

Outsourcing: Out of sight Out of Mind?

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FriendsLife

Effective auditing of outsourcing arrangements

Question:

How can internal audit more effectively monitor outsourcing arrangements

- Identify outsourcing risks
 - Understanding outsourcing lifecycle and key risks
 - Understanding role of materiality
- Recognise which auditing methods are most effective
 - Adapting approach
 - When to get involved
- Design an appropriate auditing framework
 - Practical implementation within FL

Why is this important?

Why is this important?

Heritage Friends Provident

- Major outsourcing already in place in IT and selective life and pensions administration

Heritage AXA UK Life

- Major outsourcing already in place in legacy life and pensions administration
- IT 'insourced' to other parts of the group

Friends Life

- Reliance on AXA as third party until separation complete (2 years)
- Over 20 'material' outsource providers – excluding AXA
- Well over 100 significant outsource arrangements in place
- Increasing new business propositions use of 3rd parties
- Harmonise policy and approaches

Outsourcing risk landscape

Governance

- Weak governance - No 1 factor in failing outsourcing arrangements
- Key challenge to drive “desired behaviours” / maintain flexibility

Regulatory / Compliance

- Cannot outsource responsibility
- Provider needs to support e.g. TCF
- Focus of regulator

People

- Loss of corporate knowledge
- Protect key competencies
- Drive right behaviours
- Cultural change needs to be tackled

Technology / Data / Security

- Business critical
- Tight data / access controls
- Robust Security / BCP
- Sub-contracting complication

Change / Programme

- Transformation / legacy systems a key driver
- Manages delivery risk

Performance

- Right service levels difficult to set / hard to monitor
- Still tendency for quantitative
- Not just service – also controls

Strategy

- Increasing dependence on outsourcing
- Complex to set up and exit
- Real risk of strategy misalignment

Multi-sourcing

- Multiple inter-dependent outsourcing
- Complex web of accountabilities
- Increases service risk

Location

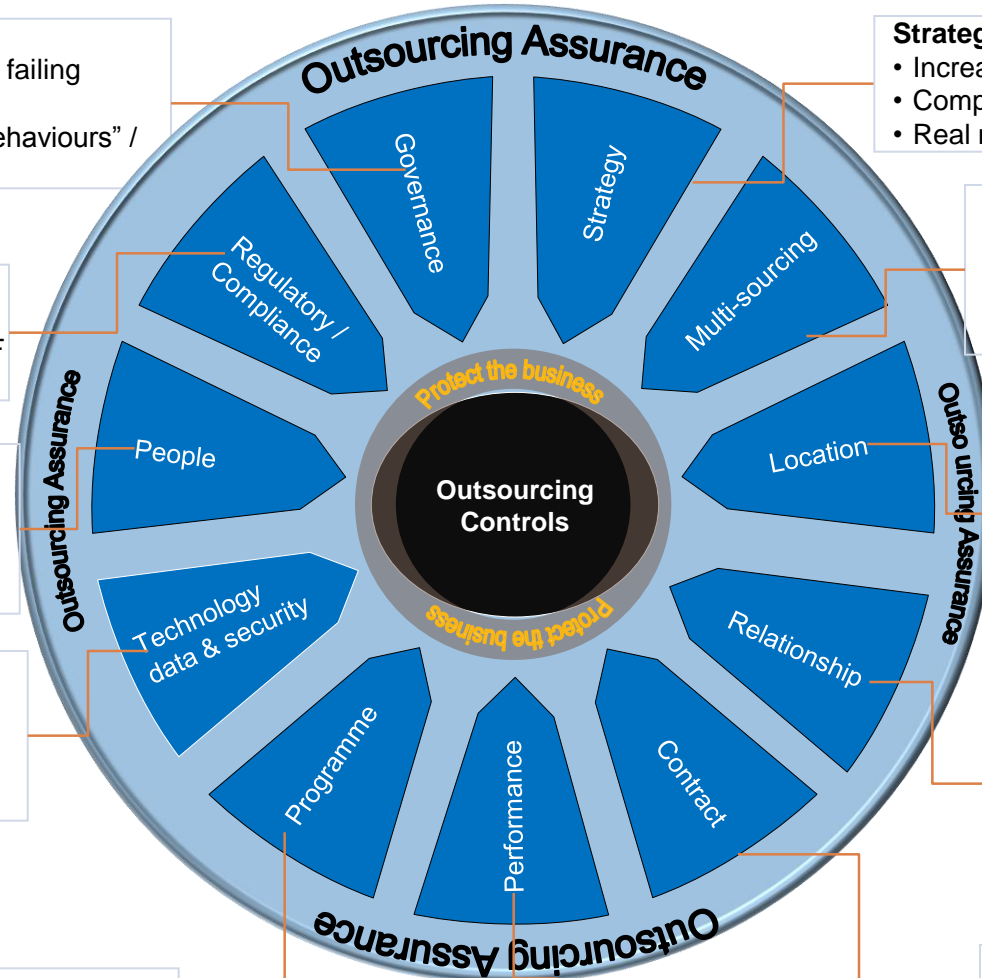
- Global providers
- Onshore/offshore
- Increases complexity
- Exposed to new risks

