



**MANAGING YOUR CONTRACT
PERFORMANCE**

**ADDING VALUE & REDUCING COSTS
THROUGH EFFECTIVE VENDOR
CONTRACT COMPLIANCE AUDIT**

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Background

In today's world of multi sourcing, multi vendor environment many client organizations have strong internal controls around the initiation and creation of contract when they outsource their services first time. However many do not have the same amount of focus and control, post contract award. Ineffective control and management of supplier contracts lead to potential failure in manage the risk, vendor performance, value leakage & cost savings.

For most client organizations the real work begins after the contract has been signed. Indeed, managing vendor relationships is a critical part of the contract performance and requires a deliberate and well thought-out approach, if the client organization wants to achieve value for money from the contract. The most successful approach is to setup a self-sustaining process where incremental changes to compliance policies and processes are introduced based on the results achieved and feedback received from the internal and external stakeholders as well as based on the vendor contract compliance assessment.

This paper details out the key issues around contract management and the need for vendor contract compliance assessment.

- Contract Management - Challenges
- A methodology for evaluating vendor contract performance
- Determining what aspects of contract performance require close oversight
- Enabling vendor process improvement over the life-cycle of the contract
- Driving additional value & benefits from the vendor relationship.

Business Drivers

Post-award, contract management and administration is a critical function for the management of contract, compliance, supplier performance and risk. If management wants to ensure that the level of performance and expected value to be achieved, then a properly designed framework with compliance & risk management components of the agreement are to be implemented and adhered to.

Facilitating such a framework or a mechanism will mutually help and benefiting the stakeholders from both the client and service provider organizations. This framework is a key enabler in multiple aspects:

- Accommodating and monitoring the changes in a transparent and collaborative manner
- Improves contract structuring for sustained cost reduction
- Improves procurement and payment processes
- Improves supplier relationships through-out the contract life cycle.
- Mitigate Sourcing risk

The prime objectives or goals of Contract Compliance Assessment/Monitoring should focus on:

- Vendor Contract Compliance Audit (VCCA) is one of the key assessment factors to ensure that the vendors are adhering to contractual obligations and the objectives of out-sourcing are achieved as planned.
- VCCA reveals about the value leakage in-terms of risk, cost control, revenue maximization and contract performance.
- The periodical vendor contract compliance audits/reviews helps the client organization to move toward a program of continual contract compliance monitoring resulting an effective vendor partnership and to achieve the core business objectives.
- However accounting and accountability of contract performance falls on both parties (Client and Service Provider) and their commitments toward contract and relationship management governance for a successful outsourcing.

Contract Management Challenges

The outsourcing and off-shoring market continues to grow with greater amount of commitment, involvement and focus from key stakeholders on both the client and service provider organization. This is primarily due to complex deals, number of contracts, managing multiple service providers, rising costs, vendor performance, economic slowdown, M&A, strategic transformation initiatives, new delivery models, new geographies and business risk.

It is important for client organizations to have proper governance, communication mechanism to communicate and collaborate in an efficient and effective manner with both internal and external stakeholders. This is a matter of necessity for many client organizations as the factors of time, information-sharing, accuracy of information, inventory liability and version control when executing contractual agreements.

It is apparent that there is a significant amount of risks surrounding the procurement/sourcing of products and services throughout the contract life cycle. This poses a serious threat to management's ability to monitor the contract risks in a consistent and continuous manner. This also provides an opportunity for client organization to reevaluate the contract risks across their pool of agreements with suppliers. Without such risk assessment capability, the client organization will see a lot of "blind spots" as to the evolving nature & significance of contractual risks and associated risk management controls.

The following are some of the critical challenges & risks in contract management.

- Managing multiple vendors with a complex contracts
- Establishing the relationship governance in line with the outsourcing strategy
- Meeting the contractual obligations
- Managing the business risk
- Managing vendor performance
- Managing dynamically changing business requirements
- Ensuring SLA compliance
- Creating and maintaining a centralized contract repository
- Clients seeking greater cost transparency from service providers.
- Analyzing contract performance
- Accessing rebates/discounts
- Enforcing internal compliance
- Tracking internal compliance
- Integrating contract data into transactional systems
- Searching for contract terms, pricing, etc.
- Failure to detect wasted expenditures, over payments, revenue leakage

Need for a Contract Compliance Audit

Client organizations are using their internal compliance mechanisms and other contract management techniques to monitor the vendor performance, overall service quality, regulatory compliance and more importantly, to minimize 'savings leakage'. Regardless of their contract compliance management processes and internal reporting mechanism (on performance, compliance, revenue leakage, cost spend etc...), a new risk is being induced knowingly or unknowingly.

