

Effective Third Party Due Diligence and Monitoring

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Today's Focus: Big Picture AND In the Weeds

- Big Picture
 - Third-party management cycle and process
 - Key considerations in each phase
- Drill down into three specific issues
 - Guidance focused on three components of third party management



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Scope of Third Parties

- Suppliers/vendors
- Service providers
- Subcontractors
- Distributors
- Sales Agents
- Intermediaries
- Joint venture partners
- M&A targets

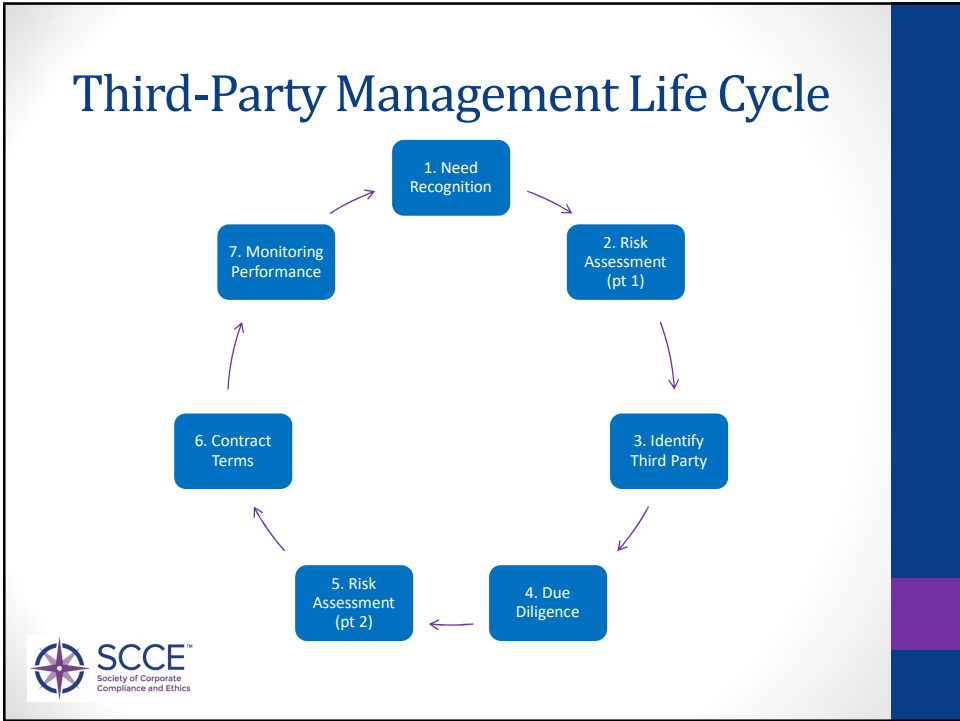


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A FRAMEWORK FOR EVALUATING YOUR THIRD PARTY MANAGEMENT FUNCTION



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Phases/Questions

1. Need recognition
 - Is there a legitimate business need for a third party?
 - What business purpose would the third party serve?
 - Can we clearly articulate the scope of what the third party will do?
 - Scope of work

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Phases/Questions

2. Risk assessment (part 1)

- What risks have been identified with the use of a third party (in general) for this service, or for this type of relationship?
 - Not third-party-specific at this point (i.e. what are the risks of us outsourcing this function?)
 - Considerations to include:
 - Monetary value of contract/relationship
 - Nature/volume of data held or accessed by third party
 - Financial risks, handling of assets, etc
 - Type of relationship (acquisition, JV, vendor, etc)
 - Nature of services provided
- Design of due diligence procedures to be applied to:
 - All initial third parties under consideration, or
 - Finalist(s) only



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Phases/Questions

3. Identification of third party(ies)

- What process was used for identifying potential third parties that could fill our needs?
- How was the specific third party selected?
 - Or how did we narrow the list to finalists?
- What preliminary background checking steps have been performed, and what are the results?