Relationship

- True collaboration
- ‘Old’ silo approach not appropriate
- Non-engaged stakeholders increase risk of failure

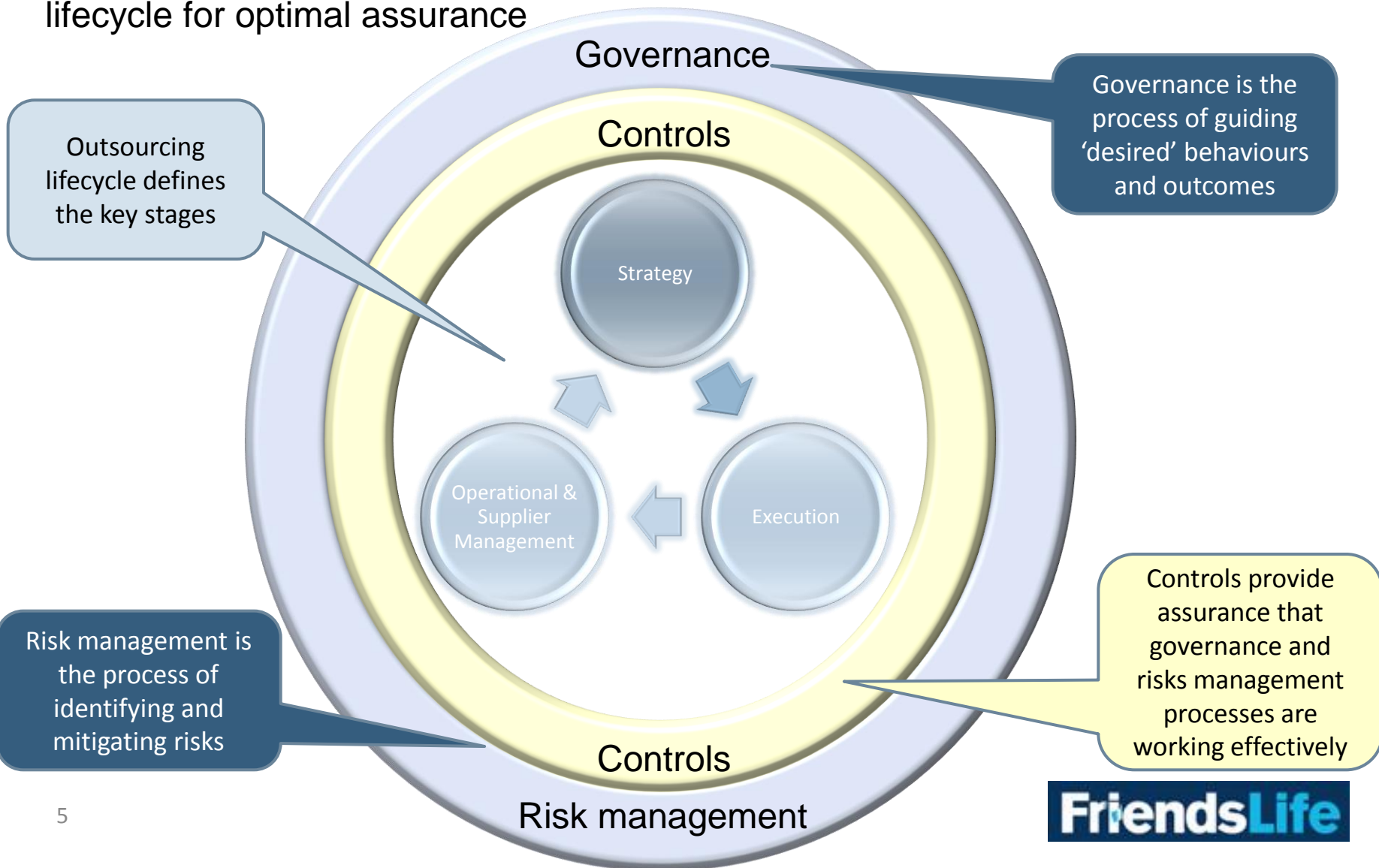
