If you only have time to read one page:

Findings

• Service providers are delivering to contract terms. However, they are not meeting buyers’ initial expectations.

• Organisations have found it difficult to measure the performance of their service provider, requiring new assessments and specifications in contract terms, and having to reduce the complexity of Service Level Agreements (SLAs).

• The selection process for service providers is changing. More subjective, non-financial metrics are being used to evaluate the potential service providers.

• Organisations believe they are aware of the risks associated with outsourcing, however, they are not appropriately monitoring or auditing the risks and controls.

• Trends indicate components of IT are being brought back in-house. Core IT functions, strategic to the business, should be maintained in-house rather than outsourced - this includes IT strategy and architecture.

• Off-shoring is being approached as an option rather than an objective, and alternative (less traditional) countries are being considered.

• Business Process Outsourcing (BPO) is mature and stable, compared to Information Technology Outsourcing (ITO) which is continuing to evolve (refer to diagram below).

Summary

• Outsourcing practices are evolving as businesses across the Asia Pacific region continue to identify opportunities and benefits.

• Performance measurements will be simplified, whilst outsourcing models become more complex, often involving multiple suppliers and subcontractors.

• Risk management practices have lagged and regulators are now more closely examining outsourcing arrangements.

• Outsourcing business processes including IT, entails significant investment. As a matter of sound business governance, organisations must be confident with every aspect of any complex outsourcing transaction.
# Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>2</td>
</tr>
<tr>
<td>Why consider risks?</td>
<td>3</td>
</tr>
<tr>
<td>Executive summary</td>
<td>4</td>
</tr>
<tr>
<td>About this survey</td>
<td>6</td>
</tr>
<tr>
<td>Where are we today?</td>
<td>9</td>
</tr>
<tr>
<td>The worrying signs on risk management</td>
<td>19</td>
</tr>
<tr>
<td>Understanding the trends</td>
<td>24</td>
</tr>
<tr>
<td>Moving to better practice</td>
<td>28</td>
</tr>
<tr>
<td>Conclusion</td>
<td>30</td>
</tr>
<tr>
<td>Glossary of terms</td>
<td>32</td>
</tr>
<tr>
<td>Contacts</td>
<td>33</td>
</tr>
</tbody>
</table>
Introduction

Outsourcing is not new. Stakeholders are increasingly demanding cost-effective business practices to improve productivity and profitability. Organisations globally and locally (Asia Pacific region) have looked towards outsourcing to satisfy these demands. The impact of such moves varies, and has significant risk ramifications for business at large.

The decision to outsource must be strategic. Outsourcing is a significant investment that will, by necessity, affect the organisation’s bottom line, culture, risk profile, customer relationships, flexibility and day-to-day operations. Consideration of complex risks such as: reliability/serviceability; availability; contractual obligations; and security are vital.

Is outsourcing worth the effort? Establishing an outsourcing relationship will be a significant and continual investment of cost and time for an organisation. If it fails, who will be accountable for the ensuing cost, loss of business and loss of reputation? If it is successful, the organisation can achieve substantial economies of scale, savings, access to expertise and diverse offerings as well as time to pursue strategic business objectives.

Media across the Asia Pacific region have demonstrated a keen appetite for outsourcing related content. In higher-cost countries, emotive and community-related issues such as employment and industrial relations (particularly in offshore arrangements), will receive exposure. Organisations’ reputations could be at stake.

Questioning the benefits of outsourcing will continue. However, as free-trade agreements between countries are negotiated, cross-border relationships or off-shoring may be further considered as options. Additionally, there will be growth in the number of multi-supplier arrangements.

Outsourcing is part of a considered business strategy and is not a straightforward business transaction. The best intentions of all parties in the relationship will not necessarily produce expected outcomes.

With increasingly common, complex multi-layered supplier outsourcing relationships, it is critical to ask ‘who is conducting your orchestra?’

Egidio Zarrella
Global and Asia Pacific Partner in Charge
Information Risk Management
KPMG in Australia
Recognising the pervasiveness of outsourcing, KPMG's member firms across Asia Pacific conducted this regional survey with three main objectives:

1. evaluate and analyse existing outsourcing relationships and buyers’ experiences;
2. discover the current state of outsourcing relationships, the impact on organisations and their risk profiles; and
3. provide insights to the future direction of outsourcing.

Organisations recognise the need for risk management in relation to outsourcing. However, outsourcing significant business functions or IT processes creates a dilemma – has the risk exposure of your organisation increased or decreased?

The answer can be either, or both, and some regulators across the region are keen to ensure that risks are identified and appropriately managed.

Understanding your organisation’s risk profile, and determining the changes in risk profile as a result of outsourcing, are essential elements of an outsourcing business case.

Outsourcing to a service provider with greater experience, more effective tools and proven methods in a function may reduce risks. However, your accountability for risk management has not altered. In fact, your organisation’s risks may have increased as a result of new threats emerging as a direct result of outsourcing. These threats include the control of confidential data, possible reduction in business agility, inability to operate or assess options (skills may be transferred to the service provider), quality of service and ability to manage the relationship with the service provider.

KPMG’s Asia Pacific Outsourcing Survey posed many risk-related questions to understand how organisations are considering the risk aspects of their current or proposed outsourcing relationships. We received first-hand accounts of specific difficulties encountered and have used a number of these to illustrate our survey findings. We have also included risk management guidance based on our methodologies to provide answers to questions posed by the survey results and participants’ experiences.

