THE TEN TOP INDICATORS THAT IT'S TIME FOR A CONTRACT COMPLIANCE AUDIT

Organizations increasingly rely on multi-year contracts to manage critical business functions. Sometimes the greatest risks are those that go undetected over long periods of time. Undetected non-compliance associated with these multi-year contracts is all too easy for organizations to overlook, and can quickly erode the organization's earnings per share.

Contract compliance is much more than just ensuring contract terms and conditions are being met. An audit can uncover overpayments or under-reported revenue, unrecorded liabilities, and missed savings. These savings quickly add up to substantial margin enhancements.

Being aware of risk indicators is paramount when deciding which contract to audit. There are a number of scenarios and indicators – either intentionally or unintentionally – that signal that it's the right time to bring in an experienced auditor.

Following is a top 10 list of these indicators, as provided by SC&H Group:

1. **You're making a major spend or investment.** Whether you are a manufacturer building a new production facility or a technology company launching a global advertising campaign, these investments are critical to the organization's strategic objectives. Prudent management of contract compliance at the inception of these investments will help ensure their ultimate success.

2. **Your contract terms are complex.** It is easy to understand that the more complicated a contract, the more difficult it is to comply with the various terms. Dynamic pricing and complicated calculations require careful scrutiny and regular oversight to avoid margin erosion and ensure carefully negotiated terms are adhered to throughout the life of a contract.

3. **Your organizational structure is decentralized.** When the "ownership" of contracts resides in various business groups, it is very easy for each of those groups to assume that compliance is managed by another part of the organization. Audits provide a unique opportunity to ensure compliance protocols are consistent across the organization, no matter how decentralized the operations may be.

4. **You're thinking about changing suppliers.** Whether the motivation is cost-savings or improved performance, changing suppliers is an excellent time to consider a contract compliance audit. The feedback an audit provides on past performance is enormously valuable and offers an opportunity to clarify or improve contract terms and conditions.

5. **You're experiencing personnel changes.** It's common to lose institutional knowledge when employees leave the company or change roles, especially when those employees were involved in contract management. Performing an audit can ensure that current practices align with contract provisions and also help new contract managers understand the nuances of an agreement they may not have personally been involved with in executing.

6. **You've undergone a merger or acquisition.** If your company has recently been involved in a business combination, chances are that the new organization inherited conflicting contracts with third parties. Managing those transitions is difficult for third parties that previously worked with each company before the business combination. An audit can validate that the third party has accurately applied the most favorable pricing terms, and also identify any transactions occurring outside of the existing agreements.

7. **Your supplier has operational challenges.** Operational excellence and contract compliance go hand in hand. If your supplier is not meeting operational objectives such as KPIs and SLAs, there is a high likelihood that pricing compliance is also lacking. Performing an audit may help identify some of the root causes of the operational challenges and thus contribute to improved operations in addition to the value of any non-compliance identified.

8. **Your supplier is owned or managed by former employees.** Has your company had a senior leader leave the company after 10 or 20 years to become a supplier? Many companies have experienced this phenomenon in services such as marketing, consulting, and contingent labor. Former employees have a high degree of institutional knowledge and can be perceived as an extension of the staff. Invoices from this type of supplier may not be scrutinized as closely as other suppliers, and when issues do arise, they may be difficult to resolve due to existing relationships. An audit can quickly establish the appropriateness of transactions and also provide objective intelligence on the competitiveness of pricing.

9. **You have large transactions with a small company.** Small private companies usually do not have the same business practice standards as larger public companies. They often lack internal controls and best practices to prevent or detect non-compliance. These risks become particularly evident when small companies experience revenue growth that outpaces the development of systems and controls appropriate for the organization's size. Audits can reduce the risk associated with engaging small suppliers and also help those suppliers see the value of investments in control development.

10. **You are the supplier's biggest client.** If your organization is a supplier's biggest client, the resulting service and leverage can be enticing. However, this relationship also brings certain risks due to the potential pressures that the supplier will inevitably encounter. For example, this type of supplier may honor the request of a plant manager to pre-bill an order to help the plant manager preserve budget before the end of the year.

Performing audits of these suppliers can ensure compliant behavior, while also providing a healthy outlet for the suppliers to communicate challenging requests that may be occurring.

For companies to remain viable and competitive, they must rely on third parties. While these third parties are often viewed as an extension of the company's internal team, it is all too easy for them to fall into contract non-compliance.

When this happens, it can drag on return on investment, and drive down overall earnings per share. Fortunately, engaging an independent auditor is well worth the effort, and can yield significant margin enhancements. Use this list to ask yourself, "Am I at risk?" If the answer is "yes," then it's time to bring in an independent, experienced firm to audit your contracts.