Contract

- Flexibility to change
- Level of risk mitigation



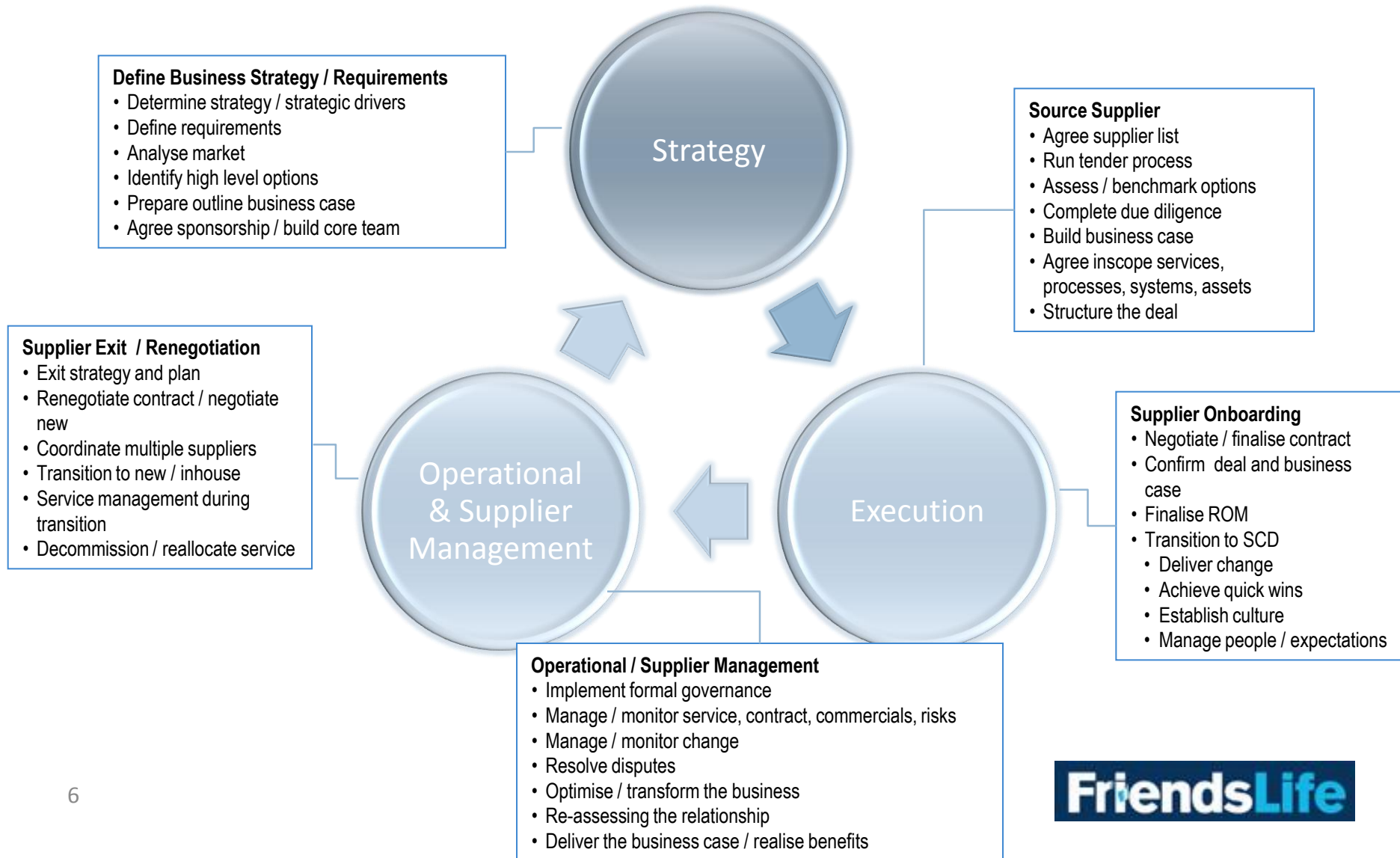
Outsourcing governance and risk management

