefficient processes that require an inordinate amount of rework or resources to conduct routine transactions

Why Outsourcing – Technology?



■ Technology

- ◆ Initial and ongoing maintenance cost of implementation
 - ◆ Need for sophisticated technology solutions to drive business
 - ◆ Lower Total Cost of Ownership (TCO)
 - ◆ Lack of knowledgeable internal resources to manage technology (applications and supporting infrastructure)

Why Outsourcing – Summary



A number of factors influence and organization's decision to outsource. These include:

- ◆ People
- ◆ Process
- ◆ Technology

In making this decision, however, how should an organization weigh the costs and benefits of outsourcing?

Risks and Benefits of Outsourcing



■ Exercise

◆ Within your tables, take 5-10 minutes to discuss:

- 1) General risks and benefits associated with outsourcing
- 2) Specific risks or challenges you may have experienced with outsourcing
- 3) Specific benefits you may have experienced with outsourcing



Outsourcing - Risks and Benefits



■ Benefits

- ◆ Maximize revenue
- ◆ Minimize expenses
- ◆ Specialized services
- ◆ Improved customer service
- ◆ Increased efficiency
- ◆ Competitive edge

Outsourcing - Risks and Benefits – cont'd



■ Business risk

- ◆ Outsourcing requires a clear understanding of the impact on the company's risk profile, including financial, political and regulatory compliance risks (core vs. non-core)

■ Complexity of decision-making

- ◆ Many viable sourcing alternatives exist – outsourced, joint venture, captive, onshore, offshore, in-source – and the decisions are becoming more complex

■ Governance risk

- ◆ Companies need a strong governance capability to monitor performance, as well as avoid value leakage and increased chance of failure

Outsourcing - Risks and Benefits – cont'd



■ People

- ◆ May create a negative image of the company for existing employees
- ◆ Internal expertise is not managed in house
- ◆ Information and value leakage
- ◆ Unclear borders for cooperation

Forrester Research estimates up to 3.3 million U.S. service jobs will be outsourced by 2015 (including white collar jobs)

Outsourcing - Risks and Benefits – cont'd



■ Process

- ◆ Severe reduction in management oversight
- ◆ Extended time for changes to be implemented
- ◆ Loss of ability to re-establish outsourced functions
- ◆ “Pain points” caused by need for integration
- ◆ Incongruent risk threshold between service provider and user organization

Outsourcing - Risks and Benefits – cont'd



■ Technology

- ◆ Inability to customize applications or loss of visibility into development process
- ◆ Dependence on outsourcing arrangement due to lack of internal expertise
- ◆ Data recovery, physical security and business continuity concerns

Which outsourcing model is right for your organization?



■ Full In-House Model

- ◆ Benefits: Process is under the full control of management. Knowledge of the company, processes and people are all maintained in house, and a traditional structure is maintained.
- ◆ Concerns: Previous concerns over people, process, technology

Which outsourcing model is right for your organization? – cont'd



■ Co-Sourcing Model:

- ◆ Benefits: Functional control remains in-house, high sense of connectivity, access to specialized resources, eliminates recruiting, training and employment costs for specialized resources, technical knowledge of provider, cost flexibility via “as needed” resources, state of the art methodologies and technologies, geographic coverage and ability to terminate the relationship.
- ◆ Concerns: Provider’s organization and industry knowledge, possible poor cultural fit, shift from managing a department to managing a relationship, dependent upon strong management oversight.

Which outsourcing model is right for your organization? – cont'd



■ Full Outsourcing Model

- ◆ Benefits: Provider “owns” human resources and is responsible for day to day administration and execution of the function. Cost and skill set flexibility, highly specialized skill sets on an as needed basis, global resource pool, state of the art technology and knowledge sharing, no investment for the purchase and upgrade or development of technologies.
- ◆ Concerns: Knowledge of organization and industry, possible poor cultural fit, internal and external coordination may be difficult, management must “own” all strategic decisions, model may need adjustment to provide a source of executive talent.