The survey is the result of a significant investment in time and intellectual property of our member firms’ valued clients and professional colleagues. KPMG’s Information Risk Management (IRM) practice in Asia Pacific appreciates and thanks all participants for their valuable contributions. Quotes, specific examples and case studies from our discussions with selected clients have been incorporated to demonstrate existing scenarios and illustrate the current climate.

KPMG’s IRM practice is committed to conducting topical research to provide insight for clients into business and technology trends in the Asia Pacific region.

Lim Huckhai  
Asia Pacific Sourcing Risk Partner in Charge  
Information Risk Management  
KPMG in Malaysia
Objectives

KPMG’s 2004 Asia Pacific Outsourcing Survey explores the state of Business Process Outsourcing (BPO) and Information Technology Outsourcing (ITO) among more than 100 leading organisations in the Asia Pacific region.

From pre-survey discussions with clients and analysis of media reports, we identified the market perceptions on outsourcing to comprise:

• mature ITO and immature or developing BPO;

• dramatic growth of off-shoring, with many organisations actively pursuing off-shoring as a key business strategy; and

• broad dissatisfaction with current outsourcing service providers.

Findings

The survey results are at a variance with the previously identified market perceptions. Survey results reveal:

• BPO is stable and mature. ITO is evolving, with many organisations varying and redefining their ITO model;

• modest growth in off-shoring can be expected. Offshore activity is an option rather than an objective, as the initial cost-saving agenda now forms part (as opposed to all) of the decision making process; and

• service providers are delivering to contractual terms. However, there is a gap between buyer expectations and delivery on ‘value-add’ options, particularly with ITO.

The survey determined that:

• ITO is being selectively and partially reversed (i.e. insourced) by some organisations;

• organisations mistakenly believe they are managing their outsourcing risks however do not have an holistic and current view of their risks;
• regulators are examining more closely the nature of outsourcing relationships in industries such as financial services;

• organisations with long-standing outsourcing arrangements want to reduce the complexity, volume and frequency of performance measurements incorporated into SLAs, where manageability and practicality are fundamental; and

• non-financial selection criteria such as cultural fit and company ethics are increasingly being used to evaluate potential service providers. The evaluation of service providers’ performance is increasingly subjective, with measurements such as customer satisfaction being used.

Where does outsourcing go from here?

Outsourcing appears to be working as a management strategy and is being embraced far more extensively than expected. For the most part, business case benefits are being achieved, disasters are rare, and selection and management processes are being fine-tuned.

As outsourcing evolves, KPMG’s IRM practice in Asia Pacific predicts the outcomes for organisations will be:

• BPO will drive outsourcing decisions and will include ITO rather than ITO being a primary objective;

• key BPO performance measures will be quality of service delivery, business ethics, and cultural compatibility;

• ITO driven strategies will be more successful in non-commercially sensitive functions, such as facilities and network management; and

• key ITO performance measures will be technical competency, systems availability and continuity, security, and unit costs.

In these changing circumstances, management of the changing risk profiles is vital to help ensure commercial viability, adherence to regulatory requirements, and to satisfy stakeholder expectations.
About this survey

Definitions

Five key terms are used throughout this paper.

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buyer/organisation</td>
<td>A business that contracts the services of an external party to perform specific business operations.</td>
</tr>
<tr>
<td>Service provider</td>
<td>A niche business contracted to provide defined services to a buyer/organisation.</td>
</tr>
<tr>
<td>Business Process Outsourcing (BPO)</td>
<td>The delegation of one or more internal business processes to a service provider. For the purposes of this survey, BPO excludes IT.</td>
</tr>
<tr>
<td>IT Outsourcing (ITO)</td>
<td>The delegation of one or more IT functions or operations to a service provider.</td>
</tr>
<tr>
<td>Asia Pacific region</td>
<td>For the purposes of this survey, the Asia Pacific region is Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore, Taiwan and Thailand.</td>
</tr>
</tbody>
</table>

Background

Participants were asked 68 questions covering:

- current arrangements and extent of BPO and ITO;
- drivers for selecting outsourcing;
- measurable benefits from the service provider;
- business impacts and risks;
- levels of satisfaction versus expectations; and
- future intentions.

Survey data was compiled through face-to-face interviews with clients of KPMG member firms, and other leading organisations across Asia Pacific. KPMG’s IRM professionals met with executives responsible for BPO and/or ITO arrangements.

Analysis of the results was performed using data analysis software developed by KPMG’s IRM practice. This involved comparisons and consolidation from multiple questions.
This paper provides an analysis and interpretation of specific responses received from participants, in addition to their observations and experiences.

**Who answered the call?**

One hundred and two organisations located in the Asia Pacific region participated in the survey, with a representative spread across major industry groups and government.

Participants are grouped into the following industry categories:

1. Financial Services (FS);
2. Consumer and Industrial Markets (CIM);
3. Infrastructure and Government (I&G);
4. Information, Communications and Entertainment (ICE);
5. Energy and Natural Resources (ENR); and
6. Not disclosed/other.¹

As illustrated in the diagram below, the proportion of participants across all industries is well balanced.

