

## Third Parties - Why Should We Care?

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## THIRD PARTY RELIANCE IS INCREASING

- The use of third parties has increased exponentially over recent years to support extended enterprises.
- Many companies even outsource core functions to enable efficiencies and savings through economies of scale, and by doing so have created complex supply chains.
- As a result organisations are exposing themselves to high profile risks like never before.
- Half of companies approached in a recent big 4 survey believe the cost of a third party risk event has at least doubled in the last 5 years.
- Pre covid 17% had faced a high impact third party risk event in the last 3 years.
- **The biggest challenge going forward will be for organisations to demonstrate the appropriate oversight over third parties that support their extended enterprises.**

## WHAT IS DRIVING THIRD PARTY RISK?

- **Regulators continue to increase their focus on supplier risk** - Regulators are increasing the pressure on organisations to better manage their suppliers and have a clearer understanding of their supply chain risks and operational resilience exposures.
- **Increased incidents related to vendors** - Suppliers are causing increased disruption so risks need to be closely managed. Information security, data privacy, operational interruptions and anti-fraud management are some examples.
- **Pressures from economic volatility** - Economic conditions and drives to improve cost/income ratios mean tighter margins for suppliers and increased risk of supplier disruption or failure.
- **Actions taken by your suppliers can have serious consequences – not just legally but reputationally. Even if a security breach or risk incident occurs on the other side of the world it will be your company's brand that is impacted.**

# IMPROVING PICTURE - SUPPLY CHAINS?

- It is recognised that events such as Covid, Brexit, Climate Change, Material Scarcity, Corporate Collapses, Rising Costs and the Political Landscape will continue to interrupt supply chains and services.....

- Petrol stations running dry/restaurants out of chickens/Weatherspoons low on beer/no milkshakes at McDonalds (shortage of HGV drivers).

- Lack of toys and goods in shops for Christmas ( Suez Canal blockage and port congestion).

- Industry shutdowns (pandemic).

- Economic volatility and tighter margins (energy sector).

- **Despite these threats companies are not investing enough in third party risk management and understanding their supply chains.**



## WHAT ARE THE RISKS?

- **Legal and regulatory** - A third party could impact your compliance with legislation or regulation. For example, if your supplier contravenes labour or environmental laws, or if it loses some of your sensitive data, your organisation can still be found liable and subject to financial sanctions.
- **Operational** - A third party could disrupt your operations. For instance, your software vendor is hacked leaving you with a system outage.
- **Financial/reputational** - A third party could damage your revenue, share price, reputation or brand. For example, it provides you with sub standard components .
- **Outsourcing and relying on suppliers doesn't mean the end of your organisation's responsibility.**



# DO YOU UNDERSTAND YOUR THIRD PARTY LANDSCAPE?

- How much of your control environment sits outside of your company's direct control?
- How much of your company is operated or serviced by some other organisation?
- Are any third parties making decisions on your behalf?
- How much do you spend on third party suppliers and how many do you have/what type?
- Do you know what all your third parties do and where they are located?
- Do they control, access or process your Critical, Personal or Sensitive data?
- How many have direct access to your company's systems?
- Have you identified which suppliers support your critical processes and how many are in each process?
- Is it clear where your supply chains start and end, including the role of fourth parties?
- **Historically third party risk has been seen as a procurement issue, predominantly focused on saving money from outsourcing, with legal providing a contract. But this is no longer enough as the risks are higher and more complex.**

## WHAT CAN HELP US MANAGE THE RISK?

Change from having no governance or informal governance over third parties and taking risk for short-term benefits, to a more risk-based approach, that reflects your enterprise and is aligned with your organisation's strategy. Demonstrating best endeavours.

- Move from having employees with no or limited training to trained professionals that can align service delivery to strategic objectives.
- Develop standardised processes and methodologies to help create a recognised control framework.
- Create customised, value add tools that support decision making and risk monitoring.
- **Risk management is the responsibility of ALL employees.**



## THE THIRD PARTY TOOL KIT

- Sourcing Policy that clearly defines the sourcing lifecycle from supplier selection to contracting.
- Supplier Management Policy that outlines how suppliers need to be risk assessed and segmented, based on agreed criteria such as value, data held, customer facing. This should establish the level of oversight and extent of ongoing management post contract.
- Clear Accountabilities and Responsibilities for managing suppliers.
- Contracts Database for all contracts , amendments, and recording of contingent liabilities.
- Regular Risk Reporting against KPIs such as achievement of service levels, financial stability, meeting contractual requirements ie Exit and DR planning, risk events etc.
- Periodic Re-performance of due diligence checks on financial stability and going concern with economic warning indicators.
- Processes or triggers to identify a change in segmentation/risk profile.
- Map out how your suppliers support your key processes.
- **Managing third parties and the associated risks is about being proactive (not reactive) in order to ensure the full benefits of the extended enterprise can be achieved.**

# WHAT AUDITS CAN YOU PERFORM ?

- Sourcing and procurement lifecycle.
- Supplier management.
- Contract management/contingent liabilities.
- Visits to suppliers and review of self assessments and external independent reviews.
- Supplier payments.
- Integrated audits that consider the role of third parties.
- Third party access management.
- Operational resilience.
- Intra-Group outsourcing.
- **How well is your supplier managing your risk and how good is your organisation's oversight?**



# WHAT DO THE REGULATORS WANT ?

Material, Critical or Important Outsourcing arrangements to be advised.

- Notification of key IT outsourcing arrangements, including cloud services.

- Notification and risk assessment of off-shoring key financial systems.

- Extra oversight for those suppliers with delegated authorities ( i.e. responsible for making underwriting decisions).

- New regulations on operational resilience are being introduced which will require identification of important business services and explicitly covers the services covered by third parties.

- **Regulators will look to your organisation for answers, not your third parties.**



## A FINAL THOUGHT

The acknowledgement of the intricacies and importance of third parties and supply chains is not new and goes back in time....

“I, Pencil: My Family Tree” as told to Leonard E Read, Dec 1958

A charming story which explains how something as apparently simple as a pencil is in fact the product of a very complex process.

Thank you