Banks outsource services for multiple reasons, including providing products and services that otherwise would not be available, freeing up resources to focus on customers, having access to experts in specialized fields of study, and ensuring continuous operations in a 24-hour retail environment. However, transferring responsibility CANNOT be a reason to outsource services. The Bank is accountable for every product, service, and process implemented by the Bank, whether it be controlled in-house or it be outsourced to a service provider. Managing service providers is accomplished through the Bank’s Vendor Management Program. Unfortunately, vendor management is often perceived as being a bothersome annual process of collecting documents from critical vendors in order to comply with regulatory requirements. A Bank’s Vendor Management Program begins long before this activity. Instead of considering vendor management as an annual activity, Banks should view vendor management as an all-inclusive program to manage risks associated with a service provider from start to finish.

Vendor Management Programs will vary depending on an Organization’s size and complexity, but overall every program should include the following:
1) Board involvement
2) Policies and procedures
3) Vendor management process
   a) Risk assessment
   b) Selecting a vendor
   c) Contract structuring
   d) Oversight
4) Documentation and reporting

Board involvement
The Board of Directors (BOD) is ultimately responsible for managing activities conducted by service providers and controlling the risks arising from the activities to the same extent as if they were being performed in-house. The BOD should be involved in developing and administering the vendor management program and be actively involved in assessing the risks with outsourcing services.
Policies and procedures
Policies and procedures should be created to clearly define the BODs expectations for managing service provider risk. Procedures for determining a vendor’s risk, the criteria used to select a vendor, terms that must be included in a contract, minimum expectation for monitoring a vendor’s relationship, and any BOD or management reporting should be clearly documented for personnel to follow.

Vendor Management Process
A vendor management program consists of four core components: risk assessment, selecting a vendor, contract structuring, and oversight.

a) Risk assessment is the first step of the vendor management process. Assessing the risk provides management and the Board with the information to identify the Bank’s high risk or critical vendors. The critical vendors should then be those that management focuses most of their analysis and oversight. There are many risks to consider, but best practice would be to consider the following risks:
- **Strategic risk:** Is the vendor providing a service that is critical to the Bank’s strategy? Is the vendor progressive enough be able to meet the Bank’s long-term strategic goals?
- **Reputation risk:** Is the vendor providing a service that if performed poorly or incorrectly cause negative public opinion?
- **Operation risk:** Is the vendor performing a function that would increase the Bank’s operational complexity? Does the vendor outsource any of their operations causing additional risk?
- **Transaction risk:** Is the vendor performing a function that requires high availability and would cause significant impact if a system outage would occur?
- **Credit risk:** Is the vendor financially viable long-term or are they a start-up company? Will the vendor perform underwriting or decisioning functions?
- **Compliance risk:** Is the vendor performing a service or have access to customer data that if performed or handled incorrectly cause the Bank regulatory penalties?

Ultimately, all service provider are not the same and without performing a risk assessment, management could be taking on risk unknowingly. Lastly, it is important to update the risk assessment at least annually to reflect any changes in the vendor’s relationship.

b) Selecting a vendor to perform services on the Bank’s behalf is a difficult decision. However, the risk assessment will significantly help management know the appropriate level of due diligence to perform. It will also assist in determining the documents to request from the vendor, as well as, the level of scrutiny to assess. For example, if the service provider has no access to customer information, assessing the vendor’s security controls would not be necessary. However, if the vendor is performing a function that requires high availability, the Bank will want to request information on the vendor’s disaster recovery plan and their service level agreements on system up-time. Before selecting a vendor, due diligence should be performed on all areas of significant risk.

c) Contract Structuring may be the most critical step of the vendor management process, but is often the one that gets the least attention. Since contract terms are difficult to understand, focus is usually spent on the contract term, renewal, and cost. The remaining clauses are frequently just scanned for uncommon language. Since the contract terms are the only items the service provider is legally required to do, the Bank

What are some risks of not effectively managing your vendors?