The risks are being overlooked in all practical aspects when the greater degree of relationship in focus. The unknown risk would bring in enormous amount of impact on your contract performance & compliance in due course. However the greater degree of accountability and managing these risks lies with client organization and not with your outsourcing partner(s).

Considering the current economic climatic conditions, contract performance, compliance and risk, client organizations are trying to monitor contract performance and improvise their extended enterprise by deploying any of the following control/or/and audit mechanisms.

- Contract Compliance Management Program
- Contract Compliance Roadmap
- Third Party Contract Compliance Assessment/Audits
- Vendor Management Program (VMO) / VMO Governance

Compliance Tracking

Contract compliance audits are most critical when a client organization has complex contracts that include volume discounts, service credits, long-term guarantees, price downs, retroactive pricing, rebates, special vendor agreements and business plans for ongoing productivity reductions. In spite of having a client's internal audit processes, the following are some of the indicative scenarios on over payments, wasted expenditures and value leakages.

Wasted Expenditures:

- Complex pricing mechanisms
- Large Quantities of Invoices
- Duplication of Invoices or charges
- Failure to apply volume discounts
- Failure to apply rebates
- Non follow-ups on the financial disputes

Overpayments:

- Invoices without reflecting applicable service credits
- Poor understanding of the contractual agreement
- Poor understanding of the SLA calculations & clauses
- Reliability of the service provider performance reporting
- Transparency and lack of visibility on transaction volumes

Value Leakages:

- Increase in spending
- Lack of prior audit initiatives
- Validation of contract controls
- Identification of risk exposure
- Identification of process improvement initiatives across CLM
- Compliance with policies and contract
- Cost Savings & recovery
- Benchmark against best practices
- Monitor Vendor Performance & Non Compliance
- Evaluating the Contract Performance

Vendor Performance

Vendor Performance is very critical especially when you are in a multi sourcing, multi vendor environment. It is crucial to know how well your vendors are delivering, with respect to quality, service, and expected cost savings besides the process and productivity gains. When you are receiving services from many vendors, tracking their performance is not only critical to spend management, but also to the integrity of your operations. Some of the top line issues can be addressed by carrying out the contract compliance audit with your vendors.

- **Beyond SLA Score Cards:** Creating 'smarter' analysis in each category to provide greater qualitative and quantitative intelligence on each vendor. (i.e. EPI- Executive Performance Indicators)
- **Manage the Un-Known Risk:** Monitoring supplier health and market conditions to uncover potential opportunities or hidden risks
- **Enduring Relationship:** Helping business users and suppliers interact more closely to identify savings opportunities and strengthen relationships.
- **Poor/or/ Lack of VMO Practice Management:** VMO Process maturity varies significantly across client and service provider organizations. Lack of governance structure (VMO) may lead to ineffective management of supplier relationships.

RISK Management

In order to effectively and efficiently manage contracts most organizations require the capability to cross-reference, interface or integrate these purchase and payment transactions with contract information. Obviously the greater the number of suppliers and contracts, and the greater the complexity of the deals, the more

important the well designed governance mechanism with technological capability becomes as the organization enablers to manage the known and unknown risk. The following are some of the indicative scenarios on risk.

- Lack of Standardized Contract Management Process
- Contracts without Audit Clauses
- Contracts without Exit/Termination Clause
- Contracts without Benchmarking Clause
- Lack of Governance framework in managing the supplier base (CMO/CPO/SVM/VMO)ⁱ
- Failure to track the unknown risk beyond the contractual obligations. (e.g. DPA, SOX, COLA etc...)

Governance (CMO/CPO/VMO)

The VMO operating model with the client organizations is varying significantly when managing multi sourcing, multi vendor environment with a complex contracts in place.

