



**SOLOMON EDWARDS**

*Where Strategy Meets Execution*

# CONTRACT COMPLIANCE: HOW MUCH ARE YOUR CONTRACTS COSTING YOU?

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## Overview

Today, organizations are increasingly more reliant on third parties to accomplish their important business objectives. Contract-driven business arrangements include:

- Advertising Agencies
- Construction Firms
- Contract Manufacturers
- Distributors
- HR Benefit Administrators
- IT Service Providers
- Logistics Providers
- Real Estate Companies
- Resellers
- Service Providers
- Suppliers
- Vendor Management Services

Complex, multi-year contracts typically govern these arrangements. Customers tell us that compliance with key terms of these agreements is often deficient or even unknown.

### Executives are asking why noncompliance is so prevalent.

- Are contracts poorly negotiated or drafted?
- Are third parties not aligned with the company's code of conduct or ethical standards?
- Is fraud a significant contributor to this problem?

Generally speaking, the answer to each of these questions is “no.” On the contrary, partners to significant business agreements are generally following well-developed processes when entering into and formalizing a business relationship.



**The root causes of compliance failure lie in a variety of factors that occur after agreement terms are finalized, some of which are listed below.**

Key contract provisions are poorly understood by those responsible for the administration of them. Although terms may be clear to legal counsel drafting the agreement, complex provisions are not communicated to those responsible for implementing financial, operational or other terms.

Ownership of a third-party relationship is often split between business functions without clear delineation of responsibility for monitoring ongoing compliance. Calculation and self-reporting of data by third parties is always a risk area that increases with the complexity of the reporting.

Changes in business operations within either party to the agreement can trigger errors in the implementation of contract terms. New system implementations, turnover of experienced resources, mergers and restructurings each raise the risk of contract noncompliance. Often times, more than one of these conditions are present, thereby exponentially increasing noncompliance risk.

Poorly designed processes or internal controls on the part of a business partner are risk indicators that provisions of complex agreements are not being followed as agreed. Likewise, when a partner is experiencing operational or financial stress, the likelihood of errors in compliance is greater.

Compliance agreements that do not include appropriate penalties when errors occur are at higher risk for non-compliance. The right to terminate an agreement for an unremedied compliance failure is a penalty that is not appropriate in most circumstances. Instead, well-crafted monetary

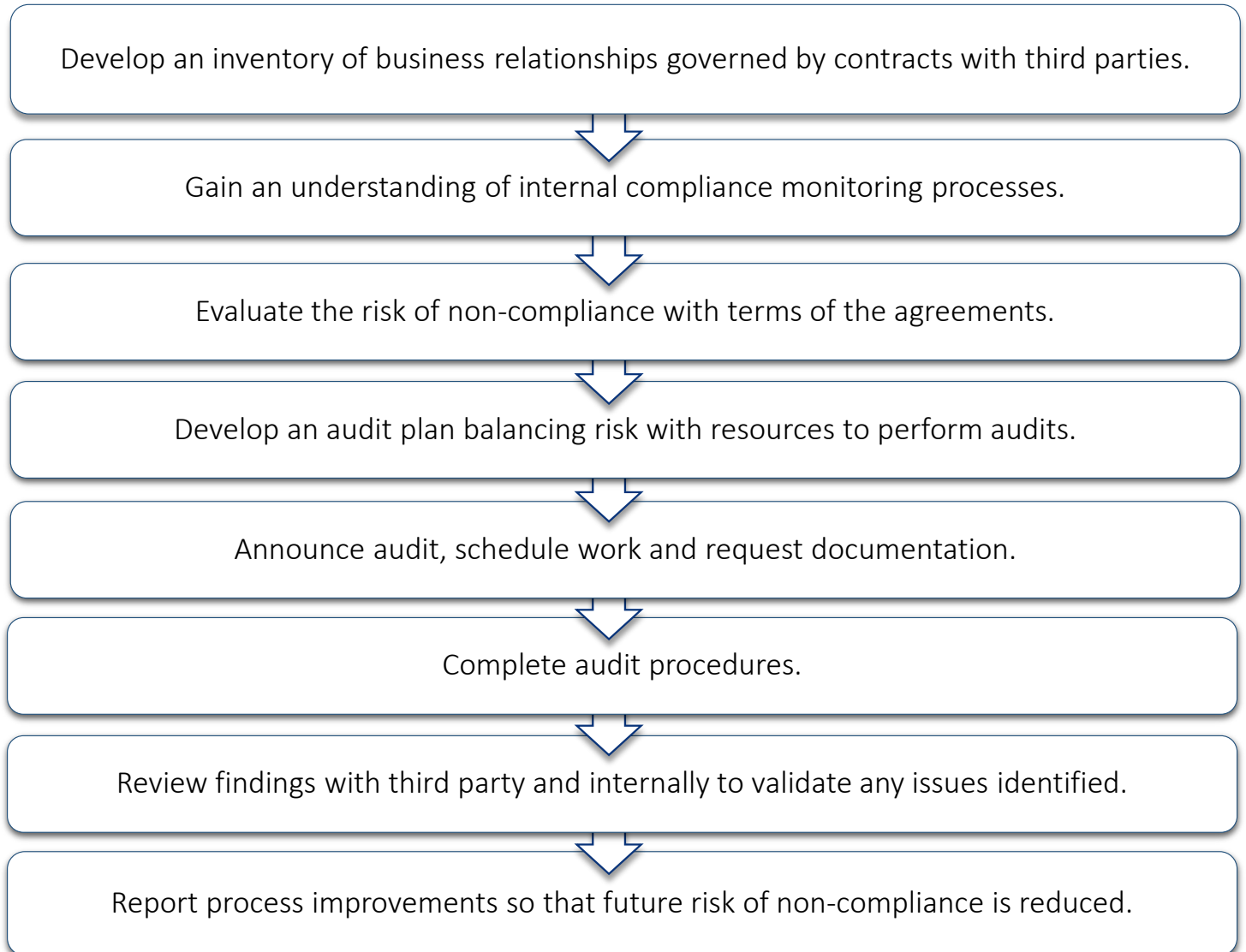
penalties can act as a disincentive and a way to keep attention on compliance.