Audit, risk and governance approach needs to be aligned to each stage of the lifecycle for optimal assurance



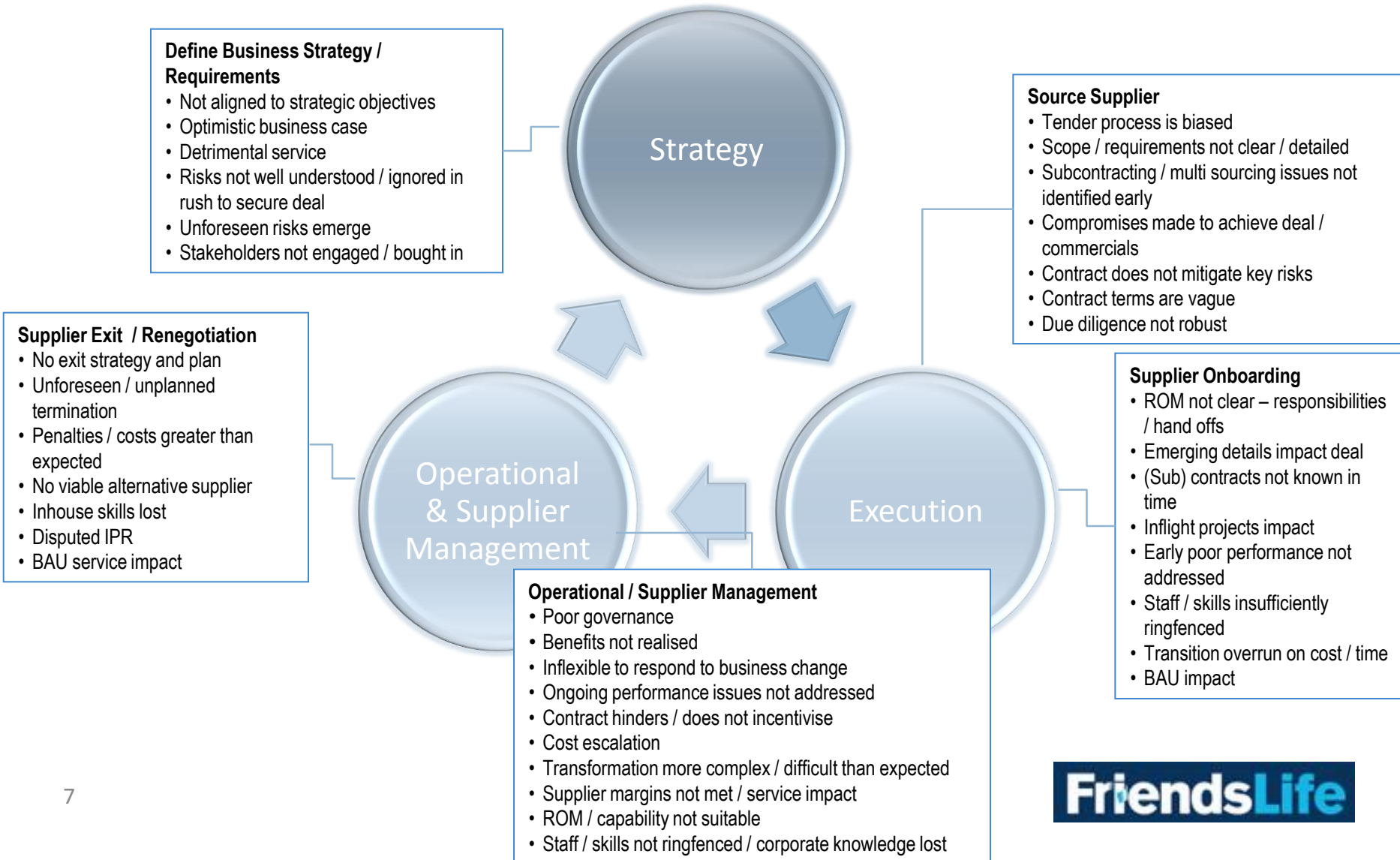
Understanding the outsourcing lifecycle

Each stage of lifecycle involves different set of activities



Understanding the risks

Each set of activities involves differing risks / risk appetites



Where is internal audit?