- Lack of Governance Framework or process mechanism around your CPO/CMO/VMO
- Lack or Poor maturity of Vendor Management Organization(VMO)
- Lack or inadequate skills or resources around CPO/CMO/VMO Organization
- In- effective management on Vendor Relationship or VMO Governance

CLM/CMO Processes

For client organization it is very critical to have a formal and well-defined CLM/CMO process in place. Without having a CLM/CMO processes can have significant long-term impacts. Some of the negative effects include:

- Inability to track or enforce contract compliance (performance or pricing)
- Inconsistent process, leading to excessive cycle times, inefficiencies and/or bottlenecks
- Inconsistent/or/ incorrect use of terms & conditions
- Failure to leverage volume rebates or negotiated terms, increasing total cost of ownership
- No single database or repository to store and search for contracts, changes and/or amendments
- Noncompliance with laws and regulations such as HIPAA, SOX, DPA, COLA etc...
- Lack of CLM Processes and Contract Management/Admin Tools
- Lack of necessary internal review or approvals
- Failure of services to meet customer expectations

Goals of Contract Compliance Monitoring

Post-award contract management and administration is a critical function for the management of contract and vendor performance and risk. Client Organizations need to be able manage and control compliance to contract by vendors and by internal users. This is essential if management is to ensure that the level of performance and expected value is achieved, and a carefully designed risk management framework with appropriate components of the agreement are implemented and adhered to.

Facilitating a framework or a mechanism through which accommodating the changes in a transparent and collaborative manner which is mutually benefitting both the client and service provider organizations. The prime objectives or goals of Contract Compliance Monitoring should focus on:

- **Enduring Relationship** -To improve relationships with vendors & other third parties
- **Revenue Recovery** - To eliminate waste or excess spending
- **Cost optimization** - To identify potential cost recoveries
- **Address the risk beyond contractual obligations** - To avoid financial, legal or reputation risks
 - Ensure that the vendors comply with contract terms & conditions
 - Ensure that performance expectations are achieved

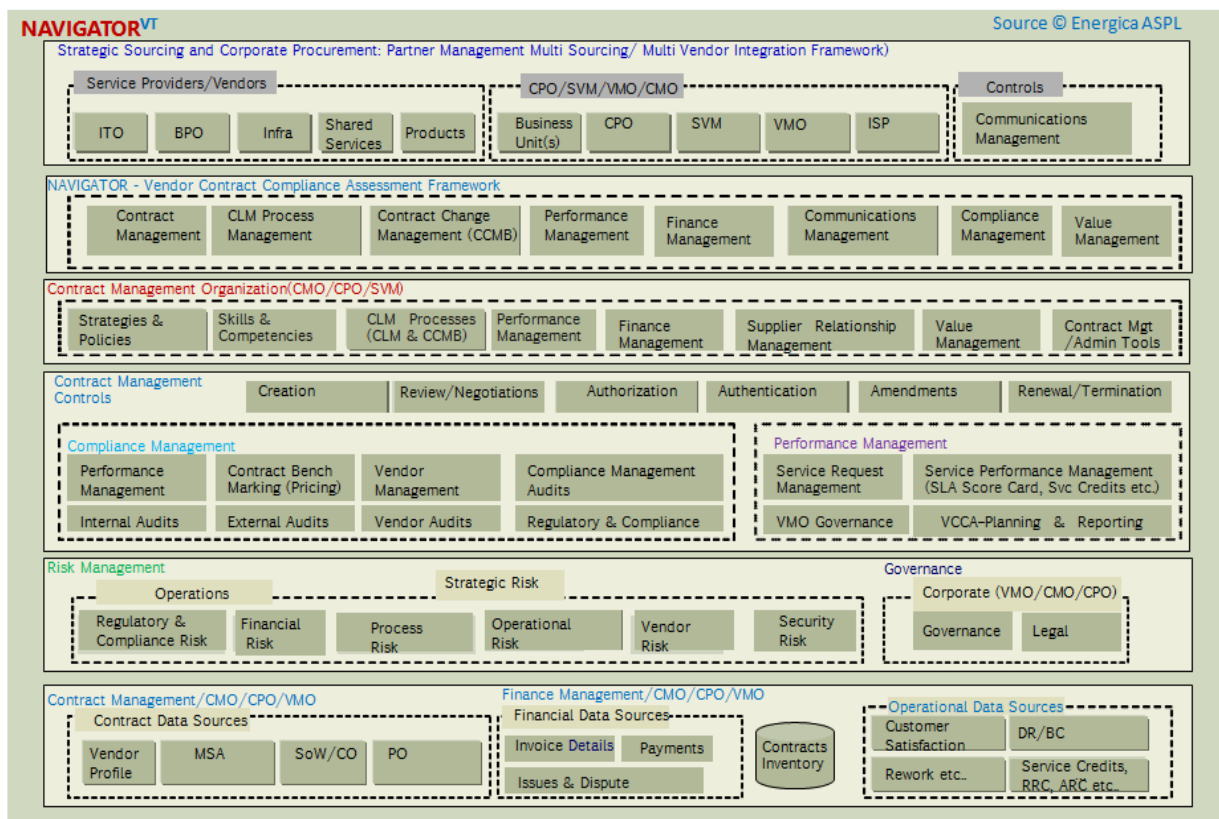
- Assess risks and address them through audits or reviews
- Identify and resolve problems, issues, dispute resolutions
- Effective contracting management process, practices & tools
- **Overall Performance Monitoring**
 - SLA performance
 - Deliverables – Quality and Timeliness
 - Compliance with contract terms and conditions
 - Fulfillment of cost and quality objectives
 - Award new work based on performance (risk-reward models)
 - Day to Day Monitoring of Vendor Relationship(s)
- **Process Efficiency** - To Streamline & implement process improvements around CLM
 - To Improve the deal pipeline (in terms of project prioritization, execution)
 - Streamline CLM Process across contract management.(overall CLM Processes & re-engineering)
 - Which process needs to be consolidated – duplicate, redundant, reengineered, improved
 - Contract life cycle modifications
 - Contract Management efficiencies