- **Reputation risk** – Everything is on social media. Don’t let your Bank be painted negatively on social media!
- **Compliance/Regulatory risk** – Examiners are looking at how Banks are managing their third-party relationships even closer due to the increased, and high profile, cybersecurity and security breaches.
- **Strategic risk** – Will your vendor be able to grow with your Bank or will they limit your potential to achieve the strategic goals your Board has established. Remember the contract term of your relationship and consider how that aligns with your future plans.
Discussions on product functionality, future road map, implementation time frames, etc. are all irrelevant unless language terms are in the contract. Regulators have even published contract clauses that should be considered when Bank’s execute contracts because this step is so critical. Below is a list of contract clauses that should be considered as part of a contract. It is not an all-inclusive list.

- Service level agreements (SLAs), performance measures, or benchmarks
- Right to audit
- Confidentiality and security
- Data governance or data ownership
- Incident management and breach notification
- Business continuity and contingency testing
- Indemnification
- Insurance
- Dispute resolution
- Default and termination
- Limits on Liability
- Customer complaints
- Contractor/Subcontracting
- Foreign-based third parties
- Regulatory Supervision

d) **Vendor oversight or monitoring** should be performed until the business relationship is dissolved. The Bank can leverage the risk assessment to determine the level of oversight that is necessary. Updated documents that were obtained during the vendor selection process can be collected and reviewed to identify changes. In addition to collecting information from the vendor, the Bank should also assess the vendors overall service quality. Compliance with SLAs, responsiveness to questions and incidents, and total quality of service is often not considered even though poor service is the primary reason business relationships are dissolved. Monitoring high risk or critical vendors should be performed at a minimum of annually.

**Documentation and Reporting**

As previously noted, the Board is ultimately responsible for managing activities conducted by service providers. To meet this requirement, the Board must be kept aware of the Bank’s vendor relationships and risks that are identified throughout the business life-cycle. The policy and procedures should define the reporting that is expected, but at a minimum, the Board must be presented with the vendor risk assessment and vendor oversight activities each year. The Board should also approve any new critical vendor relationships before executing the contract.

As outsourcing continues to be a mainstream activity, the Bank must ensure they maintain accountability for the services they provide. The Bank’s vendor management program provides the venue to meet their responsibility. If relationships are not properly managed, the Bank could experience regulatory scrutiny, financial loss and more importantly, reputation risk. Effectively managing your vendors doesn’t end at contract signing but is an ongoing process – a cradle to grave concept. How does your current vendor management line up to the suggestions offered? We at Varney can help you align your current program to comply with regulatory expectations, and provide you the tools and resources to effectively manage and monitor your vendor relationship.

**Vendor management programs are not exclusively for your information technology relationships. It is all third parties used by the bank. Risk assessments help Banks better understand which third-parties should be monitored more frequently than others. Above all, just because the Bank isn’t providing the service to the customer directly does not absolve the Bank from responsibility when something a third-party provider does on behalf of the Bank.**

Keri Nelson
IT Specialist

Keri is a former IT Governance Officer, responsible for developing and managing the vendor management program. Keri can help you navigate your vendor management program, from start to ongoing monitoring. Contact Keri at knelson@varney.com or 1-800-240-5004 to get more information.
By Amanda McKeeman, Senior Accountant

The March 2019 Flint Hills Bankers Association (FHBA) meeting focused primarily on recent legal decisions relevant to the Banking industry.

One case that really caught my attention was the 2017 US District Court case, United States vs. Christy. The bank in this case was located right in the heart of the Midwest, East-Central Kansas. This case helped stress the importance of internal controls related to cash vault transfers and balancing procedures.

