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Arc Horizon

An Arc Partners, Inc. Publication

Special points of interest:

- Cost Transparency is rapidly gaining in importance; we show you how to attain it.
- Why Enterprise Risk Management is your next big challenge.
- A Lesson from Satyam.

— A feature for online readers —
If you use Adobe Reader, you can navigate the newsletter by clicking on entries from 'Inside this Issue', 'Continued on… Continued from…' notations, or 'Special Points' above.

Featured Article

Cost Transparency Reigns Supreme in the Current Economic Climate

March 2009:
Tough Economy Enables Companies to Realize Savings through Improved Cost Transparency Initiatives

Current financial circumstances have forced companies to look beyond the benefits of traditional infrastructure enhancements and explore process and methodology changes that can significantly impact the organization in a positive way.

Cost Transparency, primarily achieved via Activity Based Costing, can improve an organization's ability to assess its strategic decisions and, if necessary, to redirect technology spending to business growth investments. It accomplishes this by providing each business unit with the information required to fully understand cost allocations and the business value derived by those cost metrics.

Evolution of Activity Based Costing

Since its inception in the 1980s, the goal of Activity Based Costing (ABC) has been to provide visibility into the cost structure of the process side of organizations. ABC was first introduced into processing operations of organizations (the "back office") where it provided directionally accurate insight into resource consumption for internal clients.

More recently, ABC has been introduced into the technology infrastructure side of organizations. Over time the software and tools required to accurately measure usage evolved dramatically. Consequently, a real challenge faced by companies has been overcome; how to understand and control IT expenditures.

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Activity-Based Costing vs. Traditional Cost Accounting

A B C	T C A
• Focus on activities that are required to produce each product or provide each service based on each product's/service's consumption of the activities • Directly trace overhead costs to products & services by identifying resources, activities, time, costs & quantities to produce output • Calculate the cost of each activity by associating a unit of output (driver) • Combines cost of the product or service and units of output of each activity consumed during any given period of time • Provides excellent support to manufacturing organizations, financial institutions & service industries	• Allocates costs to products based on the attributes of a single unit (e.g., direct hours of labor, purchasing cost of goods, numbers of days) • Varies directly with the volume of units produced, cost of merchandise sold, or days occupied by customer • Primary objective is the valuation of inventory • Does not provide a clear picture of how costs & revenues change as activity volume move up or down • Does not provide adequate information to identify the causes of cost

Inside this issue:

Leaders' Notes

Cost Transparency, Enterprise Risk Management and Sourcing

Our *Featured Article* for this issue rose to the top based on recent work performed for our clients. In this economic downturn, our clients are looking for ways to control expenses without making significant investments in their infrastructure. Arc's experience with cost transparency and various costing methodologies proves very successful with our client base. We are able to help clients realize the benefits of taking expenses down to the unit level, and building focused tools and reports to help facilitate cost, pricing, and other strategic business decisions.

The second article in Arc Horizon focuses on how clients can take an enterprise-wide approach to evaluating all elements of risk. As the economy recovers from this recession, many companies will focus on implementing risk and control frameworks to prevent recurrence.

Finally, we tackle sourcing and the diligence necessary prior to and during any type of agreements with onshore and offshore companies.

Please contact Arc Partners for more information on any of these subjects.

Enjoy!

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Cost Transparency Reigns Supreme in the Current Economic Climate (continued)

(Continued from page 1)

The Practicality of ABC

Attributing costs on an activity basis to the products being sold and serviced provides more effective and efficient understanding and control of the expenses associated with management decisions, thereby promoting the achievement of corporate objectives. The benefits of an ABC management methodology are essential for any forward-looking company in today's economic climate. Having a process or product view of costing versus an organizational view allows you to align cost management with the core direction of the business, not the administrative infrastructure. This more clearly reveals which product costs are directly associated with cost drivers. Executives will have a stronger understanding of the dynamics of the business and how product, customer, and delivery channel returns compare to industry standards.

A unit costing approach associates individual IT cost components with business transactions based upon the measurement of resource consumption patterns.

The following are some of the benefits achieved by implementing a robust cost transparency plan:

- Enables budget variance analysis which separates the components and volumes of spending and promotes sound decision making.
- Provides support for multi-dimensional profitability reporting for products, channels and customers.
- Provides a basis for estimating plan requirements based on volumes and productivity-affected unit costs.
- Explains year over year charges by reporting volume and rate variances.
- Holds managers accountable to both spending and volume components of budget variances.
- Provides the information needed to justify additional spending due to volume variances.