NAVIGATOR^{VT} - Vendor Contract Compliance Assessment Framework

Energica' has developed a comprehensive framework (NAVIGATOR^{VT}) for Vendor Contract Compliance Assessment (as depicted below in Figure-A).

CMO Governance

NAVIGATOR^{VT}: Vendor Contract Management Compliance Framework



NAVIGATOR^{VT} Methodology for Contract Compliance Assessment

Energica's NAVIGATOR^{VT} helps the client organization in streamline the contract management and administration process in a continual manner on an ongoing basis. The NAVIGATOR^{VT} process is a five-step approach (Figure-B) that includes Plan, Analysis, Review, Compile and Optimize stages.

Stage 1: Plan

- High-level assessment that identifies and conducts calls with appropriate contacts at both the client and the vendor organization to be audited to understand the relationships, nature & design of the contract, contract type, billing and payment methodologies, perceived or known concerns, discuss timing and logistics, and to set the expectations and communication timelines for the audit(s).

Stage 2: Analyze

- Understand and obtain client organization' audit compliance footprint, Inventory of current Contracts, PO, Invoice details, performance data, Contract Management Plan (CMP) and tools that allow for updating, tracking and auditing.
- Obtain and understand all contracts and addendums to be audited. Understand and analyze the related spend, invoices, purchase orders, etc. Analysis will provide a clear understanding of client spend patterns and possible/potential savings opportunistic areas. This provides an insight view of client's actual spend, and the greatest potential areas for reducing costs/improvisation.
 - Review Contract, SoW, Vendor Contracts, T&C, Audit Clauses etc.
 - Analyze CSS (Customer Satisfaction Surveys)
 - Perform Contract reviews
 - Track Performance, SLA Score Card, Service Delivery, Credits, Earn backs, and Critical Milestones etc.
 - Analyze and Plan Vender Costs
- Analysis on CLM Processes and related contract documents will reveal with accurate expiration dates, options, committed value, compliant and defaulting suppliers with detailed contract terms.
 - For example, in accurate procurement data, inconsistent service levels to internal clients may tend to bypass procurement the current process laid for contract management.
 - Analysis outcome will lead towards a high degree of standardization, improvisation in CLM Processes, cycle times, outcomes and end user satisfaction.

