



THE TRUTH ABOUT CONTRACT COMPLIANCE AUDITS: DISPELLING THE MYTHS

HOW SENIOR EXECUTIVES ARE SEPARATING FACT FROM FICTION TO IMPROVE TRANSPARENCY, EFFICIENCY, AND SAVINGS

INTRODUCTION

A contract compliance audit is a powerful tool for senior executives. With today's rising competitive and cost-cutting pressures, a well-executed audit can help executives to recover overpayments, increase supplier transparency, improve communication and processes, and strengthen internal controls.

Many organizations are fully embracing the use of contract compliance audits. However, according to a recent Aberdeen Group Research [report](#), some organizations are holding back. The reason: widespread misconceptions regarding audit requirements and results.

Fortunately, times are changing. Many senior executives are separating fact from fiction, arming themselves with the right information to make sound audit investments. Specifically, they are overcoming seven key myths—allowing their organizations to realize the substantial short- and long-term benefits of contract compliance audits.

MYTH #1

AUDITING A SUPPLIER WILL HARM THE RELATIONSHIP

Although the U.S. economy has steadily improved since the global recession, most businesses have continued their commitment to cost-reduction initiatives. In fact, 63 percent of companies initiated a cost-reduction program from 2012 to 2014, according to a [Alix Partners global executive survey](#).

Since contract compliance audits typically increase efficiency and recover 2-4 percent of the transaction values audited, they would seem to be an obvious means for meeting cost-reduction goals. However, some companies worry that the audits will irreparably harm their valued supplier partnerships.



FACT

Contract compliance audits increase transparency and foster communication, which in turn, enhances trust and strengthens relationships between a company and its suppliers.

Both parties to a contract have a stake in its success. By ensuring that the company's requirements and goals are fully aligned with the supplier's expectations, audits improve mutual understanding, minimize mistakes, and support the successful delivery of products and services. The company gains assurance that the specified terms and costs are being followed. Meanwhile, the supplier confirms its ongoing compliance with the contract terms, which can further support its relationship with the company.

MYTH # 2

AN AUDIT WILL DISRUPT SUPPLIER OPERATIONS

As a result of onsite visits and other requests and activities, some companies fear that contract compliance audits will distract supplier personnel and potentially delay delivery of goods and services.



FACT

When a contract compliance audit is performed by an experienced auditor, day-to-day supplier operations are generally not interrupted.

Auditors with deep contract compliance knowledge are skilled at maintaining order and minimizing disruption to a supplier's staff and operations. During audit planning, they develop and communicate a clear process and timeline to supplier personnel. Further, they usually limit the involvement of key operational personnel, instead leveraging support from the supplier's back-office finance department.

MYTH #3

AUDITS REQUIRE SIGNIFICANT TIME AND SUPPORT FROM COMPANY STAKEHOLDERS

Some companies believe that effective corporate compliance audits demand a considerable time commitment from company stakeholders. As a result, potentially valuable audits are often postponed or deprioritized.



FACT

An experienced auditor will generally require less than three hours of stakeholder support per audit—a time investment more than offset by the potential for cost savings and process improvement.

A typical contract compliance audit will include a one-hour stakeholder conversation to review and sign off on audit specifications before work begins, an hour to provide updates during the audit process, and an hour to discuss results once the audit is complete. Additional stakeholder support is required only on rare occasions, such as when substantial errors are identified.

MYTH # 4

AUDITS CAN BE PERFORMED ONLY IF THE CONTRACT CONTAINS AN AUDIT

When a supplier contract does not include an audit clause, some companies believe that they forfeit their right to such an audit.



FACT

While a well-crafted audit clause guarantees access to the necessary supplier tools and records, the existence of a continuing supplier relationship is usually sufficient to conduct a thorough contract compliance audit.

Suppliers nearly always cooperate with an audit request when there is an ongoing relationship, as the audit is a way for them to build additional transparency and trust with the company. In addition, most suppliers recognize that an audit offers opportunities for both parties to improve their processes.

MYTH # 5

MOST BILLING ERRORS ARE THE RESULT OF INTENTIONAL FRAUD

According to a recent Kroll Global Fraud [Report](#), one in five organizations were victimized by vendor, supplier, or procurement fraud in 2015. These experiences, combined with a number of recent, [highly publicized cases](#) of procurement fraud, have caused speculation that most billing errors are the result of intentional fraudulent activity.



FACT

Most invoice and payment errors are the result of a misunderstanding of intricate contract terms, an unintentional oversight in manual billing processes, or programming glitches.

While it may be comforting to know that most invoice and payment errors are unintentional, they are nonetheless costly—and extremely common. For instance, a recent Institute of Finance and Management report found that 3.6 percent of supplier invoices have errors. Fortunately, an experienced contract compliance auditor can pinpoint errors and their possible causes, then recommend enhancements to internal controls that reduce future errors.

RESOLVING AUDIT FINDINGS REQUIRES LEGAL ACTION

Some companies are discouraged from embracing contract compliance audits due to a belief that resolving audit findings will be burdensome, requiring legal or unilateral actions, such as credit offsets.



FACT

Since most billing errors are unintentional, legal or unilateral actions are exceptionally rare.

The most common resolution to findings of inadvertent errors is a negotiated settlement, which is mutually agreed to by both parties. The company-supplier relationship is strengthened, with process improvements and contract clarifications that ensure future alignment and compliance.

MYTH #7

AUDITS MUST BE PERFORMED BY THIRD-PARTY AUDITORS

Given the resources and expertise required for a successful contract compliance audit, some companies believe that audits must be performed by independent auditors.



FACT

Unlike financial statement audits, contract compliance audits can be performed by in-house personnel.

Since internal personnel are already familiar with company processes and controls—and have earned the trust of company management—many organizations use these resources to conduct contract compliance audits.

However, while internal resources are an option, many companies are recognizing the various benefits of engaging an independent, third-party auditor. For instance, many organizations do not have the staff bandwidth or technology resources to successfully conduct such audits in-house. Hiring an outside resource frees up internal staff and reduces the impact on company workload.

Independent auditors also bring a fresh perspective to the contract review process. By objectively assessing internal systems and controls with both the organization and its suppliers, a third-party auditor can often identify unique opportunities for improvement.

Most important, though, are the benefits gained by engaging professionals who focus exclusively on contract compliance auditing, not general business consultants who include contract compliance as one of their many service capabilities. The service specialization and expertise of dedicated contract compliance auditors allows them to most effectively identify ways to improve a company's business processes, produce substantial ROI, and provide outstanding transparency.

Ultimately, by overcoming all seven myths and engaging an independent contract compliance auditor, senior executives are realizing the full benefits of their audit investments. In turn, they are maximizing supplier efficiency, communication, and savings—all of which ensure a powerful competitive advantage.

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