The Value of Cost Transparency

IT unit costs are one component of a total cost view, which also includes Operations, Middle Office Support, and Front Office costs. The Value Proposition of a metric-based decision making process, with transaction unit costs as the foundation, includes:

- ***Support Pricing*** – A firm understanding of costs can provide better analysis of pricing decisions.
- ***Decision support for further investment or deferral*** – knowledge of production unit costs can better predict the pricing and business impact of new capital investment, or the election to delay an investment.
- ***Internal billing for services*** – A detailed and understandable bill for IT services can result in a much more productive dialogue between IT service providers and users.
- ***Enhanced profitability analysis*** – Solid transactional costing can support multi-dimensional profitability reporting for products, services, and customers.
- ***Sourcing decisions*** - Providing unit costs for all transaction types highlights those activities that are supportive of business growth, and can act as a catalyst for either realigning existing resources or outsourcing them.
- ***Performance measurement*** - Unit cost information allows for valid benchmark comparisons.

ABC in Good and Bad Times

In both good times and bad, the two most important elements of business success, expense and revenue, can be unpredictable. In an economic downturn, ABC is an ideal way to isolate and understand costs, while preserving the organization's overall infrastructure. This approach allows companies to choose how they focus their resources, products, and services going forward and it can also help account for market conditions and other economic drivers.

With the eventual return to economic improvement, an ABC approach can be the ideal mechanism to keep spending under control; so your company doesn't get ahead of its revenue growth.

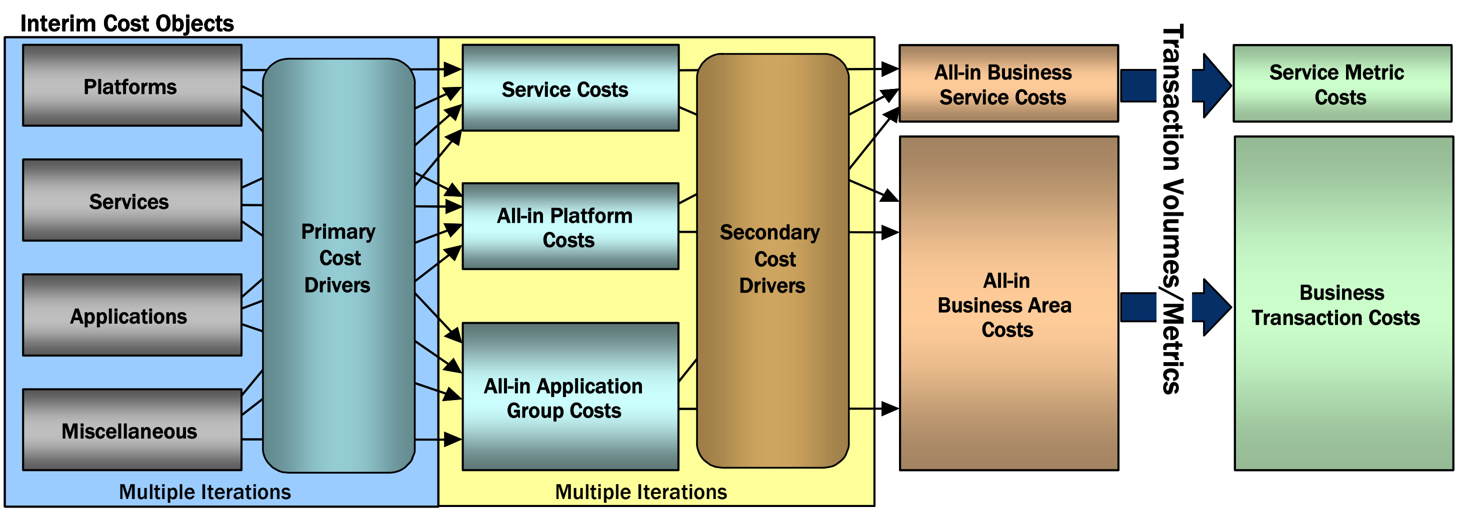
At Arc Partners, we strongly advocate that our clients fully understand the more controllable element of a P/L statement (expense) and actively work to measure how effectively expenses are employed.

Arc Partners, Inc. has extensive experience around cost transparency initiatives including delivery of unit cost and activity based costing projects. We work with your teams and lead them to success by:

- Analyzing current-state costing processes and developing a roadmap to future-state cost transparency.
- Assisting in Tool Selection. We provide prototype requirements and a tool selection template to structure the selection. We also provide insight into industry-leading vendors with which we have first-hand experience.
- Assisting with Cost and Profitability Implementation. We team with your management and analysts to configure the package, load the cost and profitability data and rules, and develop reports and extracts from the package.

If you have any questions about how Arc Partners can help you achieve cost transparency, please contact us at 212-370-4112.