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Phases/Questions

4. Due diligence

- What process was used for determining level & type of due diligence required (based on types of risk, monetary amount, what else?)
- Which characteristics are important to vet?
- Documentation and retention
- Five levels:
 - I. Checking organization and individual names through watch lists, criminal databases, excluded parties lists, etc
 - II. Screening of media, more in-depth internet searches on company, key execs, closely related parties
 - III. Comprehensive background checks of key individuals, reference checking, etc
 - IV. Review of submitted documentation (licenses, financials, policies/procedures, etc)
 - V. Site visit to perform due diligence, inspections, test controls, processes, interviews, etc (always done for acquisitions, maybe for others)



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Phases/Questions

5. Risk assessment (part 2)

- What unique risks have been identified with respect to this specific third party?
 - Based on due diligence (e.g. results of assessing third party's internal controls, etc)
- Match/map risks to:
 - Contract provisions, where applicable
 - Specific ongoing monitoring procedures to be performed during period of performance



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Phases/Questions

6. Contract terms

- Is there a clearly stated scope of work?
- Are fees and payment terms clear and appropriate?
- Have we properly customized an audit rights clause?
- Have appropriate termination (and, if appropriate, penalty) provisions been included in the contract?



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Phases/Questions

7. Monitoring during Period of Performance

- Do we have a plan or monitoring the third party?
- What monitoring techniques will we utilize?
 - Mapped to Part 1 and Part 2 risks
 - On-site vs. from our office
 - Doc review vs. analytics
- Who will be involved in monitoring?
 - Internal audit? Others?
 - Third parties?
- Process for escalating/terminating, etc if problems arise during monitoring



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**SPECIFIC ISSUES INVOLVING
THIRD PARTY MANAGEMENT**




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ISSUE NO. 1

Audit Rights and Access to Records Clauses



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Audits

- Financial vs. Compliance
 - With financial, focus is on billing
 - Compliance focuses on contract provisions, compliance with laws
 - Either can address processes, policies, etc
- Surprise vs. With Notification
 - Surprise is more likely to detect fraud, noncompliance, etc, but creates other problems and inefficiencies
- Our Staff vs. Third Parties
 - Expertise, availability, cost considerations



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Audit Clauses

- Establishes right to perform an audit of a third party
- Customized terms, not boilerplate, for each scenario
- Key issues:
 - Audit vs. inspect, review, examine, etc
 - Type of audit (financial, compliance, other)
 - Audit period – how far back
 - Record retention (which records and for how long)
 - Access to, copies of, documents and records
 - Which ones?
 - Format of records
 - Planned (and notification) vs. surprise
 - Facilities, assistance, copying records, etc
 - Third party auditors? Who?
 - Application to subcontractors
 - Cost recovery, extrapolation, penalties, repayment, etc



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Audit Clauses – Good or Bad?

“Upon reasonable notice, Company will have the right to audit books and records of Contractor to determine the accuracy of Contractor invoices at a time and date mutually agreeable to Clinic and Contractor.”



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Audit Clauses – Good or Bad?

“Hospital shall have the right to inspect, with Contractor’s assistance and cooperation, Contractor’s books and financial records pertaining to the services Contractor provides for Hospital...”



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Audit Clauses – Good or Bad?

“Contractor shall provide all necessary information in electronic form.”



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Audit Clauses – Good or Bad?

“All audit work will be done on Contractor premises, and no Contractor documentation shall be removed from Contractor’s office. Contractor shall make personnel available to answer questions for the auditors.”



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Audit Clauses – Good or Bad?

“Audits may be conducted only by independent third parties that are mutually acceptable to Company and Contractor.”



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ISSUE NO. 2

Auditing/Monitoring of Third Parties



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Audit and Monitoring Plans

- Risk-based plan customized for each third party
 - Detailed plan describing:
 - Steps/techniques
 - Frequency
 - Approach to sample selection(s)
 - Responsibility
- Utilize forensic data analytics
 - Use multiple data sources to monitor for specific indicators
 - Multi-factor risk scoring vs. single-factor analytics
- Exercise audit rights clauses
 - When red flags arise
 - Periodically even when no red flags



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Auditing/Monitoring of Third Parties

- What data do/can we have access to digitally?
- Should we utilize a third party to audit third parties?
- Plan should be based on risk assessment
 - Don't automatically repeat every year
- Consider what to do if you find problems
 - Extrapolate, calculate damages
 - Mandated training
 - Termination
- Remember to update due diligence on third parties:
 - Periodically, fixed intervals
 - As circumstances, risk factors change



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ISSUE NO. 3

Additional Considerations for Mergers and Acquisitions



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M&A Targets

- Important to perform compliance and ethics program assessment
- Review cases, hot line results, investigations, etc
- Include C&E questions in interviews of sample of employees
- Assess culture, fit, etc
- Consider similarities and differences in policies, practices, etc
- Plan on a lengthy integration process
 - M&A targets never “simply adopt” your program components as is; Changes are inevitable
- Post-M&A:
 - Integrate risk assessments
 - Consider impact on training, audit/monitoring plan



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QUESTIONS ??

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