

HOW TO DO Vendor Due Diligence Reviews



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THE **COMPLETE** BREAKDOWN

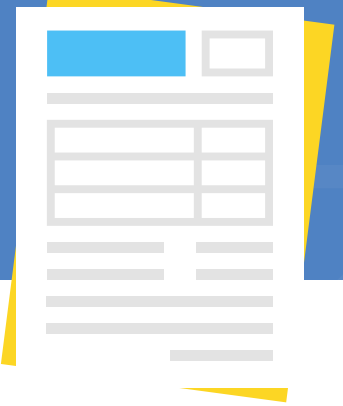
If you're like most of us in the industry, collecting due diligence on vendors can feel like one of the most challenging tasks that you're presented. You feel like you're constantly calling, emailing and chasing your vendors to obtain the report you've been needing for weeks now. Once you've got it, you then realize the battle is only halfway done.

Next, you, or a subject matter expert (SME), must fully analyze the report received and then write up a thorough analysis with your findings. Remember, you should never have a check-the-box mentality when it comes to due diligence. Checking the box can lead to some very unwanted consequences.

Analyzing the documentation can become overwhelming. Sometimes it's difficult to determine where to begin, what to review and how to interpret what it all means. We're here to breakdown how to do vendor due diligence reviews on 5 of the most common reports we see every day.



SOC REPORT



Overview:

SOC stands for system and organization controls. It's an independent audit report performed by a certified public accountant (CPA) that shares additional details around the vendor's controls in place. It's an attestation that your vendor has a control to safeguard your data, and if the safeguards are operational, they would effectively mitigate part of the risk inherited by using the vendor.

Steps to Review a SOC Report

- 1 Take a look at the reporting period.** Confirm it's the most current report available to review. If the report is older than 15 months, then it's best to request additional information from your vendor, like a Gap Letter. The Gap Letter, or Bridge Letter, covers the gap between the last SOC reporting period end date and the date of the letter.
- 2 Review the Organization and Administration section.** It will give you a great deal of information regarding the vendor such as how they're set up, who is responsible for what, the management structure and governance processes.
- 3 Confirm the products and services** listed within the SOC report are the ones that your organization is utilizing. You will often find that many vendors have multiple reports covering different products and services; therefore, it's very important that you verify you're reviewing the correct one.
- 4 Understand the information system.** Know what type of information the vendor processes and how it's protected. Within the SOC report, your vendor should provide details on how they secure servers, networks and computer systems.
- 5 Also, understand the data center information.** Review the infrastructure's environmental, monitoring and access controls. You want to ensure the vendor is managing their data center properly and keeping their infrastructure resilient. This is crucial to protecting data.
- 6 Thoroughly analyze the control objectives and activities.** The audit firm will test the controls in place and note if they're operating effectively.
- 7 Review audit findings.** See how management responded to the findings. This will help you determine if the vendor is reliable and can provide you with the contracted service as promised.
- 8 Have a qualified SME write up the analysis.** This should be an experienced IT professional or someone with a related credential.
- 9** Once you have your analysis in hand, **reach out to the vendor to discuss any findings and next steps.**

BUSINESS CONTINUITY PLAN (BCP)



Overview:

Business continuity planning assists vendors (or any business) in ensuring that their significant operations and products/services continue to be delivered in a full, or at a predetermined and accepted, level of availability. The expected level of availability is typically outlined in the Service Level Agreement (SLA) that your organization has with the vendors.