Typically audit get involved once the deal is operational



Appropriate outsourcing framework required

Lifecycle needs to sit within an appropriate corporate governance framework

Policy

- Consistent definition of 'material'
- Linked to corporate risks / risk appetite
- Enshrined in Policy
- Corporate ownership clear
- **Auditable**

Framework

- Applicable across the organisation
- Clarity of roles and responsibilities across LOD
- Clarity over who gets involved when
- **Auditable**

Process

- Applicable to each contract depending on materiality
- Consistency of reporting on services, risks, controls
- **Auditable**

Using materiality to determine level of controls

Corporate Risks

Risk / Materiality Impact	Tier 3	Tier 2	Low	Medium	High
Financial Impact Materiality	1. Low	2. Medium	3. Medium High	4. High	5. Very High
Business Unit (may vary by unit or subsidiary)	Below £xk	£xk - £ym	£xm - £ym	£xm - £ym	Above £ym
Regulatory / Legal / Reputational Impact	1. Low	2. Medium	3. Medium High	4. High	5. Very High
Operational Impact	1. Low	2. Medium	3. Medium High	4. High	5. Very High
Customer Detriment Impact	1. Low	2. Medium	3. Medium High	4. High	5. Very High

Financial

- Contract Spend
- Supplier Failure Risk

Regulatory / Legal / Reputational

- Performance Failure:
 - Damages, non-compliance, fund losses, intellectual property
- Negative publicity

Operational





- Change
 - Level of risk in changing 3rd Parties
- Market Concentration:
 - Who can deliver the service / value

Customer

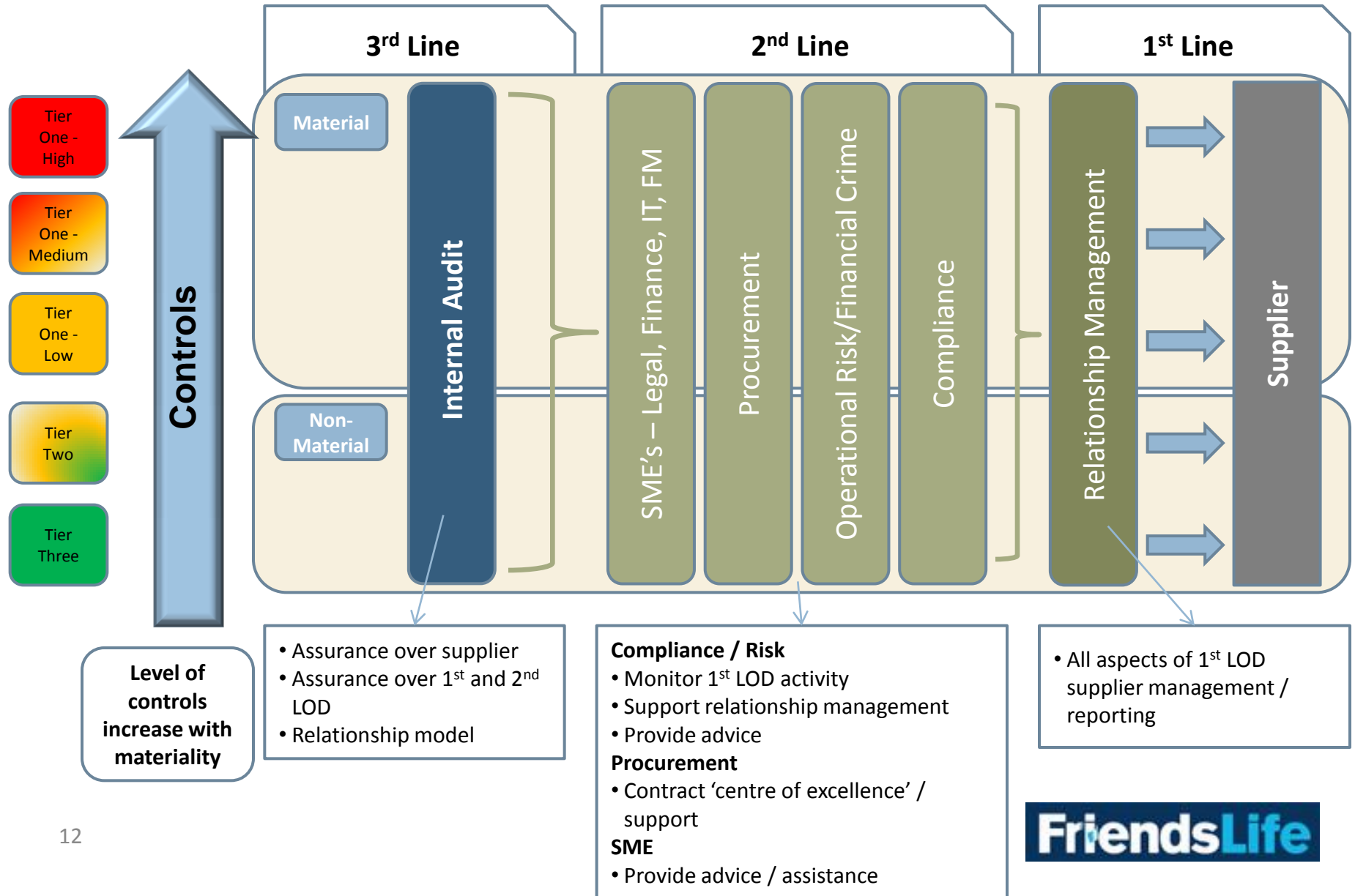
- Policyholders
- Performance Failure:
 - TCF outcomes
 - Customer detriment