1 Some participants did not disclose their industry group due to ease of identification within their country. Others did not fit the provided demographics.
The distribution of participants by revenue (USD) also demonstrates a balanced profile of organisations (refer to diagram below).

**Participants by annual company revenue (USD)**

- Under $10 million: 11%
- $10 million to $49 million: 36%
- $50 million to $99 million: 10%
- $100 million to $499 million: 6%
- $500 million to $999 million: 9%
- $1 billion to $5 billion: 6%
- Over $5 billion: 10%

![Diagram showing the distribution of participants by annual company revenue](image)
Where are we today?

Key messages:
• ninety five (95) percent of survey participants engage in BPO or ITO irrespective of size or industry classification;
• buyers are generally satisfied with the performance of service providers, although many had higher expectations, based on initial promises;
• performance evaluation is moving towards business needs rather than statistical measurements, and the measures for service provider selection are moving to business values;
• certain functions of ITO are being brought back in-house;
• off-shoring is an option, not an objective, and will be considered for reasons other than cost savings;
• loss of experience, knowledge and information exposure were considered the highest risks of outsourcing;
• subcontracting by service providers was substantial – increasing risks to the buyer; and
• regulators are reviewing outsourcing arrangements, particularly in industries such as financial services.

Overview
Since the commencement of trade, sound business economics has acknowledged that contracting the services of an external party, as opposed to an organisation undertaking its entire business functions, is frequently a viable and attractive proposition.

The following section addresses the specific results of this survey and provides commentary and analysis using quotes, anecdotes and specific examples provided by participants.
The existing arrangement

Unprecedented levels of sophistication in outsourcing have now been reached. Consider the example of an airline (illustrated below), with complex multi-vendor outsourcing arrangements in place.

Far fetched? No. This is an extreme example, however certain organisations today are very close to achieving an equivalent model. Other businesses are seriously probing for the most cost effective, efficient, strategic or pioneering sourcing models to deliver competitive advantage.
The extent of outsourcing

Ninety five (95) percent of survey participants outsource some component of either or both business process or IT functions (refer to diagram below).

![Outsourcing arrangement diagram]
There is a strong correlation between the number of years an organisation has been using service providers and the penetration of the service provider into core business operations.

The results of the survey indicate a number of clear messages related to BPO and ITO, namely:

- industry or organisation size (by revenue) does not correlate to the uptake of outsourcing;

- the large uptake of outsourcing indicates organisations believe outsourcing to be a strong management tool that will deliver returns on investment;

- participants will more substantially increase outsourcing in non-customer-facing rather than customer-facing activities. Unsurprisingly, this suggests that organisations prefer to directly manage the customer relationship aspects of their business; and

- as illustrated below, for BPO on average, 33 percent of core business operations are outsourced. There is a strong correlation between the number of years an organisation has been using service providers and the penetration of the service provider into core business operations.

![Average percentage of business processes outsourced to external service providers](image)

1 Core business operations include the major products or service delivery of the business. For example, using the airline scenario on page 10 core business operations includes ticket sales, freight sales and reservations management.

2 Financial Management e.g. accounting, transaction processing.
The penetration of ITO

Over 80 percent of survey participants use multiple service providers at different stages of the System Development Life Cycle (SDLC). This is depicted in the diagram below indicating an increase in the percentage of overall functions outsourced as the SDLC progresses. Therefore, the practice of internally building systems is diminishing as organisations depend heavily on specialist IT service providers for these functions.

Most buyers are content, for now

Dissatisfaction of buyers with their outsourcing service providers was not a conclusion for survey participants. The results defy media and general perceptions – in the main, organisations are more than satisfied with the services provided in both BPO and ITO.

More than 95 percent of BPO and 90 percent of ITO service providers delivered at least to contract terms. Of these, over 40 percent of service providers are delivering beyond contract terms and are pursuing joint performance enhancement initiatives.

---

1 SDLC - conceptual model utilised in project management of Information System development projects.
Traditional performance measurement has not delivered.

**Performance measurement has not delivered**

Traditional performance measurement has been found too hard, too imprecise, time consuming and error prone, leading to disputes.

Renewal of contract terms will involve changing performance measures and repositioning future expectations of buyers. The diagram below illustrates the change in performance measures as evidenced by the survey findings.

---

Consider the airline once again and its outsourced online reservations system. The service provider claims the system is available and functioning 24 hours a day. However, unhappy customers telephone the airline to complain of data inaccessibility even though the site was online. Monitoring the downtime of the reservation system could be an impractical, immeasurable and inefficient use of the airline’s resources. A refined measure could be monitoring customer complaints and sales patterns rather than simply downtime.

---

\[n^5\] KPI - key performance indicator
Outsourcing intents
The shift in selection criteria

Many participants provided an instinctive negative response when discussing service providers. Service providers are meeting contract terms, but not meeting promises. As a result, organisations will redefine priorities and performance measures when selecting a service provider or renegotiating contract terms. The diagram below illustrates the origin of the frustration.

Buyers need to be vigilant that their expectations, as well as their needs, are reflected in the service contract. The change in buyer selection criteria for future BPO and ITO is illustrated in the two diagrams below.