Steps to Review a BCP

- 1 Verify the vendor has a formal BCP.** Ensure it meets your organization's needs and covers critical components that are needed to ensure operations continue. If the vendor becomes unavailable, will your services operate normally?
- 2 Review the vendor's strategy for addressing personnel loss** – aka their succession plan. Look for cross-training, job rotation, staffing agencies, etc. as mitigations. Social unrest may occur.
- 3 Determine if the BCP contains plans for pandemic contingencies or mass absenteeism** following Center for Disease Control guidelines.
- 4 Check their relocation plans.** Confirm they're acceptable and verify the vendor has a secondary office facility or remote work capabilities. This includes things like assets, equipment, building relocations, remote access strategy, contract third party office space and more.
- 5 Review their breach/disruption notification policy** to verify a clear communication plan is in place, it's adequate and aligns with the information security language that's in the contract between your organization and the vendor. This step is very important as it's confirming the timing of when the vendor will notify your organization of a breach or disruption.
- 6 Understand the vendor's testing procedures.** Ensure the testing is at least annual and ask to see the actual or redacted test results. Any testing results showing room for growth should be followed up on.
- 7 Review the vendor's Business Continuity Impact Analysis (BIA) within the BCP and that it matches your expectations.** This includes the following:
 - Recovery Time Objective (RTO):** RTO help identify the targeted duration of time in which the vendor must restore a business process, post-disruption, to avoid unacceptable consequences associated with business continuity.
 - Recovery Point Objective (RPO):** RPO help identify how much data may be lost if data needs to be recovered. Typically, this matches with your backup or replication frequency. It really becomes important if a computer, system or network goes down.
 - Maximum Tolerable Downtime (MTD):** MTDs specify the maximum period of time that the vendor can be down before their survival is at risk.How much data may be lost and how long will normal operations be impacted? This is what you're learning when reviewing RTO and RPO. Some vendors will have different objectives for different services and client tiers. How does this relate to your contracted service level agreement (SLA)?
- 8 Analyze the frequency of ongoing maintenance of the plan.** The plan should be reviewed regularly as part of the vendor's routine policy maintenance but should also be updated when a significant change occurs in the vendor's organization.
- 9 Have a qualified SME write up the analysis.** This should be an experienced IT professional or someone with a related credential.
- 10 Once you have your analysis in hand, reach out to the vendor to discuss any findings and next steps.**

DISASTER RECOVERY PLAN (DRP)



Overview:

Disaster recovery is a subset of business continuity. A disaster recovery plan involves processes and procedures for an organization to follow immediately, as soon as a business impacting incident occurs, until normal operations are resumed.

Steps to Review a Disaster Recovery Plan

- 1 Verify the vendor has a disaster recovery plan in place that is readily available to staff in the event of a disaster and addresses data loss and system availability.**
How much data may be lost and how quickly availability is restored should be represented by RTO and RPO.
- 2 Check whether criteria is defined and in place for declaring a disaster.** Without defined internal communication and an incident management program, employees may not know when to formally declare a disaster, attempting to fix the business impacting event instead of communicating the issue to key stakeholders.
- 3 Verify the plans cover availability and potential loss of equipment, data and the data center/server room.** Look at how data is stored, the location and status of the recovery information system.
- 4 Check if a secondary data center is readily available** in the event of a disaster and ensure it's sufficiently geographically separated so that a regional impacting event won't affect the vendor's production and recovery sites simultaneously.
- 5 Review the configuration of the vendor's data center recovery locations** to assess the adequacy of recovery capacity to meet your business needs.
- 6 Ensure that a clear communication plan is in place and verify their client notification process meets your requirements.**
Communication can save a relationship. Verify that the vendor's notification timeline meets any requirements you have, including regulatory requirements.
- 7 Review critical IT functions outsourced to a third party** and ensure communication plans exist with subcontractors (aka your fourth parties).
- 8 Understand the vendor's testing procedures.** Ensure the testing is at least annual and ask to see the actual or redacted test results. Any testing results showing room for growth should be followed up on.
- 9 Analyze the frequency of ongoing maintenance of the plans.** Plans should be reviewed annually and after any significant organization changes as part of the vendor's routine policy maintenance.
- 10 Have a qualified SME write up the analysis.** This should be an experienced IT professional or someone with a related credential.
- 11 Once you have your analysis in hand, reach out to the vendor to discuss any findings and next steps.**

CYBERSECURITY PROGRAM



Overview:

A cybersecurity program helps protect your organization and the vendor from potential vulnerabilities like a data breach. Evaluating your vendor's cybersecurity posture will help you identify potential weaknesses. From there, you can effectively communicate with the vendor about those weaknesses and develop strategies to strengthen controls prior to a breach happening.