— by Michael Merkur and Paul Besnia, Senior Managers at Arc Partners.



- Total Systems
- Voice Network
- Software Expense
- Servers

- Desktop Support
- Platform(s)
- Data Network
- Acquisition Systems

- Marketing
- Acquisitions
- Fraud
- Collections
- Back Office Support

$ X / New Account
$ Y / Fraud Account on File
$ Z / Account in Collection

Arc Advice

Sourcing After Satyam: What Do We Do Now?

In a January 7 letter to his Board of Directors, B. Ramalinga Raju, the CEO of Satyam Computers, India's fourth-largest IT services firm, admitted that he had systematically falsified accounts over a period of several years and that the over billion-dollar bank balances in Satyams' accounts were, in fact, nonexistent. Since that date, the scandal has roiled the Indian stock market, rocked the IT services and audit industries, sent jitters down the spine of one-third of the Fortune 500 (Satyam's customer base) and even called into question the future of much-venerated India Inc.

In a rapidly unfolding sequence of events, the Indian government took control of the company, the original board was immediately routed, and Mr. Raju, his co-founding brother, and the CFO all sit behind bars. The story continues to evolve, but as of the date of this publication 'well-placed sources speaking under condition of anonymity' within the Indian government now claim that contrary to Mr. Raju's claims, the money did exist but was systematically skimmed from the company's coffers via the artifice of transactions with over 300 companies connected to various members of the Raju family.

In short, it's a fine mess. So what now? With so many companies relying on Satyam for vital technology and business operations, what should be done in the short term to address the risks suddenly revealed by the scandal?

Prepare for the Worst

What does this mean for U.S. companies caught up in the whirlwind? First, don't expect that this is going to go away any time soon, or that other Indian companies are unlikely to be caught up in the aftermath. Second, if you have not already done so, prepare for the worst:

1) ***Companies that have engaged nearshore and offshore sourcing in general should actively review their exposure and assess their options.*** This assessment should include a review of any work the sourcing firm is doing to understand what the potential disruption to business operations could be.

2) ***If you do not have a business continuity plan in place, develop one.*** Many sourcing contracts contain clauses requiring IT disaster recovery or business operational recovery planning. However, the actual work of, and responsibility for

(Continued on page 4)

Why You Need Enterprise Risk Management

Suddenly, but not surprisingly, enterprise risk is a top priority, making Enterprise Risk Management (ERM) your next big challenge.

What just happened?

Over the last year, the sub-prime mortgage debacle and associated crises have resulted in over $1.4 trillion in losses. These losses cascaded to investment management firms, driving down the hedge fund composite index 18.3% in 2008. Assets under management are down over 30%, while capital attrition is up and so are insolvency rates. Many household brands like Wachovia, WAMU, Merrill Lynch, Lehman and Bear Sterns are disappearing. The "Lehman Ripple Effect" has destabilized the industry while firms have had a temporary loss of access to assets and increased exposure from OTC contract defaults.

What Does This Mean for 2009 and beyond?

As the industry recovers, financial firms have prioritized restructuring for greater solvency and enhancing risk and control frameworks to prevent recurrence.

Financial solvency restructuring is well under way as firms are reducing their global workforce by 10% to 20%. Cost management programs are being implemented to analyze expense patterns and identify any savings opportunities while balance sheets are being restructured.

Across the board there has been an overwhelming demand for stronger corporate governance and transparency by Audit Committees, Stakeholders and Executive Management. Risk and control frameworks are also being enhanced. Most noticeably, S&P has incorporated ERM into its Rating Process while Moody's, Fitch, and A.M. Best have stated their intent to follow S&P's lead.

What is ERM?

Enterprise Risk Management is a unified framework for the management of a firm's risk across all core business processes. It encompasses all pillars of corporate risk: Strategic, Operational, Financial, and Compliance. Each pillar consists of five components of Culture, Controls, Extreme Event Management,

Risk and Capital Models and Strategic Risk Management. In effect, ERM enables coordinated risk management coverage across all of the firm's business functions, processes and activities. When it is properly implemented it provides a standardized language for the communication of risk monitoring and consistent measurement criteria to guide risk decision controls across the organization. Using standardized language and controls provides a framework across the firm that communicates the level of risk and insures adequate oversight on risk and control.

Implementing ERM

Implementing an ERM framework involves achieving the desired alignment and balance across a firm's core risk management processes.

Arc Partners 5-Stage ERM methodology has been utilized across the full spectrum of business and technology impact areas including:

- Sales & Trading Risk Management
- Basel II Operational risk
- Interest Rate and Credit Risk
- Technology Infrastructure
- Logical Access Management
- Clients, Products & Business Practices
- Operations, Execution and Settlement
- Employment

We have used this methodology to assist premier global organizations with enterprise risk management initiatives to strengthen controls and mitigate exposure to business losses.