- Applied to all 3rd parties to determine materiality based on corporate risk and impact
- Determines level of governance and controls needed

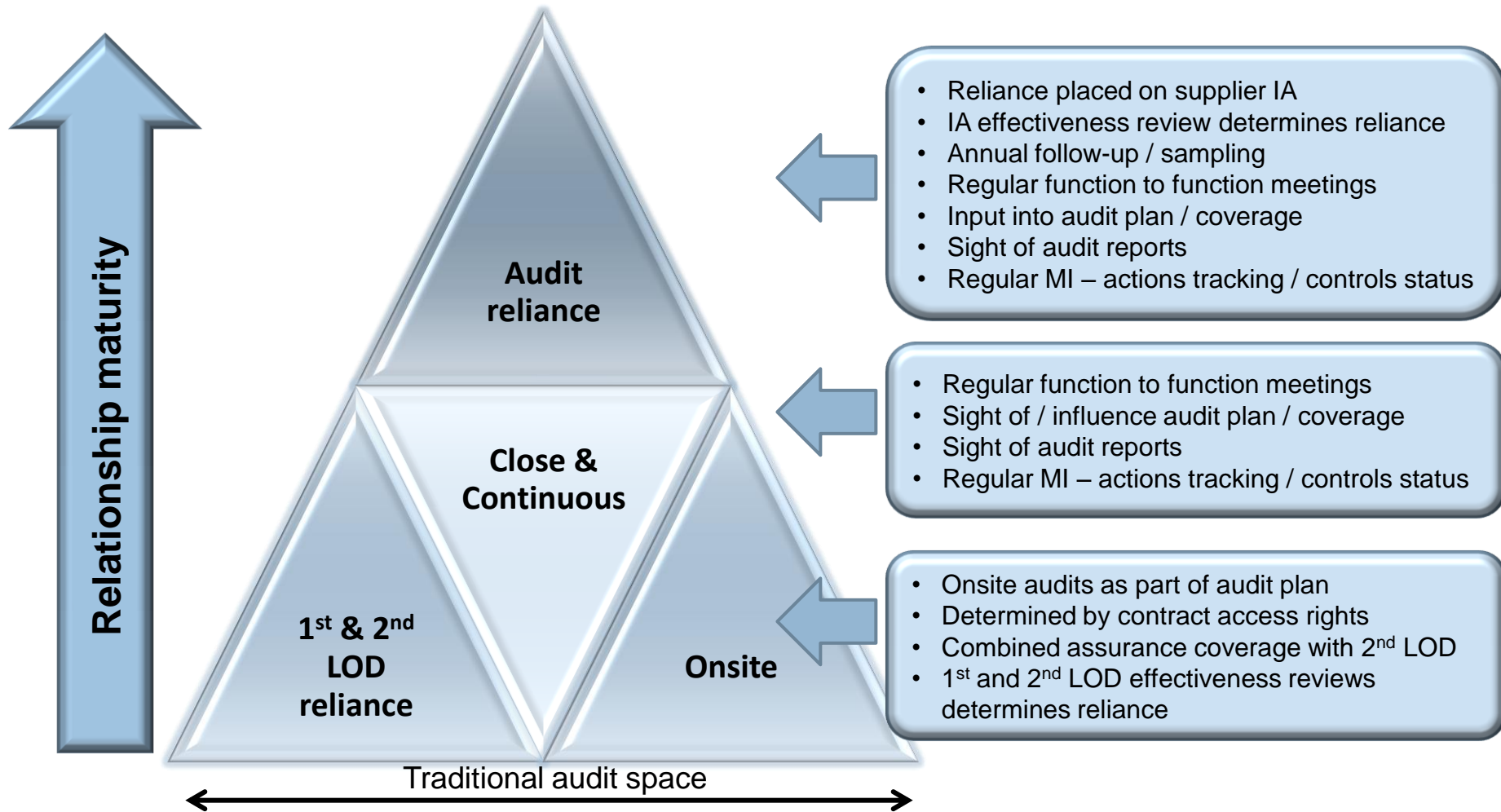
Prioritising outsourcing arrangements – 3 tiers