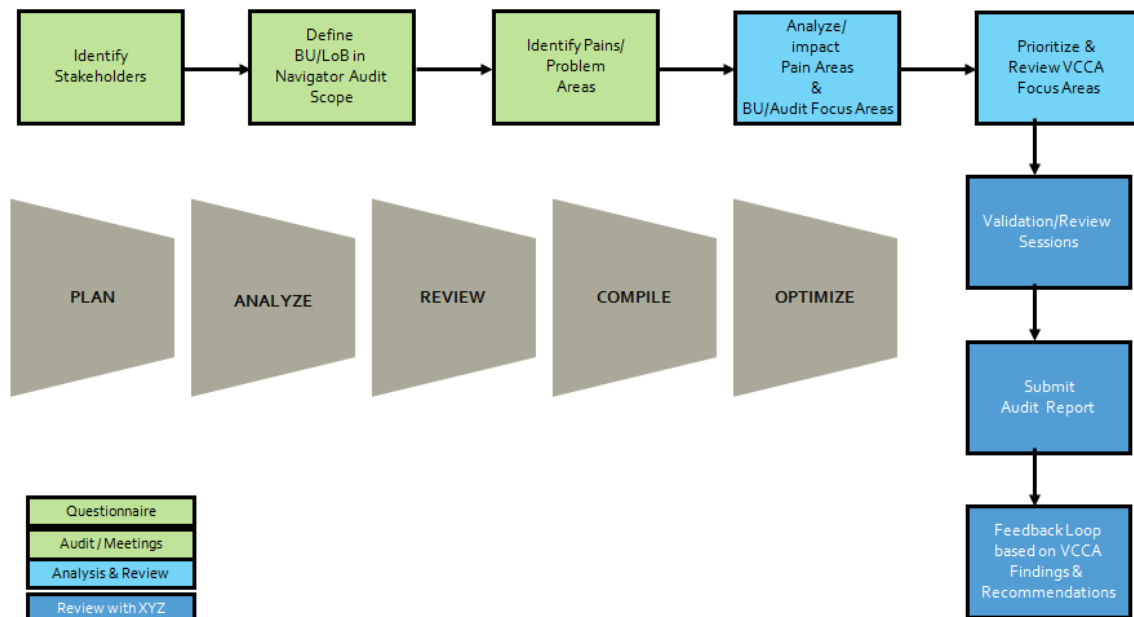
Stage 3: Review & Compile

- Interview the client & vendor touch points being audited and about their CMO policies and procedures as they relate to the contract
- Conduct vendor site visit, including all compliance verification and validation on the audit focus areas;
- Discuss audit findings and follow-up questions that arose from the field audit with client & service provider(s) regarding any unanswered questions.
- Review and cross verify SoW, PO and Invoices
- Analysis on your Contract Management Processes (CLM Processes, Contract Mgt Practices, CCMB, & Contract Admin Process)
- Review CLM Processes (contract authoring, review, approval and negotiation processes.)
- Identify Value Leakage (Wasted Expenditures, Over Payments, Value Leakage)
- Review PO process; PO process have a complex and moving parts across CLM and this is one of the core areas on audit focus and always provides an opportunity for improvements.

- PO processes (Request Mgt, PO Processing/Generation, Approval & Release, PO Corrections and Changes, Discrepancy and resolving issues on PO)
- Payment processing, Invoice management, dispute and issue resolution on Invoices. (Approval, release, pending, outstanding etc...)
- Compile an audit report with your assessment findings, observations and recommendations.
- Review your initial audit report with the client and vendor organization and incorporate feedbacks.

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NAVIGATOR^{VT}: Vendor Contract Compliance Audit Approach (Methodology)



Stage 4: Optimize

- Assemble and present a draft audit report including executive summary, audit methodology, findings and recommendations to Client for final review and incorporate with any additional remarks/ findings.
- Submit the final audit report with a Vendor Contract Compliance Roadmap with recommendations.
 - Mitigate Value Leakage
 - Manage Invoices
 - Chargeback to LOBs
 - Administering individual contracts to incorporate changes and revisions
 - Tracking and managing compliance to contract terms
 - Administering database of contracts
 - Aligning the client VMO governance mechanisms in line with audit feedback & compliance roadmap.

Based on this vendor contract compliance assessment, client organization can then monitor performance trends and changes in risk drivers to enhance predictability and reduce the likelihood of costly surprises in violation of contract terms. The leading practice involves building controls into current contract operational process models