Arc Partners has extensive experience in ERM and Compliance, consequently we have many case studies relevant to securities processing, operational risk and controls and financial risk management. If you would like to discuss these case studies or how Arc Partners can help your firm address its Enterprise Risk Management needs please feel free to contact Kabir Bhagat at:

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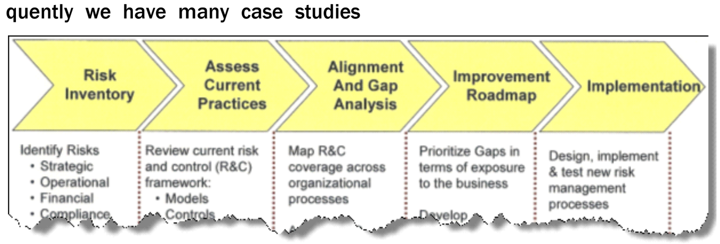
— by Kabir Bhagat, a Director at Arc Partners.



Sourcing After Satyam: What Do We Do Now? (continued)

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recovery is frequently left to the sourcing vendor. Most U.S. companies have been content to have the sourcing vendor certify (or even prove) annually that it has sufficient plans in place to enable recovery from a major disaster, usually fire, flood, hurricane damage, electrical outage, etc. However, this type of protection will be of little comfort if the sourcing firm goes out of business. Your business continuity plan should presume that your sourcing provider is beginning to falter or can no longer provide services. Use their disaster recovery planning as a starting point, particularly for the minute details of recovery for day-to-day operations, but prepare for the possible need for third-party intervention to actually make it happen.

3) ***As part of your business continuity plan, evaluate migrating some operations to a balance of alternative sources to reduce your current sourcing risks.*** Consider spreading risk among other sourcing vendors within the same country or region (Wipro, TCS, Infosys), spreading risk among several different regions (India, Philippines, Eastern Europe), or retaining some residual capacity (either foreign-captive or U.S-based) that could be used as both overflow capacity and in an emergency to spin-up newly in-sourced operations quickly. We say this in full realization that multiple sourcing arrangements are less likely to be as financially or operationally appealing as a single arrangement. However, part of your evaluation should take into consideration where your optimal balance lies along the spectrum between sub-optimizing financial returns and sub-optimizing operational risk.

4) ***Review sourcing risk profile regularly.*** Clearly, in today's world no country or region is without risk. Companies who source key functions must be aware of the potential risk inherent in the locations frequented by their sourcing providers and plan accordingly. Among the risks to take into account are global warming (or cooling), civil unrest, terrorism, war, legal and regulatory efficacy, and governmental instability.

5) ***Ensure all future contracts have a Contract Termination framework.*** Depending on the relative size and economic / legal clout of the participants, many companies have in the past accepted the contract proffered by the sourcing company as the basis for negotiations. This is not an unusual situation; what is unusual is for a sourcing vendor to freely offer a broad-based termination framework that would not only allow termination by expiration or non-renewal, and termination for cause (under specific circumstances) but ***termination for convenience***. A discussion of relevant contract termination frameworks is beyond the scope of this article; more importantly, Arc Partners is not in the business of dispensing legal advice, however, your attorneys should be able to help ensure that you are not captive to a rapidly deteriorating sourcing situation.

These 5 steps, while not comprehensive in scope, will go a long way toward helping you prepare for the possibility of problems in the future with your sourcing arrangements.

While it's ok to hope for the best, that Satyam will be able to overcome its present difficulties and remain a strong player in the sourcing industry, it's prudent to prepare for the worst. Arc Partners can help you in your preparations. We have a great deal of experience helping our clients evaluate and select their sourcing arrangements, preparing and implementing business continuity plans, and reviewing and mitigating sourcing risk.

—by Brendan O'Sullivan, Managing Director at Arc Partners and John Harris, Senior Manager.

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Arc Partners was founded during a time of unprecedented business and technology change in the financial services industry. Our goal is to assist financial services companies in improving business performance through better management and application of technology.

We are a high performance management consulting firm that works with clients to ensure key business process and technology initiatives succeed. We don't do projects to our clients. Our combination of industry expertise and consultative skills allows us to creatively analyze fast-changing environments and recommend best-fit solutions.

Arc Partners has earned a reputation for high quality, value-added service. We perform multiple engagements for over 90% of our clients, reflecting their satisfaction with our service. We continue to expand, but pace our growth to ensure continued excellence in the quality of our work.

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