“Our provider didn’t deliver on the marketing pitch. We are much more realistic about our expectations now.”
IT Manager, Consumer and Industrial Markets Organisation

© 2004 KPMG, an Australian partnership, is part of the KPMG International network. KPMG International is a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG.
The key messages from these results are:

1. BPO selection criteria of ethics and the ability to rapidly introduce new technology into business processes have at least doubled in importance; and

2. ITO selection criteria rank highly the human dimensions of cultural fit and quality, while reducing expectations of the rapid introduction of new technologies.

“We ended up paying for a resource when we wanted a service. We are bringing these functions back in because of the culture and to reduce cost. Our outsourcer had a completely different work ethic. Our team comes in and stays until the job is done, but the outsourcer’s team left at 5:00. Poor dress standard and lack of professionalism…we felt like they took advantage of us. They said they would reduce costs but our costs only ever went up. Insourcing is probably not the right thing for all organisations, but we had to. Maybe we picked the wrong supplier.”

COO, Government Agency

KPMG’s IRM practice in Asia Pacific believes the redefinition of selection criteria signifies a shift to a more mature outsourcing environment, where attributes of partnership rather than, buyer/service-provider, are the major drivers.

“We are disillusioned with the big outsourcers. We are experimenting with a cooperative model where we share facilities with a number of like-sized companies. This shared services model is our third go at outsourcing.”

CIO, Financial Services Organisation

Organisations are bringing the help desk function back in-house.

Returning to insourcing

While BPO appears to be stable, certain functions of ITO are being brought back in-house. However, common for both models is the intent to return IT or business help desk functions to within the organisation.

Forty one (41) percent of participants using ITO intend to insource some components of IT. Loss of IT control as a result of outsourcing has led organisations to re-establish IT architecture, planning and project management disciplines internally. This suggests that organisations recognise that total IT function outsourcing is not appropriate, and they need to outsource selectively.
KPMG's IRM practice in Asia Pacific believes this indicates a maturing market where organisations are choosing to re-establish and strengthen control of IT functions related to core business operations. The expected result will be increased business agility, and reduced leakage of sensitive information to competitors.

“We are bringing IT strategy planning, application and technical architecture, project management and system investment justification/prioritisation back in from our outsourcer. We are doing this to improve our governance and control.”

*IT Manager, Consumer and Industrial Markets Organisation*

### Off-shoring future is over emphasised

Media interest in off-shoring throughout the Asia Pacific region is considerable. In high-cost countries, emotive issues such as employment and industrial relations are strong drivers and considered hot story items.

Results reveal that less than 10 percent of participants intend to commence or increase off-shoring. BPO off-shoring functions may not grow as fast in areas with direct customer contact, and not surprisingly, grow for back office functions with no customer contact (refer to diagram below).
Organisations are ready to consider a wider range of off-shoring sourcing choices, helping to ensure a balance of benefits, not just cost. This may require consideration of lower-cost options available in other countries, or options within the same country in different geographical locations.

A number of Australian organisations are considering off-shoring to New Zealand which will achieve more modest cost reductions than other countries might offer. The choice is based on ease of access and a similar business and regulatory environment.

Traditionally, organisations often look to off-shoring for significant cost savings. The cost advantages of using countries such as India are diminishing, and consideration is given to alternatives such as China.

A multi-national organisation moves call centre operations to a country not using the same national language. Language is the first barrier, requiring time and resources to bring staff to acceptable client-facing communication standards. Cultural differences and idiosyncrasies are the second, teaching personnel to manage a range of cultures while dealing with the company’s services in a professional manner.

Language and cultural barriers must be considered, particularly as KPMG’s IRM practice believes negotiation of Free Trade Agreements (FTAs) between Asia Pacific countries will facilitate off-shoring models, and various countries will be better suited to promote their advantages including:

- highly skilled workforces;
- access to energy sources;
- access to scarce or abundant natural resources;
- technology excellence;
- proximity to markets;
- FTAs with a third country;
- access to transport and trade routes; and
- cultural empathy.

“Efforts will be made to position Malaysia as a more attractive shared services and outsourcing hub in the world by providing better infrastructure and infrastructure facilities for multinational companies.”

New Straits Times Press (Malaysia) Berhad, August 12, 2004
The worrying signs on risk management

Key messages:
- main concerns are lack of in-house business process and IT systems expertise, and information privacy issues;
- there is room for improvement in the audit and review of management controls in outsourced environments;
- many service providers are using five or more subcontractors, sometimes without the buyer being aware of these arrangements;
- complex outsourcing arrangements have increased risks; and
- regulators are tightening requirements, particularly in financial services.

Overview
Successful outsourcing requires complex business relationships that make business boundaries permeable.

These relationships require a significant transfer of sensitive business knowledge, intellectual property and other assets to the service provider. The buyer is then exposed to numerous additional risks which increase the probability and impact of current risks.

The minimum risk is non-performance by the service provider to meet contract terms. An extreme risk is the service provider performing or failing to perform activities leading to catastrophic consequences.

Risk concerns in the market
Participants are concerned about the risks of outsourcing and have indicated their greatest concerns as:

- loss of businesses processes or IT systems experience;
- loss of responsiveness/flexibility; and
- exposure to information privacy issues.