Vendor Selection



Define Vendor
Evaluation
Criteria

Review and Rate
Vendors

Establish a
Short List of
Vendors

Contract Terms
Clearly
Identified

On Going
Monitoring

Critical Success Factors

- Identify scope, stakeholders, risks, and issues up front
- Submit a clear RFP to vendors
- Conduct vendor due diligence
- Execute detailed, agreed upon vendor transition plan with targeted milestones and timeline
- Place 'right to audit' clause in contract terms
- Define clear scope and responsibilities, with Service Level Agreements (SLAs)

Key Challenges & Issues

- Vendor overpricing (higher than usual) if time is restrained , and vendor is needed in a short period of time
- Contract is not flexible to meet changing business circumstances
- Required legal consultation
- Vendor may not be financially stable

Internal Control Ownership



- One of the benefits of outsourcing is a “reduction of management oversight”. By outsourcing, has the organization relinquished its responsibility for internal control over outsourced processes or functions?



It is important to understand that an organization can outsource an activity or process. However , the organization cannot outsource the responsibility or ensuring proper controls are in place to mitigate risks.

Gaining Comfort Over Internal Control



- **What are the areas an organization should attempt to retain or gain comfort over when outsourcing processes or functions?**
 - ◆ Internal controls over financial reporting
 - ◆ Compliance with laws and regulations (HIPAA, privacy, etc.)
 - ◆ Compliance with established standards (i.e., restricted access, system availability, transaction processing integrity, etc.)
 - ◆ Contractual compliance

Gaining Comfort Over Internal Control



- **Successful practices**
 - ◆ Referrals and References
 - ◆ Contractual terms
 - ◆ Service Level Agreements
 - ◆ Pre-audit

Gaining Comfort Over Internal Control – cont'd



■ Common Third Party Reports or Attestations

- ◆ SAS 70 Report (Type I / Type II)
- ◆ Readiness Assessments
- ◆ Trust Services for Security, Privacy, Confidentiality, Availability and Transaction Processing
- ◆ Agreed-Upon Procedures
- ◆ Management Assessment/ Internal Audit review



■ Relevant Standards

- ◆ Statement on Auditing Standards (SAS) No. 70 is a widely recognized financial audit standard set forth by the AICPA that provides:
 - ◆ Guidance on factors financial auditor should consider when auditing the financial statements of an entity that uses a service organization to process transactions relevant to financial reporting
 - ◆ Guidance for independent auditors who issue SAS No. 70 reports on the processing of transactions by a service organization

SAS No. 70 – cont'd



■ Relevant Standards, cont'd

- ◆ Requirements of Section 404 of the Sarbanes-Oxley Act of 2002 make SAS No. 70 reports even more important to the process of assessing internal controls over financial reporting (“ICOFR”)
- ◆ Reports provide a consistent method for auditor to auditor communications on the design and effectiveness of relevant controls
- ◆ The AICPA Audit Guide “Service Organizations: Applying SAS No. 70, as Amended” provides guidance to service auditors and user auditors engaged to audit the financial statements of entities that use service organizations
- ◆ Visit www.aicpa.org

SAS No. 70 – cont'd



■ Benefits of SAS No. 70 Report to User Organization

- ◆ Recognized industry standard to provide user organizations, and their auditors, information regarding ICOFR
- ◆ Enables user auditors, internal and external, to place reliance on service organization's controls in support of the financial statement audit of user organizations
- ◆ Specified user control considerations
- ◆ Reduction in audit hours

What is greatest benefit to service organizations?

SAS No. 70 Readiness Assessments



■ Readiness Assessments

- ◆ Should not be confused with attestations, as no assurance is provided
- ◆ Often performed for service organizations in advance of initial SAS No. 70 audit or other attestation
- ◆ Helps to identify and remediate gaps to avoid a qualified or adverse opinion
- ◆ Useful for information gathering, such as due diligence; however, users should not place reliance on the reports
- ◆ Usually accompanied by “gap analysis” report