Steps to Review a Cybersecurity Program

- 1 Know that there are 4 critical areas** – security testing, sensitive data security, employee, contractor and vendor management and incident detection and response – that we encourage you to focus on.

- 2 Review the vendor's security testing.**

The vendor should be performing three tests annually:

Vulnerability Testing:
This test will identify any security vulnerabilities in the infrastructure (e.g., computer, network or communications).

Penetration Testing:
Assists with finding any vulnerabilities that could be exploited by an attacker.

Social Engineering:
This type of testing will focus on human error within the organization, meaning testing employee vulnerability to common tactics (e.g., phishing email).

- 3 After reviewing the security testing, note any issues found.** You'll want to mention things like critical and high risk vulnerabilities, how vulnerabilities have been addressed and corrected – or mention if they haven't been – and the vendor's plan to prevent future vulnerabilities like the ones identified.

- 4 Review the vendor's sensitive data security.**

Sensitive data security is important as it's information that should be protected, at all times, against unintended disclosure. Make sure the data is encrypted, as well as being protected from destructive forces and unwanted actions of unauthorized users.

- 5 Request the vendor's data retention and destruction policies and data classification privacy policies.** These go hand-in-hand with sensitive data security. If they don't have these policies, that's a huge red flag.

- 6 Verify the vendor has trained their employees, contractors and vendor management team to protect data.** Look for things like confidentiality agreements, employee background checks, annual security training with documented completion, management of vendors and access management policies to confirm they've all been properly trained.

- 7 Review the vendor's incident and response plan.** Request that it's tested annually and ask to review the results of the last test. It's crucial the vendor has one in place to address any issues that may arise. This will help minimize the impact. Confirm they're acceptable and meet your organization's expectations.

- 8 Have a qualified SME write up the analysis.** This should be an experienced IT professional or someone with a related credential.

- 9 Once you have your analysis in hand, reach out to the vendor to discuss any findings and next steps.**

FINANCIAL STATEMENT



Overview:

Financial statements should be reviewed to identify the financial health of any vendor you outsource a product or service to. This helps you determine if the vendor can continue to provide secure, safe and quality products or services that meet your organization's expectations.

Steps to Review a Financial Statement

1 First, be aware that you're not only looking at the numbers when reviewing financial statements. It's so much more than that. Poor financials can be early indicators of slow pay problems, a decline in service levels, changes in executive leadership and more.

2 Public Company – If the company is public, the statement is usually a form 10-K. Thoroughly review the form and watch for the following:

The risk factors – Shared within the financial documentation, with notes related to any regulatory actions that may have occurred.

Active legal proceedings or lawsuits – Be aware of any pending legal proceedings or lawsuits, as well as what the settlement charges will likely be.

The auditor's opinion on financial statements – Look at the auditor's opinion on the vendor's comprehensive income.

The auditor's opinion on internal controls – See if the auditor deemed the controls adequate or not.

Private Company – If the vendor is a private company, the financial statements are no different; you just have less information. With private companies, be sure to insist upon an audited financial review to ensure accuracy and appropriate disclosure in the financial notes section.

3 As you review the financial statement, look at the following to **compare year-over-year numbers for the last 3 years:**

Balance Sheet – To understand if their net worth (and tangible net worth) is rising or declining

Income Statement – To understand their revenue and gross margin

Cash Flow Statement – To understand how they're funding their operations

Ratios – To understand the Altman Z-score, which determines a company's likelihood of bankruptcy

4 As you dig through the statement, thoroughly evaluate what you're reading. Ask yourself questions like:

- 1 *Is the vendor making money?*
- 2 *Do they have sufficient capital, or access to capital, to support their ongoing operations?*
- 3 *What is the vendor's debt-to-worth?*
- 4 *What is their tangible net worth?*
- 5 *Can the vendor continue operations at the current cash level?*

5 Have a qualified SME, such as a CPA, **write up the analysis.**

6 Once you have your analysis in hand, **reach out to the vendor to discuss any findings and next steps.**

CONTRACTS



Overview:

A contract is an agreement between two parties creating a legal obligation for your organization and vendor to perform specific activities. Each of the parties to the contract are legally bound to perform the specified duties outlined within the contract. Contracts are very important since if the expectation isn't set in the contract, then it isn't in agreement between the two parties.