Unsurprisingly, many participants indicated that outsourcing has led to a loss of internal capabilities. This is because of their ability to understand the service provider, manage the relationship and knowledgeably make strategic decisions affecting the relationship or the scope and volume of services provided. This presents a strong conflict.
Fifty seven (57) percent of participants believed they were highly aware of the risks of outsourcing and 39 percent were somewhat aware. However, risks that would normally be addressed in a comprehensive risk management framework were not strongly identified as issues by participants. This is a major concern as without attention to risks in the outsourced environment, ongoing exposures will not be subjected to scrutiny and management response.

Over 30 percent of participants do not audit management controls.

Equally concerning is that a significant portion of participants (over 30 percent) do not audit or review the management controls over the key risks presented by outsourcing.
Risk management framework

Outsourcing risks are categorised as in the table below, to demonstrate a comprehensive risk management framework.

<table>
<thead>
<tr>
<th>Risk category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transactional/operational risk</td>
<td>Risks attributable to operational problems with service or product delivery.</td>
</tr>
<tr>
<td>Legal/compliance/fiduciary risk</td>
<td>Risks caused by violation of laws, rules, regulations, prescribed practices, contracts and ethical standards.</td>
</tr>
<tr>
<td>Strategic risk</td>
<td>Risks associated with adverse business decisions or failure to implement.</td>
</tr>
<tr>
<td>Reputational risk</td>
<td>Risk of negative publicity regarding business practices associated with the outsourced operation.</td>
</tr>
<tr>
<td>Technology risk</td>
<td>Risks relating to the failure of the service providers electronic data processing environment to effectively and securely process and deliver products to the buyer’s customers.</td>
</tr>
<tr>
<td>Business continuity risk</td>
<td>Risks attributable to the inability of an entity to minimise outages, operate under adversity and recover fully and promptly from unforeseen events.</td>
</tr>
</tbody>
</table>

Contract management

Mature organisations are addressing risks in contractual frameworks. This is usually only adequate for contracts between the buyer and one service provider. Increasingly, service providers engage subcontractors, potentially rendering the original contract controls inadequate.
Thirty four (34) percent of participants had outsourced arrangements with five or more subcontractors. Another 33 percent are unaware of how many sub-contractors are involved in their business operations as illustrated in the diagram below.

In order to address this situation, organisations can consider implementing Operating Level Agreements (OLAs)\(^7\) between the various subcontractors and their service provider. However, these add complexity and require careful consideration to help ensure a suitable outcome.

A Japanese bank contracts an IT service provider to run its customer accounting systems. This IT service provider then subcontracts a mailing house to print and dispatch customer account statements. The bank has no interaction or agreement with the mailing house and cannot ensure Privacy legislation requirements are met, even though the bank has the primary responsibility for Privacy legislation compliance.

Complex relationships can be difficult to manage in terms of data confidentiality, intellectual property protection, legislative/regulatory compliance and business continuity management (BCM) – particularly if the buyer is unaware of the complexities involved.

\(^7\) OLA - contractual arrangement between two service providers delivering services to a mutual client. The buyer is not a party to the OLA but rather the recipient of the service under the outsourcing agreement.
A subcontractor provides (directly or indirectly) services to one of your competitors. What is the increased risk and exposure that your intellectual property, business plans or customer information may be leaked?

The challenge is to ensure outsourcing risks are identified and subsequently mitigated at all stages of the outsourcing process.

**Regulators are watching**

Regulators are becoming increasingly concerned with outsourcing arrangements in the Asia Pacific region. Regulations by authorities such as the Australian Prudential Regulatory Authority and Singapore Monetary Authority are addressing outsourcing as a whole, in addition to specific areas such as IT.

IT security and BCM have already received some regulatory tightening in a number of Asia Pacific countries. Organisations must ensure that contracts and SLAs adequately provide them with the level of control required by regulators.

Regulation is an issue, particularly for organisations under U.S. Securities and Exchange Commission (SEC) supervision. These organisations have an obligation to comply with the requirements of the Sarbanes-Oxley Act. Compliance requires adequate consideration of the impact of outsourced operations. On October 6 2004 the U.S. Public Company Accounting Oversight Board (PCAOB) stated that if management recently renewed its contract with a service organisation, it should either:

- execute an agreement to obtain a suitable SAS70 (Type II) (assessment of controls effectiveness over a period of time) report; or

- gain permission to test controls at the service organisation.

The PCAOB further stated that if the contract with the service organisation is long-term and management has made no attempt to negotiate the ability to obtain the necessary evidence of the operating effectiveness of internal controls, the auditor ordinarily would determine that management has not fulfilled its responsibilities.

“Privacy and confidentiality are major issues for us. All provider staff have to go through police security checks.”

CIO, Government Department
Understanding the trends

Key messages:
• business process needs will drive outsourcing decisions;
• ITO will service non-commercially sensitive IT functions; and
• participants were further advanced than anticipated on the Sourcing Maturity Model.

Overview
As discussed, results indicate that outsourcing is maturing. It is widely accepted and being utilised as a management strategy. Participants believe that outsourcing is achieving the following:

• realisation of business case benefits; and

• refinement of service provider selection processes.

The challenge in adopting more mature outsourcing frameworks such as these, is comprehension of the resulting change in risk profiles. Management of these risks is vital to help ensure commercial viability and adherence to regulatory requirements, and to satisfy stakeholder expectations.