	Materiality	Key Features	FL Examples
 Tier One - High	Strategic or Joint Venture	<ul style="list-style-type: none"> • 5 to 10 year relationship • Limited to a number of key players • Long term collaboration on a variety of complex projects • Jointly developing product or process improvements • High level of risk to organisation • Need to have control 	<ul style="list-style-type: none"> • Major ITO and BPO <ul style="list-style-type: none"> • Capita • HCL • IBM • Wipro
 Tier One - Medium	Performance Partner	<ul style="list-style-type: none"> • 3 to 5 year relationship • Continuous improvement and development • Cost transparency • Seeking to improve costs/performance • Shared rewards for delivery 	<ul style="list-style-type: none"> • Fund managers – F&C • Specialists – FNZ, JLT • Printing / production - Williams Lea
 Tier One - Low	Contract	<ul style="list-style-type: none"> • Medium term (2 to 3 years) • Continuity of supply important and controlled by SLAs • Cost and quality most important 	<ul style="list-style-type: none"> • Bank • Custodians • Investment managers
 Tier Two	Commodity or Transactional	<ul style="list-style-type: none"> • Least complex • Short term solution • Does not add direct value • Cost driven • Easy to replace 	<ul style="list-style-type: none"> • Software providers • IFA portals • Facilities
 Tier Three			

Who does what?



Assurance toolset for different engagement levels



- Approach adopted determined by materiality, maturity of relationship and strength of internal governance framework

- Not an either / or – can be combined or used as a route map

Audit route map - How is this applied?