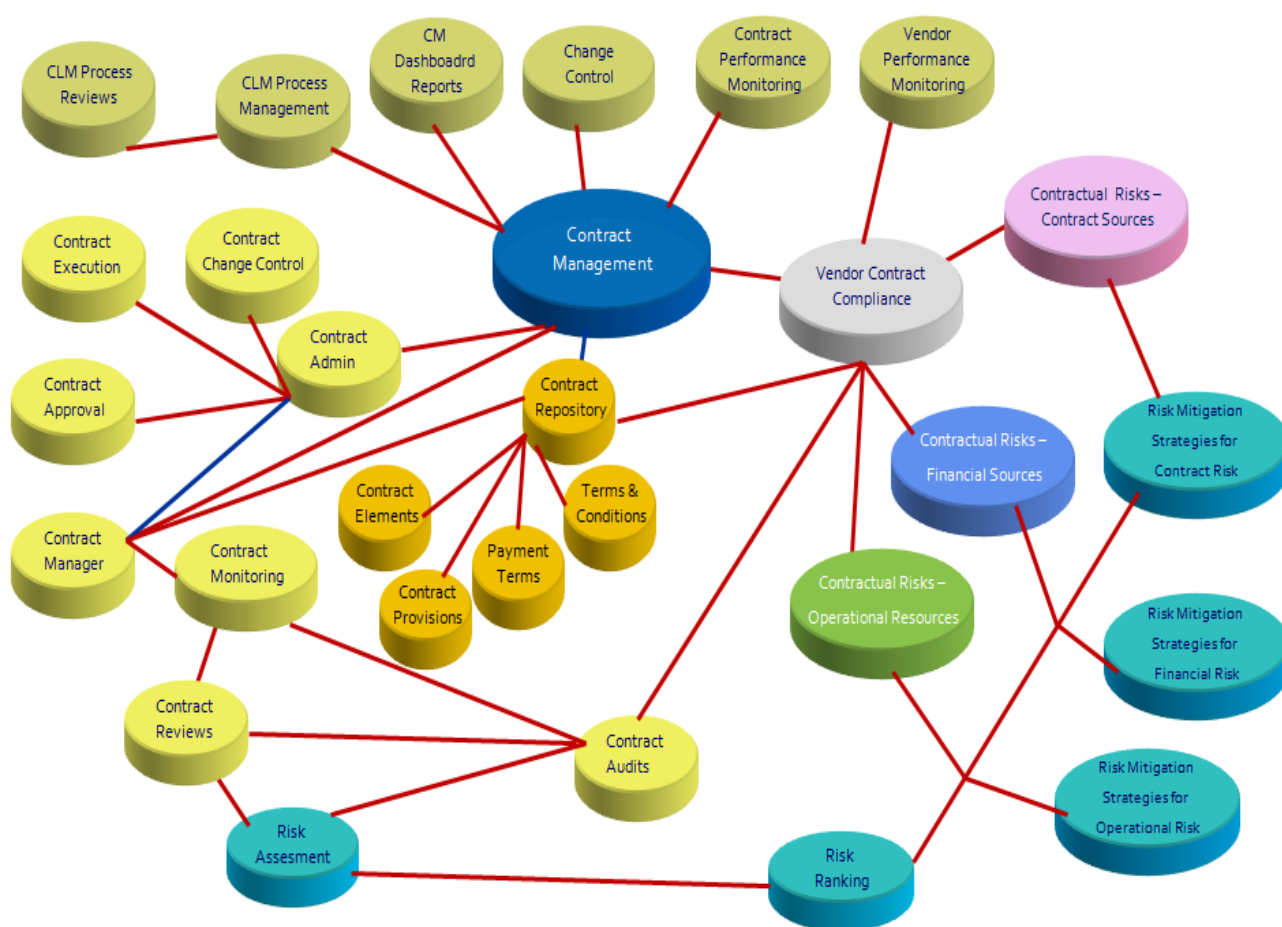
that give management visibility into the project's performance over time. These controls take several forms, including management reporting, establishment of leading key performance indicators, adequate segregation of duties, and periodic assessments and audits.

NAVIGATOR^{VT} Contract Compliance Assessment Focus Areas

Vendor Contract Compliance Assessment (NAVIGATOR^{VT}) will review the core process elements of Contract Management. The following is an indicative schematic map (as depicted below in Figure-C) provides you an insight on the compliance assessment focus areas.

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NAVIGATOR^{VT}: VCCA – Audit Focus Areas



NAVIGATOR^{VT} Contract Compliance Audit Dashboard:

The following is an indicative NAVIGATOR^{VT} Dashboard (Figure-D).based on Vendor Contract Compliance Assessment and provides you an insight on compliance focus areas, maturity level and the degree of compliance.