Measuring sourcing maturity
KPMG’s IRM practice in Asia Pacific has developed a five level model to represent the Sourcing Maturity Model, (refer to diagram below) and details the maturity of survey participants compared with marketplace expectations prior to survey commencement.
What level are organisations at?
The model (depicted on the previous page) shows observations of the evolution of outsourcing and how the practice of outsourcing is maturing. Based on current media, the majority of participant organisations were expected to be at level two (functional outsourcing). The reality, however, was a spread between levels two, three and four.

This confirms that outsourcing is functioning as a widely accepted management tool, and organisations are moving towards level four of the model where:

1. BPO drives outsourcing decisions and strategies, particularly those with IT functions such as applications development and maintenance that are close to the business. Key performance indicators include quality of service delivery, business ethics, and cultural compatibility; and

2. specialist IT companies will be contracted to provide non-commercially sensitive IT functions, such as facilities and network management. Key performance indicators will include technical competency, systems availability/continuity, security and unit costs.

Organisations adopting these models must consider the impact on their risk profile, how to manage the new and varied risks while continuing to meet commercial objectives, regulatory requirements and stakeholder expectations. Organisations will move progressively through phases of the model and obtain incremental improvements in business performance. However, organisations should progress cautiously and steadily through the levels, and not move above their capability level in managing complex relationships.

A high level overview of these phases and some of the changing dimensions is summarised in the table on the following page, KPMG’s Sourcing Maturity Model framework.
Organisations consolidate back office functions from several divisions into a shared pool. These functions are usually some mix of IT, HR, purchasing, and finance. Often conducted on the premise of cost reduction.

Organisations consolidate back office functions from several divisions into a shared pool. These functions are usually some mix of IT, HR, purchasing, and finance. Often conducted on the premise of cost reduction.

A consolidated back office function is outsourced on the basis of a functional outsourcing relationship. Often initially performed on the basis of cost reduction. Simple, often back office business processes are outsourced, usually on the basis of cost reduction and potential capital recapture. Examples include payroll, finance transaction processing, and call centres.

Organisations combine and outsource a business process and underpinning IT package. This stage is the beginning of the transformational stage and usually takes time to organise, transition and stabilise. Sourcing decisions are driven by the business process needs rather than ITO.

Organisations contract out multiple functions and processes that many would see as ‘core competencies’.

Organisations contract out multiple functions and processes that many would see as ‘core competencies’.

**Maturity dimensions**

<table>
<thead>
<tr>
<th>Shared services</th>
<th>Functional outsourcing</th>
<th>Simple BPO</th>
<th>Integrated BPO and ITO</th>
<th>Networked business partners</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Definition</strong></td>
<td>Organisations consolidate back office functions from several divisions into a shared pool. These functions are usually some mix of IT, HR, purchasing, and finance. Often conducted on the premise of cost reduction.</td>
<td>A consolidated back office function is outsourced on the basis of a functional outsourcing relationship. Often initially performed on the basis of cost reduction.</td>
<td>Simple, often back office business processes are outsourced, usually on the basis of cost reduction and potential capital recapture. Examples include payroll, finance transaction processing, and call centres.</td>
<td>Organisations combine and outsource a business process and underpinning IT package. This stage is the beginning of the transformational stage and usually takes time to organise, transition and stabilise. Sourcing decisions are driven by the business process needs rather than ITO.</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td>Internally owned.</td>
<td>Selectively transferred to vendor.</td>
<td>Selectively transferred to vendor.</td>
<td>Shared with vendor/partner.</td>
</tr>
<tr>
<td><strong>Performance improvement</strong></td>
<td>Cost reduction, some better practice sharing.</td>
<td>Cost reduction.</td>
<td>Cost reduction, better practice access.</td>
<td>Revenue and cost improvements, access better practice.</td>
</tr>
<tr>
<td><strong>Source of intellectual property</strong></td>
<td>Consultants.</td>
<td>Consultants and vendor.</td>
<td>Internal experts, consultants and vendor.</td>
<td>Create and share with vendor partner.</td>
</tr>
</tbody>
</table>

Risks will not automatically be mitigated with the move towards outsourcing, but rather, risks need to be managed differently. Outsourcing creates new risks such as increased access to sensitive information and loss of business expertise. These risks need to be fully considered in the outsourcing business case.
Moving to better practice

Key messages:
• different organisations will strive to differing levels of outsourcing maturity;
• risk management requires detailed analysis in the outsourcing business case and operational model; and
• practice objectives are provided for guidance.

Overview
Not every organisation will want to move up to level five of the Sourcing Maturity Model – networked business partners. Specifics of industry regulation, culture and comparative position in the market will govern what to outsource and in what mode.