These root causes of compliance breakdowns involve people, process, and systems across each organization in a contractual relationship. Making process improvements to raise the level of compliance is a significant challenge. Companies are instead focusing on implementing strong detective controls to identify areas where non-compliance is having the most serious effects. It is no surprise that well-designed compliance audit processes are delivering benefits that often exceed the cost of conducting audits. Audits are not only identifying cash savings but are surfacing issues that erode brand value or damage business operations.

**The development of a risk-based contract compliance process is clearly a best practice to controlling this important and growing part of the business landscape.**



## Contract Compliance Process



## How SolomonEdwards' Approach is Different

Many firms provide contract audit services. At SolomonEdwards, we believe our approach is unique to the marketplace.

Our focus is on improving the way businesses manage their increasing reliance on third party providers for critical goods and services. We view non-compliance with contract terms as an indication that business processes to manage and monitor third-party performance have not kept pace with the increasing scope and complexity of third-party agreements. Our focus at SolomonEdwards is to provide additional value beyond identification of non-compliance.

Our approach can be tailored to your needs. We can assist in the process to inventory your relevant contractual relationships, evaluate your internal contract monitoring capabilities, establish a risk assessment and conduct contract compliance audits.

The SolomonEdwards approach to contract compliance audits is what we believe sets us apart from the competition. Our deliverable includes an analysis of findings to identify root causes. An evaluation of the third party partner's capabilities is a key element of this analysis. Our final reports will often include recommendations for changes at the third party and your company. We often find that small changes in process and/or reporting can greatly improve transparency and the level of confidence in internal compliance monitoring. This in turn reduces the risk of future non-compliance.

Additional deliverables include, but may not be limited to:

- Prioritized risk assessment and inventory of business relationships and contracts, including a dashboard with evaluation points. This is dependent on the final agreed-upon scope of the review.
- Recommendations for contract enhancements.
- Process improvement recommendations for enhancements to contract compliance policies, procedures and monitoring activities.



In addition to the tangible deliverables developed during our review, value gained from our contract compliance reviews typically includes the following:

- Identification of lost revenue, missed savings opportunities and/or additional fees.
- Enhanced spend visibility via an inventory of product and service vendors with whom contractual relationships exist.
- Enhanced contract monitoring capabilities.
- Accuracy verification of the data reported by in-scope vendors.
- Improved internal controls processes.
- Strengthening of contract language, improved financial terms, and enhanced internal controls.

The SolomonEdwards Contract Audit teams are skilled at providing the deeper level of assessment required to add value beyond the identification of losses from non-compliance. Senior staff with deep experience conducting contract audits organize teams that include a full range of skills including data analysis, industry knowledge, deep internal controls and process improvement capability.

## About SolomonEdwards

SolomonEdwards is a national professional services firm focused on strategy execution. We create success for our clients by providing extensive experience, deep subject matter expertise and adaptability within ever-changing business dynamics. Through our business consulting division, we execute custom solutions that solve clients' critical business issues related to business transformation, accounting and finance, governance and regulatory compliance, and mergers and acquisitions.

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