The defendant in this case had worked for the same bank for more than 15 years. During the course of that time, she had gained enough authority, responsibility, and trust to maintain the cash vault and cash transfers to the Federal Reserve Bank without any formal internal oversight. According to public court documentation, the defendant made fake tickets between the cash vault and the Federal Reserve Bank to indicate that cash was picked up by an armored vehicle several times over the course of several days. However, a majority of the cash recorded had not actually been picked up from the bank – it was instead embezzled by the defendant. A senior accountant at the bank realized that something was amiss when agreeing vault records to the FRB daily statements. It was determined by an internal auditor at the bank, through a surprise cash count, that a total of $764,000 was missing from the bank’s cash vault. An investigation by the FBI and IRS revealed that the defendant had later made fake receipts from the armored vehicle company to prove the receipt of the cash taken out of the vault. The receipts were deemed illegitimate due to signature and date discrepancies.

The defendant was indicted for bank embezzlement and false bank entries by a grand jury, and was sentenced to 51 months in prison and three years of supervised release. As we often discuss with our clients during consulting engagements, it is critical for a bank to have proper internal controls, including segregation of duties, when it comes to cash maintained at the bank. This case also reminds us that tenure of an employee should not automatically result in authority and responsibility without oversight.

Internal control testing is something that can be very valuable, and in some cases, reveal weaknesses within a bank’s internal processes. How strong are your controls? Do you possibly place too much trust in your employees, and allow weaknesses in your controls to save time? Possibly it is time for a checkup....

If your bank is interested in having a ‘check-up’ of your control environment, give Amanda, or any one of the banking team members, a call at 1-800-240-5004.

Key internal controls for any institution:

- Dual control
- Segregation of duties
- System controls
- Tone at the top
- Job rotation
- Surprise verification

Thank you Justin Whitney, legal counsel at Woner, Reeder & Girard, P.A. for sharing your insight at the recent FHBA program!
We have added a new face to the banking team since our last issue! Mike Tomandl joined the firm in February 2019, and brings valuable experience to the team. All new people deserve a little ‘SPOTLIGHT’ and that is what we are going to give Mike!

Mike has focused his accounting career working in the banking industry. In fact, he was a former Varney associate, a long, long time ago. Throughout his career, Mike has worked with a variety of banks in Kansas City, Missouri, primarily serving in the role of Chief Financial Officer. He has watched banks grow (his most recent bank grew almost 10 times during his tenure), and has experienced the stresses of the banking industry during the financial crises. Mike has worked with Boards of Directors, Audit Committees, regulatory agencies and accounting firms, and now, he is working as a consultant at Varney and we are excited for you to get to know him more!

We had a little Q&A with Mike, and here is what he shared!

Before joining Varney, what was the most unusual or interesting job you’ve ever had? Probably the most interesting job I had was working for my most previous bank as Chief Management Accounting Officer. When I started in July 2012, the bank had roughly $380 million in total assets. Today, it has over $4 billion. Watching that growth occur and to see it done so well was fascinating.

How would you describe your day job to a child? I help banks by checking their records and let them know what kind of shape they are in, offering suggestions on how to improve things.

What do you like most about your job? I like the opportunity I have to meet and visit so many banking clients.

How do you recharge? I love spending time with my family and watching or participating in activities with my kids.

What is one or two of your pet peeves? Probably my biggest pet peeve is having another car tailgate me. I am amazed at how close some drivers drive to the car in front of them.

Your dream vacation spot is..... My mother was from Australia and my father was from Czechoslovakia. Several years ago before we had kids, my wife and I visited Australia and got to meet my mother’s family. I have yet to visit what is now the Czech Republic. Someday I hope to visit that country and see the land where my father grew up.

What kind of impact do you believe you have on others, people/companies? My hope is I make others feel important regarding themselves.

What inspires you? What are you passionate about? My faith in God inspires me the most and makes me passionate regarding my relationship with Him, my family and others.

What is your motto or personal mantra? Philippians 4:13 “I can do all things through Christ who strengthens me” along with Matthew 22:39 “You shall love your neighbor as yourself.”

We know you will enjoy working with Mike as much as we do. Mike brings real world experience to his client relationships. You can reach Mike at mtomandl@varney.com or 1-800-240-5004.