To better manage risks, the following better practice objectives have been identified to be considered in the formulation of an outsourcing relationship (refer to table below).
<table>
<thead>
<tr>
<th>Better practice outsourcing objective</th>
<th>Key aspects of the objective</th>
</tr>
</thead>
</table>
| Partnerships                         | • The relationship is based on clearly stated and understood business needs or objectives.  
• The relationship model is set at the commencement of the process. |
| Business output oriented SLAs        | • Specify and agree what is required, not how it will be created.  
• SLAs measure and pay for business outputs rather than resource inputs.  
• SLAs mirror the KPIs of the buyer. |
| Transparency                         | • The buyer has a view of performance and an understanding of the constraints and business imperatives of the service provider. |
| Flexible structuring                 | • Structure to exploit joint work teams for the entire planning and operation cycle.  
• Flexibility around scope and term.  
• Continuous improvement and relationship remediation.  
• The relationship should allow new partners to be added in or existing vendors to be exited as the business evolves or market conditions change. |
| Cultural compatibility               | • Identify your cultural values, and ensure the service provider is able to match them. |
| Experience in both business and IT management | • Have a senior business manager who knows the business process to oversee projects and relationships. |
| True understanding of costs          | • Have a detailed understanding of what is being outsourced: facts and figures on throughput; direct and indirect costs; forecasts; root cause analysis of problems; and outcomes of previous attempts to reduce costs.  
• If something is not working well in-house, then it will almost certainly cost more to make it work effectively. |
| Product independence                 | • Service providers frequently have commission arrangements with other product companies which allows them to reduce costs, but potentially compromises their independence in solution design. |
| Risk awareness                       | • When a function is outsourced, existing risks might or might not be shared with the service provider.  
• Risks never totally become the responsibility of the service provider.  
• Some risks like security and business continuity can be accentuated.  
• New risks emerge around service provider selection and relationship management.  
• Risk management functions need to be an integral part of the outsourcing model from the commencement of the process. |
Conclusion

There are many positive indications that buyers and service providers are working to improve relationships and partnership models.

KPMG’s IRM practice in Asia Pacific is concerned by the level of organisation’s risk management. Clearly, there are still some areas to work on.

KPMG member firms will continue to monitor developments in outsourcing models and related risk management, and publish thought leadership materials for the benefit of clients and professional colleagues.
KPMG’s IRM practice assists organisations to identify and manage business technology risks. IRM professionals offer a range of services that are aligned to an organisation’s business IT lifecycle to provide focused, client-specific advice across all levels of the IT spectrum. These service offerings are detailed below.

<table>
<thead>
<tr>
<th>Service offering</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Programme Management &amp; Quality Assurance</td>
<td>• Assisting with the delivery of projects to specification, on or below budget and on time. IRM focuses on helping to enhance the processes surrounding project and programme management offices and evaluating project deliverables, focusing on benefits realisation and accountability.</td>
</tr>
<tr>
<td>Security, Privacy &amp; Continuity</td>
<td>• Assisting organisations to protect their information assets – including availability and reliability, to protect the business itself. Particular attention is provided during the phases of assessment, architecture and monitoring.</td>
</tr>
<tr>
<td>IT Attestation</td>
<td>• Assisting clients increasingly affected by a business’ IT systems often requires extra help to satisfy stakeholder expectations. This service offers assessments to provide comfort to customers and business partners through seals and distributable reports such as SysTrust and SAS70.</td>
</tr>
<tr>
<td>Business Systems Controls</td>
<td>• Assisting organisations to assess and verify that controls in major system implementations are enhanced, in place and operating effectively.</td>
</tr>
<tr>
<td>Outsourcing Risk</td>
<td>• Advising businesses across stages of the outsourcing model including: option analysis; business case development; vendor evaluation and selection; development of SLAs and risk analysis; managing and monitoring the SLA; and transitional risk management on outsourcing.</td>
</tr>
<tr>
<td>Governance &amp; Performance</td>
<td>• Effective IT Governance and Performance helps organisations ensure that business systems deliver value to the business and that the unique risks inherent in technology are monitored in an appropriate governance framework. Our IT Assurance and Advisory services include: governance; strategy; performance improvement; cost reduction; risk management benchmarking and risk framework; and due diligence.</td>
</tr>
<tr>
<td>IRM in External Audit</td>
<td>• Identifying financial and operational risks embedded in business systems and processes, and providing advisory on risk mitigation. IRM professionals integrate technology issues into the framework of the audit, working as part of the audit team to assess the technology component of business issues, risks, and strategies.</td>
</tr>
<tr>
<td>IT Internal Audit</td>
<td>• Assisting with full internal audit outsourcing arrangements, co-sourcing arrangements, a standing agreement, or secondment basis. IRM works with clients to understand the risk profile of the business and determine the appropriate risk profile and ultimately help to mitigate risk exposures. IT internal auditors consider both compliance and operational risks, determining if appropriate mitigation strategies exist.</td>
</tr>
</tbody>
</table>
# Glossary of terms