Trust Services



- **Attestation intended to increase comfort of management, customers, and business partners and based on the following principles and criteria:**
 - ◆ Security - The system is protected against unauthorized access (both physical and logical)
 - ◆ Availability - The system is available for operation and use as committed or agreed
 - ◆ Processing Integrity - System processing is complete, accurate, timely, and authorized
 - ◆ Confidentiality - Information designated as confidential is protected as committed or agreed
 - ◆ Privacy - Personal information is collected, used, retained, and disclosed in conformity with the commitments in the entity's privacy notice and with criteria set forth in Generally Accepted Privacy Principles issued by the AICPA

Trust Services – cont'd



- **Principles and criteria are evaluated based on the following:**
 - ◆ Policies - The entity has defined and documented its policies relevant to the particular principle.
 - ◆ Communications - The entity has communicated its defined policies to authorized users.
 - ◆ Procedures - The entity uses procedures to achieve its objectives in accordance with its defined policies.
 - ◆ Monitoring - The entity monitors the system and takes action to maintain compliance with its defined policies.

Trust Services – SysTrust vs. WebTrust



- **SysTrust engagements are intended to provide assurance on the reliability of a system**

- ◆ Example:

- ◆ A data storage business wants to demonstrate to potential buyers that they provide reliable systems

- **WebTrust engagements are intended to provide assurance on an organization's system related to e-commerce**

- ◆ Example:

- ◆ An on-line merchant wants to demonstrate effective privacy protection of personal and credit card information to their customers

Agreed-Upon Procedures (AUP)



■ Agreed-Upon Procedures (AUP)

- ◆ Independent accountant is engaged to issue a report of results based on specific procedures performed
- ◆ Is NOT an audit, as the independent accountant only reports results of the procedures; they do not attest to the sufficiency of those procedures for any objective
- ◆ The AUP procedures performed can vary widely due to the requirements of the parties, as such the nature, timing, and extent of procedures

Agreed-Upon Procedures (AUP) – cont'd



■ Agreed-Upon Procedures (AUP)

- ◆ The party requesting the AUP is responsible for determining the scope of procedures, but all parties relying on the report must ascertain sufficiency for their purposes
- ◆ The independent accountant does not issue an opinion; results are communicated in the form of procedures and results
- ◆ AUP reports are not for general use and are limited to parties specified in the AUP

Agreed Upon Procedures (AUP) – cont'd



- **Examples of types of appropriate procedures include the following:**
 - ◆ Execution of a sampling application after agreeing on relevant parameters
 - ◆ Inspection of specified documents evidencing certain types of transactions or detailed attributes
 - ◆ Confirmation of specific information with management
 - ◆ Comparison of documents, schedules, or analyses with specified attributes
 - ◆ Performance of specific procedures or work performed by others (including mathematical computations, the work of internal auditors)

Summary of Reports



<p style="text-align: center;">SAS No. 70</p> <ul style="list-style-type: none">• Performed under audit standards, which includes an opinion• Auditor to auditor communication• Intended to support the auditor in the financial reporting process	<p style="text-align: center;">SysTrust</p> <ul style="list-style-type: none">• Can be published• Can be tailored to address combinations of principles / criteria in the Trust Services framework• Attestation opinion issued
<p style="text-align: center;">WebTrust</p> <ul style="list-style-type: none">• Provide assurance over an organization's system(s) related to e-Commerce• Principles are selected to focus on relevant objectives (i.e. Online Privacy, Security, Availability, etc.)• Attestation opinion issued	<p style="text-align: center;">Agreed-Upon Procedures</p> <ul style="list-style-type: none">• Specific procedures agreed upon between the interested parties.• Can only be used by the parties who agreed to the sufficiency of the procedures.• No opinion is issued

Upcoming changes to SAS 70 reports



Discussion:

- Similarities and differences of SSAE 16 and SAS 70**
- Effective date**
- SSAE 16 and ISAE 3402**
- Focus of standards**

Source:

“New level of trust and transparency: A perspective on the transition from SAS 70 to SSAE 16 and ISAE 3402”

***Available at pwc.com or by contacting the speaker.**

Business Case



- **Within your tables, take 15-20 minutes to discuss the scenario in the exercise.**



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