Relationship maturity

Controls

Tier One - High

Tier One - Medium

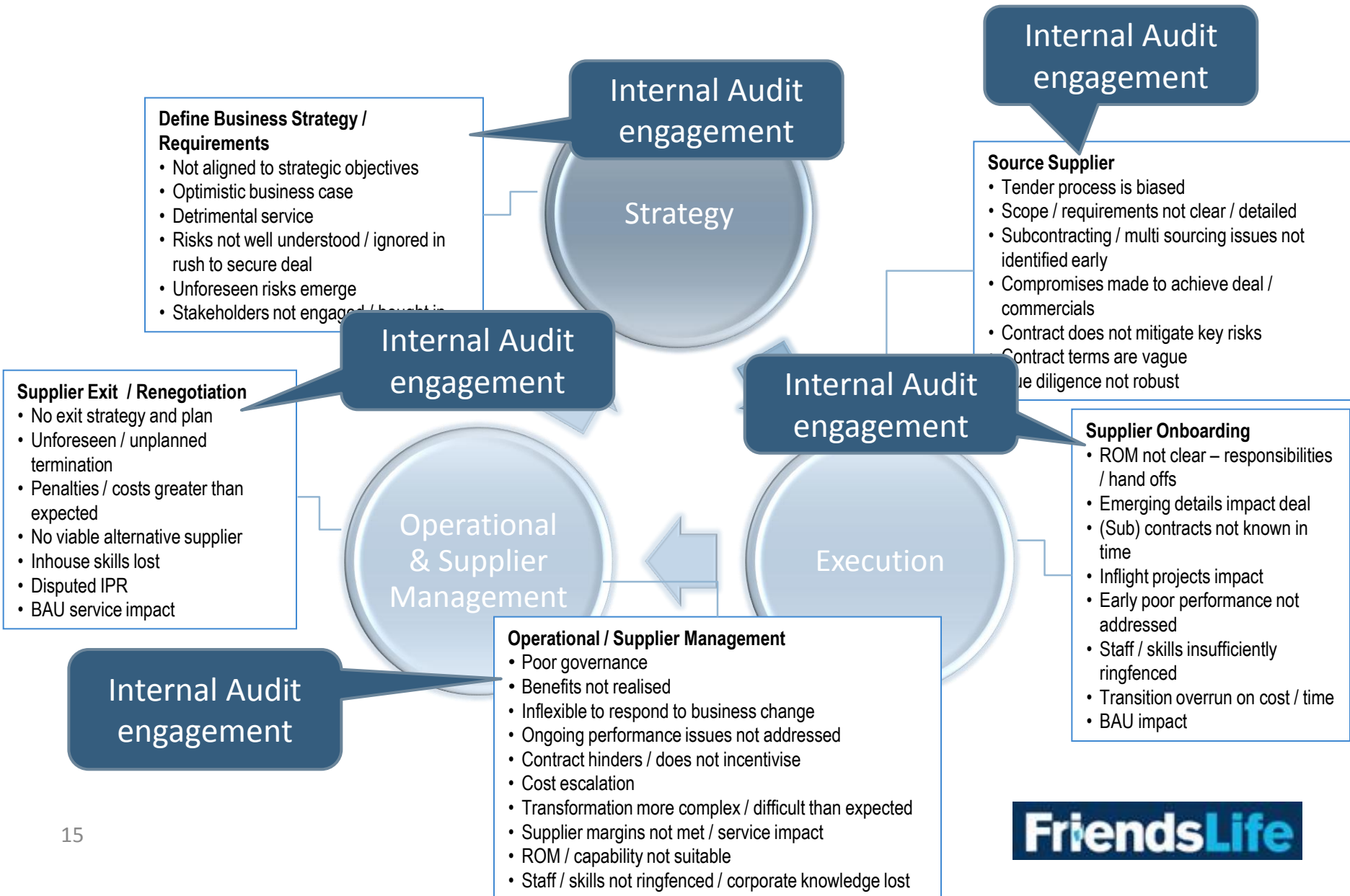
Tier One - Low

Tier Two

Tier Three

Materiality	'Ideal' Audit Engagement		
Strategic or Joint Venture	<ul style="list-style-type: none"> • Due diligence • Contractual access rights 	<ul style="list-style-type: none"> • Regular meetings • Audit plan input • Sight of audit reports 	<ul style="list-style-type: none"> • Supplier audit reliance
Performance Partner	<ul style="list-style-type: none"> • Audit service provision • Regular meetings • Onsite audits / controls assessment • Combined assurance with 2nd LOD • 1st and 2nd LOD effectiveness reviews 	<ul style="list-style-type: none"> • Sight of supporting quality and control assessments • Regular MI – actions tracking / controls status • Supplier IA capability assessment 	
Contract	<ul style="list-style-type: none"> • Contractual access rights • Regular meetings • Combined assurance with 2nd LOD • 1st and 2nd LOD effectiveness reviews 	<ul style="list-style-type: none"> • Regular meetings • Regular MI – SLA / supporting quality and control assessments • Potential to invoke audit access rights 	
Commodity or Transactional	<ul style="list-style-type: none"> • Contractual access rights • Assurance over 1st and 2nd LOD 		

What do we check?



Effective auditing of outsourcing arrangements

Conclusion

How can internal audit more effectively monitor outsourcing arrangements

- Understand outsourcing as a lifecycle
- Determine materiality of key outsourcing arrangements
- Define where internal audit should be involved
- Adapt approach and understand end-game
- Ensure appropriate skills in place – relationship model

Thank you