| **Business Process Outsourcing (BPO)** | The delegation of one or more internal business processes to a service provider. The service provider then administers and manages the selected process(es), usually based upon defined and measurable performance metrics. For the purposes of this survey, BPO excludes IT. |
| **Call centre** | A function within an organisation responsible for interfacing with customers and handling sales or service, usually by telephone. The problems may be passed on to a help desk or technical support area. |
| **Capability Maturity Model (CMM)** | The framework that describes the evolutionary improvements of an effective process for an organisation. |
| **Core business operations** | Includes the operations supporting or providing major products or services, delivered by a business. |
| **Change control** | The set of structures, procedures and rules governing the adoption and implementation of changes in the commercial or financial relationship between the customer and the service provider. |
| **Infostructure** | The technology, business environment and government framework to support the use and advancement of information handling, storage and transmission in commerce, government and the broader community. |
| **Insourcing** | The delegation of one or more IT or business functions/processes to an in-house/internal provider who in turn, owns, administers and manages the selected functions/processes, based upon defined and measurable performance metrics. |
| **Offshore/off-shoring** | The outsourcing of processes to be managed by a service provider at a location foreign to the country where their services originate i.e. at centres in countries outside the originating location. |
| **Operating Level Agreement (OLA)** | A contractual arrangement between two service providers delivering services to a mutual client. The agreement will set out service levels between the parties to ensure a delivery of service to the client at the agreed SLA (as specified in the outsourcing arrangement). The buyer is not a party to the OLA but rather the recipient of the service under the outsourcing agreement. |
| **Information Technology Outsourcing (ITO)** | The delegation of one or more IT functions or operations to a service provider. The service provider then administers and manages the selected process(es), usually based upon defined and measurable performance metrics. |
| **SAS70 (Type II)** | An examination that provides reports on the effectiveness of controls in operation (during the reporting period) at a service organisation over the business processes, IT systems and infrastructure provided by the service organisation to its clients. |
| **Service Level Agreement (SLA)** | Agreements between a service provider and a buyer of services that define and drive the relationship between the two parties. They typically include clearly defined service offerings, the terms of provision of services, and key performance indicators. They might include performance-related penalty or bonus clauses. |
| **Service provider** | A niche business contracted to provide defined services to a buyer/organisation. |
| **Shared services** | The consolidation of common (often back office) functions, systems, processes and personnel across several business units into an internal shared services pool. It is managed as an independent organisation. These functions are often a mix of IT, Human Resources, purchasing and finance. |
| **Stakeholder** | Those persons with an invested (financial) or other interest in an organisation and to whom management is accountable. |
| **Systems Development Lifecycle (SDLC)** | Conceptual model often used for project management of an Information System development project. It describes the stages of the process with the initial stage being a feasibility study through to the final stage being maintenance of the application. |
Contacts

For further information on the services offered by KPMG’s IRM practice, please contact:

**Egidio Zarrella**
Global and Asia Pacific Partner in Charge
Information Risk Management
KPMG in Australia
+61 2 9335 7590
ezarrella@kpmg.com.au

**Lim Huckhai**
Asia Pacific Sourcing Risk Partner in Charge
Information Risk Management
KPMG in Malaysia
+603 2095 3388
hliml@kpmg.com.my
<table>
<thead>
<tr>
<th>Location</th>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Jim Walker</td>
<td>+61 3 9288 6135</td>
<td><a href="mailto:jwalker2@kpmg.com.au">jwalker2@kpmg.com.au</a></td>
</tr>
<tr>
<td>China/Hong Kong</td>
<td>John Barnes</td>
<td>+852 2978 8248</td>
<td><a href="mailto:john.barnes@kpmg.com.hk">john.barnes@kpmg.com.hk</a></td>
</tr>
<tr>
<td>Indonesia</td>
<td>Iwan Atmawidjaja</td>
<td>+62 21 574 2333</td>
<td><a href="mailto:iatmawidjaja@siddharta.co.id">iatmawidjaja@siddharta.co.id</a></td>
</tr>
<tr>
<td>Japan</td>
<td>Hiromi Iwashita</td>
<td>+81 3 3266 7519</td>
<td><a href="mailto:hiromi.iwashita@jp.kpmg.com">hiromi.iwashita@jp.kpmg.com</a></td>
</tr>
<tr>
<td>Korea</td>
<td>Chang Soo Lee</td>
<td>+82 2 2112 0600</td>
<td><a href="mailto:changsoolee@kr.kpmg.com">changsoolee@kr.kpmg.com</a></td>
</tr>
<tr>
<td>Malaysia</td>
<td>Lim Huckhai</td>
<td>+603 2095 3388</td>
<td><a href="mailto:hlhml@kpmg.com.my">hlhml@kpmg.com.my</a></td>
</tr>
<tr>
<td>New Zealand</td>
<td>Graeme Sinclair</td>
<td>+64 4 802 1218</td>
<td><a href="mailto:gssinclair@kpmg.co.nz">gssinclair@kpmg.co.nz</a></td>
</tr>
<tr>
<td>Philippines</td>
<td>Jorge Ma. S. Sanagustin</td>
<td>+63 2 840 4001</td>
<td><a href="mailto:jsanagustin@kpmg.com.ph">jsanagustin@kpmg.com.ph</a></td>
</tr>
<tr>
<td>Singapore</td>
<td>Ho Wah Lee</td>
<td>+65 6213 2563</td>
<td><a href="mailto:wahleeho@kpmg.com.sg">wahleeho@kpmg.com.sg</a></td>
</tr>
<tr>
<td>Taiwan</td>
<td>Richard Chen</td>
<td>+886 2 2715 9813</td>
<td><a href="mailto:richardchen@kpmg.com.tw">richardchen@kpmg.com.tw</a></td>
</tr>
<tr>
<td>Thailand</td>
<td>Chainarong Kaeowaranonchai</td>
<td>+66 2 677 2000</td>
<td><a href="mailto:chainarong@kpmg.co.th">chainarong@kpmg.co.th</a></td>
</tr>
</tbody>
</table>
KPMG thought leadership publications

Voice over IP - Decipher and decide

Security Strategies - Adopting a strategic approach to security management

Wireless Networking - Issues to consider

Asia Pacific Business Continuity Management Benchmarking Survey

International Programme Management Survey