



Third party due diligence

Augmenting technology with necessary human insights

Third-party relationships may create a variety of risks for companies, including corruption exposure, cyber threats, and impact on brand and reputation. These risks can be compounded by the sheer growth in the number of such relationships. A large company can have tens of thousands of third parties (i.e., trading partners, distributors, customers, suppliers, vendors, etc.) that should generally be subjected to customized levels of due diligence in order to identify, mitigate, and potentially avoid these risks. This due diligence works most effectively with a combination of technology and human insights.

Companies are increasingly looking to technology to increase efficiencies in vetting companies and individuals in countries around the world for legal, ethical, financial, or other “red flag” issues. What many do not realize is that they may be increasing their risk and exposure by discounting the need for human involvement in the process. The insights and judgment of investigative and compliance professionals are vital to

uncovering signs of corrupt, criminal, or otherwise disqualifying behavior. While it is important to keep abreast of technology solutions, companies must maintain the investigative resources who can wield those tools effectively on an ongoing basis. The following insights may help organizations streamline their approach to third-party due diligence by utilizing technology without impacting the quality

and thoroughness of the traditional due diligence process.

Technology's role in enhancing third-party due diligence

Software tools are now available to help companies vet individuals and/or companies in countries around the world for legal, ethical, or financial issues or other red flags. These solutions automate a portion of the

work associated with risk-management and compliance activities, including documentation, workflow, reporting, controls, surveys, testing, external research, and remediation.

An investigative database aggregation platform is used to gather and analyze relevant information about the third party from a variety of external sources. The database aggregator is designed to enable a single, simultaneous search of numerous open-source and subscriber data feeds. For example, a database aggregator may include several data feeds that allow searching of global regulatory actions, media reports, sanctions and watchlists, lists of politically exposed persons and state-owned entities. The information gathered from external database sources via an investigative platform helps investigators to develop a potentially rich profile of a third party; but that's not the end of the story.

Understanding the limitations of automation

The difference between “screening” (against a database of sanctions and watchlists) and enhanced due diligence (consulting the full breadth of public record sources in a given jurisdiction) is an important one when it comes to applying technology. The screening process is more easily automated since a single structured source file (such as a vendor file) can be programmed to search against the single structured-database data file, with the resulting potential matches, or “hits,” presented on a platform. Still, no technology tool can “automatically” determine what information is a true hit, and what information is relevant and requiring action. Human intervention is required during this “last mile” of the screening process.

Applying technology to the EDD process presents even more of a challenge. No platform can conceivably incorporate every resource that may be required to research a given high-risk subject. As EDD accesses more information sources, even more analysis and “false positive” review is required.



Likewise, any algorithm that can be applied to disparate data sources will be limited in its ability to automatically eliminate false positives and extract insights. Successful EDD will likely require the investigator to consult sources that are not aggregated into the platform to clarify or further investigate a given subject. Thus, the analyst needs to know what those resources are, how to access them (perhaps speaking a local language) and be able to process the information.

The value of human insights

Without skilled investigators who can help streamline the process, wield investigative tools effectively, and analyze the research results appropriately, companies may still face significant third-party risk. The following three steps, all of which require human intervention, will be critical to the success of a third-party due diligence program.

Agree on an appropriate methodology using a risk-based approach.

It is imperative that companies implement a risk-based approach to focus due diligence efforts on higher-risk third parties to best prioritize limited resources. A risk-ranking methodology should be created and third parties classified as low, medium, and high risk before initiating due diligence. This

classification should be based on predefined risk categories (i.e., jurisdiction, interaction with government officials, total spend/ annual sales, etc.) and will vary based on risk exposure. A “one size fits all” approach for due diligence will not suffice in today's regulatory environment and should be the end result of an overall third-party risk assessment conducted by the company.

Identify appropriate talent. Good investigators come from a variety of backgrounds, including lawyers, journalists, and other professionals with a knack for research, thinking critically, and extracting and reporting insights. Given that the riskiest third parties are geographically dispersed around the globe, a team of analysts should be skilled in multiple local languages and have knowledge of industries, key players, as well as the regulatory, political, and social climates in dozens of countries.

Unsurprisingly, overcoming language barriers is a major hurdle to automating due diligence. Deloitte's analysis of one company's population of third-party relationships determined that most red-flag findings were identified in local-language media reports that did not appear in other sources such as the most highly utilized database aggregators.

The capacity to search resources and review research results in the native language is essential to the effectiveness of the due diligence process.

Furthermore, high-volume screening, which companies are now automating, can result in a large number of “false positive” hits, which cannot be ignored. As a result, companies need skilled investigators who know how to remediate these hits with accuracy and efficiency.

Accurately interpret and analyze the data. Personnel reviewing and analyzing data on the third parties should be knowledgeable about the local government, economic environment, principal industries and political figures. They should know the schemes and issues that other companies have faced in the locale, which enables them to provide valuable insights to the due diligence process. For example, a skilled investigator with knowledge of the local jurisdiction may be able to identify subtle risk indicators, such as a known political figure, that is not flagged by a database of politically exposed persons.

Furthermore, analyzing the results from an effective due diligence program can prove extremely useful in identifying problematic trends (i.e., regional “hot spots”) and business issues which can help companies refine

internal risk management strategies and compliance procedures. A company that finds little to no adverse information in the vetting process may prompt questions from regulators regarding the effectiveness of their program. A good program is well demonstrated by finding potential red flags that could disqualify some potential third parties, or at least require clarification.

In summary, technology is critical for companies looking to effectively manage third-party due diligence programs for rapidly growing third-party populations. Tools can create a more manageable workflow, document due diligence procedures, and provide efficient access to relevant open-source and subscriber data. These tools, however, should be managed by skilled talent who can develop appropriate procedures, conduct effective searches, and effectively analyze search results. Many large companies increasingly rely on advisory firms to conduct third-party due diligence investigations because of the complexity of the process, the number of countries involved, the volume of their third parties, and the need for skilled talent with the appropriate geographical knowledge and language capabilities. Whether a company chooses that route or decides to handle the function internally, they should understand the importance of human intervention in the due diligence process.

Contact us:

John Leonard

Managing Director
Deloitte Financial Advisory Services LLP
Tel: +1 212 436 4292
jleonard@deloitte.com

Jessica Raskin

Managing Director
Deloitte Financial Advisory Services LLP
Tel: +1 212 436 6544
jraskin@deloitte.com

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