How to Review a Vendor Contract (Before Entering the Relationship)

- 1 First, remember that negotiation is vital.** Don't accept the first contract that you see. Changes to accommodate special requests by both parties are common and often necessary.
- 2 Review the scope of services.** You want to verify there are provisions such as the following included:
 - *The products/services the vendor will provide*
 - *Rights and responsibilities*
 - *Language around any timeframes promised or custom services requested*
 - *Rights to modify*
 - *Any guidelines around contract re-negotiation*
- 3 Locate the performance standards and make sure they're adequate.** This is where you should find the SLA requirements, remedies and any penalties if the SLAs aren't met.
- 4 Confirm the duration of the contract is correct.** Verify that the term, renewal term, non-renewal and termination notice periods and anything else related to timeframes are accurate.
- 5 Ensure there's a default and termination clause** within the contract.
- 6 Consider costs and price increase language.** In the fee description, you're looking for information pertaining to cost overview, increase limitations, support for merger/acquisition activity and costs, payment terms, late fee language, deconversion fees and, if applicable, who's responsible for cost to maintain software or hardware.
- 7 Always look for security and confidentiality provisions.** This should include information on how the vendor plans to safeguard your data, prevent exposure to breaches, how they'll notify you of a breach and how they plan to maintain a log of incidents. You also want to confirm how the vendor will return or destroy your data or assets if the relationship terminates.
- 8 Look at the audit requirements.** Verify there's a description of audit reports your organization is entitled to receive – like a SOC 1, SOC 2 and SSAE 18 – and that they're accurate.
- 9 Understand what reports will be made available to you and if there will be any fees for customizations** (e.g., financial statements, performance reports, PCI compliance certification).

CONTRACTS (continuation)



10 Look to verify business resumption and contingency plan language is included within the contract. You're seeking provisions around disaster recovery, business continuity and back-up record protection.

11 Be sure the vendor outlines their policies around subcontracting. This should include that your vendor will provide required due diligence documents for any subcontracted vendors.

12 Ownership and license information should be included in the contract. There should be a description of ownership, rights and allowable use of your organization's data, system documentation and other intellectual property rights, such as protection by the vendor in the event of a patent/copyright infringement claim. It's important to make sure there's protection rights for your organization outlined within!

13 Confirm the contract includes a clause pertaining to indemnification so that the vendor will hold your organization harmless from liability due to a negligent vendor.

14 Review the limitation of liability to verify it equates to the amount of loss your organization might experience as a result of the vendor's failure to perform.

15 Provisions around dispute resolution should always be included too.

16 And, to bring it all home, review the general provisions. You're looking for provisions such as the following:

- *Survival*
- *Governing law*
- *Contract conflict – order of precedence*
- *Severability*
- *Failure to exercise/waiver*
- *And more, depending on the vendor relationship in review, as the provisions necessary aren't limited to these 5*

17 Have a qualified SME, such as a paralegal, write up the analysis.

18 Once you have your analysis in hand, reach out to the vendor to discuss any terms that may be missing and next steps to negotiate them into the contract.



Due diligence is a fundamental component of any third party risk program.

When done correctly, it tremendously helps prevent risk to an organization and the customers.

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About Venminder

Venminder is a leading third party risk management provider dedicated to helping the financial services industry mitigate vendor risk.

Venminder's team of due diligence experts offer a suite of services that can significantly reduce the workload by addressing the tactical challenges of vendor management tasks. Venminder's vendor management software can guide a user through critical processes such as risk assessments, due diligence requirements and task management.

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