NAVIGATOR ^{VT} Vendor Contract Compliance Assessment Dashboard	Client XYZ
OVER ALL SCORE	G
PLAN PHASE	
CONTRACT INVENTORY BASE - Consolidation of Contract & Related Components	G
ANALYZE PHASE	
Contract Management Organization (CMO/CPO /SVM)	G
Performance Management (Vendor Performance, Innovation & Value Management)	G
Compliance Management (Compliance,Performance Mgt, Process Improvements,Payments & Risk)	R
Finance Management (Payments, Issue & Disputes & Value Leakage)	R
Risk Management	G
REVIEW PHASE	
A1) Contract Management Organization - Strategies and Policies	G
A2) Contract Management Organization - Skills and Competencies	G
A3) Contract Management & Change Control Processes (CM,CCB,IDR)	R
A4) CMO - Supplier Relationship Management (Vendor Categorization, Performance Management & Rationalization)	R
A5)Contract Management Administration Tools (Admin, Analysis and Reporting Tools)	A
B1)Contract Performance Management (Performance Mgt)	G
B2) Value Management (Best Practices, CM Lifecycle Analysis & Improvements)	A
C)Contract Compliance Management (Compliance)	G
D) Financial Management (Payments, Issues & Disputes)	G
E)Risk Management (Risk)	A
COMPILE PHASE	
Vendor Non Compliance	R
Vendor Performance	A
VCCA Report - Observations & Recommendations	G
OPTIMIZA PHASE	
CMO/CPO/VMO Recommendations	A
Final VCCA Score	3.00

NAVIGATOR^{VT} Benefits of Contract Compliance Assessment

The most successful approach is to setup a self-sustaining process where incremental changes to compliance policies and processes are introduced based on the results achieved and feedback received from the internal and external stakeholders as well as based on the vendor contract compliance assessment. In addition, explicit support and commitment from the top management is necessary to enforce these control measures & processes at all levels to ensure maximum compliance to achieve the desired outcomes and to ensure a smooth & successful outsourcing experience.

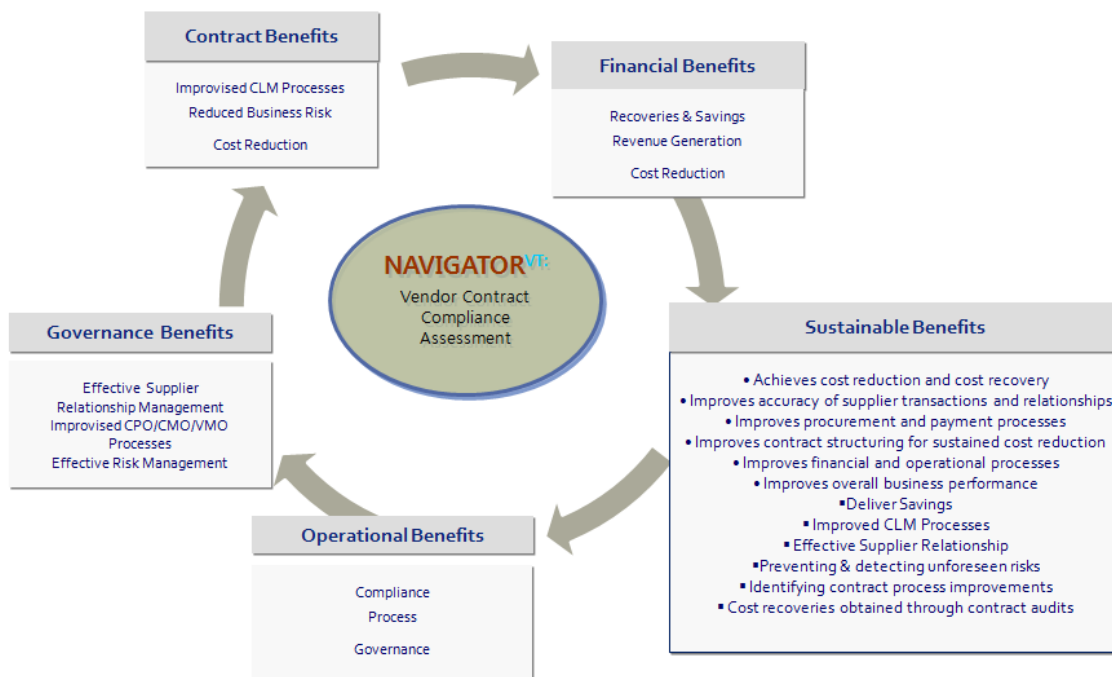
The following Figure-E shows the high-level benefits of Vendor Contract Compliance assessment.

- Achieves cost reduction and cost recovery
- Access & Prioritize deal pipeline
- Improves accuracy of supplier transactions and relationships

- Improves procurement and payment processes
- Improves contract structuring for sustained cost reduction
- Improves financial and operational processes
- Improves overall business performance
- Improves overall CLM Process performance & refinements
- Improves supplier relationships with vendors & other third parties

CMO Governance

NAVIGATOR^{VT}: Benefits of Effective Contract Compliance



Momentum on Contract Compliance

The Industry trend reveals that greater amount of focus and improvements would be on effective contract management and the prime emphasis focusing on Vendor Contract Compliance. Below are some of the industry observations on Spend analysis and invoices audits:

- Aberdeen Group survey indicates that Best-in-Class procurement units have :
 - 81% - Spend Analysis is high-value function in today's economy
 - 5% to 20% cost savings for each new \$ brought under spend management
 - 76% compliance to contract agreements. (Source: Aberdeen Group Survey 2008, Aberdeen Group: Vault-Unlocking the Goldmine, 2010)
- The average invoice error rate alone falling in the range of 8-10% on Invoices. (Source: EquaTerra'-KPMG Invoice Audit)

Conclusion

Historically, compliance audits have been performed for compliance reasons and focused on validation of controls, policy and process improvements. Vendor Contract Compliance Assessment is a compliance & performance management tool for effective contract management. Client organizations are now realizing that a valuable by-product of the contract compliance audits are the cost recovery/savings, risk mitigation and vendor performance.

An effective vendor management program built on this contract compliance assessment framework will provide a leading edge to client organization. The vendor contract compliance audit provides you a feedback loop mechanism with deep insights, knowledge and greater degree of managing the controls over the relationship partners in order to meet your strategic sourcing objectives.

In summary designing/redefining and implementing an effective vendor management office (VMO) for client organizations will add significant value through effective relationship management, financial management, improvised governance across CPO/CMO/SVM/VMO, and efficient risk management by enabling and leveraging the strategic value of your sourcing relationship partners through-out the contract life cycle.

Governance Matter. Perfecting Partnership. Delivering Value.

Energica's Vendor Contract Compliance Assessment (NAVIGATOR^{VT}) helps clients identify outsourcing engagement value leakages. Regardless of the outsourced process, there are often inadvertent mistakes made commencing from contract creation, amendments, PO processing, CLM processes, risk management, governance till invoice processing. If the value leakage not identified in a timely manner, cannot be recovered and may continue to grow with the unknown risk. Energica's Vendor Contract Compliance Audit (NAVIGATOR^{VT}) focuses and improvises your overall CMO/CPO/VMO efficiency, vendor performance, contract compliance, risk management and resulting an enduring partnership with your service providers.

Energica's Vendor Contract Compliance Assessment (NAVIGATOR^{VT}) methodology varies depending on the size and scope of the client's outsourcing contract(s). Energica considers several environmental factors when evaluating the scope of a vendor contract compliance audit project, including: the number of deals, spend, geography, service provider, maturity of the relationship, degree of CMO reporting, pricing structure, business unit - the number of services or resource units, maturity of the contract monitoring processes, and the number of months of historical data.

Contract Management Services

Energica offers and executes the following Contract Management Services to our clients across the globe in a unique service delivery model from India in a cost effective manner.

- VMO Vendor Contract Compliance Audit
 - Contract Compliance Reviews(Compliance, Performance, Cost Recovery & Risk)
- VMO Contract Management Compliance Roadmap
- VMO Contract Management process assessment and Improvisation
- VMO Contract Management Product Selection (Software) and Implementation
- VMO Contract Governance & Admin Services.



How Energica can help?

Energica ASPL offers IT Vendor Management Services to the outsourcing clients across the globe. Energica team has very rich & practical experience across sourcing and vendor management value chain. Energica can help you achieve your organizational goals through objective and experience advice with a unique service delivery model from India.

For further details, Please Contact **Ramesh Somasundaram**, Energica ASPL, at +91 99620.55678 or write to ramesh.somasundaram@energica-global.com. For more information, please visit www.energica-global.com.

¹CMO/CPO/SVM/VMO

CMO - Contract Management Organization

SVM - Sourcing & Vendor Management Organization

CLM - Contract Lifecycle Management

CPO - Central Procurement Organization

VMO - Vendor Management Organization

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