A contract is the cornerstone to any business transaction. In this economic environment, companies that treat all contracts alike often then fail to realize or meet expectations with regard to logistics, services, quality of procured product or service, address embedded risks and often fall short of overall business targets.

Improving the area of contractual controls should be a focus for most companies. In recent studies it has been shown that ineffective control and management of supplier contracts costs businesses $153 billion per year in missed savings opportunities and increased risks. It is no surprise a fundamental part of managing contract risk is clearly understanding your contract in-depth and getting it right while highlighting what-could-go-wrong as a risk management initiative.
The Increased Importance of Contracts As a Risk Management Tool

ABSTRACT

A contract is the cornerstone to any business transaction. In this economic environment, companies that treat all contracts alike often then fail to realize or meet expectations with regard to logistics, services, quality of procured product or service, address embedded risks and often fall short of overall business targets.

In addition to specifying certain quality requirements, contracts also can specify price, quantity to be produced, and services to be provided. Contracts typically specify certain conditions associated with a product or service and combine various market functions while generally reducing participants’ exposure to risk.

Contracts expose a company to unique risks that extend beyond typical controls. However, many companies’ method to managing these risks has been neither systematic nor comprehensive. As the volume and complexity of contracts increase, this is becoming a major risk exposure for many companies.

Types of contract risk that can erode the value of a contract include poor or perverse incentives, bad planning and demand management, ill-informed buying, deliberate contract manipulation, embedded options, elaborate pricing structures, and miscommunication. Still other risk may include poorly managed knowledge transfer leading to loss of intellectual property, inability to act as an informed buyer leading to loss of bargaining power, and loss of momentum leading to increased costs, repeated efforts, and loss of momentum.

Improving the area of contractual controls should be a focus for most companies. In recent studies it has been shown that ineffective control and management of supplier contracts costs businesses $153 billion per year in missed savings opportunities and increased risks. It is no surprise a fundamental part of managing contract risk is clearly understanding your contract in-depth and getting it right while highlighting “what-could-go-wrong” (WCGW) as a risk management initiative.

To protect company and shareholder interests, companies need to be proactive in assessing their contract risks. Companies should consider a periodic operational assessment program of the contract process, assessment of the contract controls and a review of certain key contracts. By taking a proactive approach to contracts, companies help mitigate contractual risks while making improvements that will enhance the business through increasing revenues or reducing costs.
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INTRODUCTION
A contract is the cornerstone to any business transaction. Leading organizations realize, due to continuing efforts to establish adequate governance structures and maintain transparency, that contractual relationships play a crucial role to their internal controls and risk framework. Contracts are usually defined as a written or oral agreement between two or more parties as a binding relationship and a typically enforceable commitment to do or refrain from doing something. In addition to specifying certain quality requirements, contracts also can specify price, quantity to be produced, and services to be provided. Contracts typically specify certain conditions associated with a product or service and combine various market functions while generally reducing participants’ exposure to risk.

In this economic environment, companies that treat all contracts alike often then fail to realize or meet expectations with regard to logistics, services, and quality of procured product or service. Contractual relationships are becoming a focal point for many organizations and those that fail to address embedded risks often fall short of overall business targets. Two, or in many cases multiple, parties have to cooperate, coordinate, and determine whether the initial purpose of a specific contractual relationship is fulfilled. Companies are beginning to realize they need a greater understanding of contractual risks and how to manage these risks.

However, it is important to understand the difference between an agreement and the supporting contract terms and conditions. This demand for effective solutions to deal with the increasing number of agreements that organizations maintain, as well as the growing complexity of contracts, has risen dramatically over the last few years. There is no doubt that contract management is a complex area, seen in most organizations as highly specialist. In others, it is viewed as largely administrative.

These divergent views have resulted in some confusion over the options – and requirements – for managing contracts as a risk management tool. Mounting contract volume and intricacy, coupled with intense regulatory pressure to shore up corporate governance, have resulted in vast concerns regarding contract compliance, as well as the adoption of technology to help monitor and manage compliance issues. It can be hard for management to distinguish between ‘pure play’ contract management and processes for managing risks which may be embedded in all contracts. This lack of clarity seems likely to have been a contributor of great inefficiency and contract visibility problems, inaccurate forecasts, inadequate controls, and increased costs.

THE INCREASING IMPORTANCE OF CONTRACTS AS A RISK MANAGEMENT TOOL
Improving the area of contractual controls should be a focus for most companies. In their recent study, The Contract Management Benchmark Report1 the Aberdeen Group cited, "ineffective control and management of supplier contracts costs businesses $153 billion per year in missed savings opportunities and increased risks." Almost all facets of a company's business are guided by contracts. Globalization and the trend to outsource non-core business processes have also contributed to the increasing use and importance of contracts.

For example, customer agreements, purchases from suppliers and service providers, distribution agreements, and licensing of property are all situations where companies are directly impacted by contracts. As a result, the number of contracts a typical company employs has skyrocketed. Based on estimates from the Institute of Supply Management, the typical Fortune 1000 company has more than 20,000 contracts. Contracts have also become increasingly complex from a legal and technical perspective. As the number and complexity of contracts increases, so does the volume of risks associated with those contracts. As a result, managing risks from non – compliance to default, to misrepresentation with contractual requirements has become increasingly important. However, under most corporate risk management structures, contract risks are often not addressed using a systematic approach.

UNDERSTAND CONTRACT RISKS AND WHY THESE RISKS ARISE
Very often, contract-related problems center on the lack of transparency between parties. This fundamental contract problem could arise for several reasons. One party may be reluctant to provide information for confidentiality reasons, while another may not have personnel at the proper level or skill to oversee the contract commitments. Other reasons may include inadequate or constrained processes and systems necessary to generate the desired information.

THE INCREASED IMPORTANCE OF CONTRACTS AS A RISK MANAGEMENT TOOL

Contracts may be complex but the dynamics that govern their creation are simple: one side wants the largest amount of revenue, the other the smallest expense. Regardless of the values attributed to your contractual position, one lesson is vital - the value of a contract is realized only after it is signed. One issue holds true - tuck your contracts away in a drawer and you could not only lose out on benefits you've sought to secure, but also increase your risk and limit performance. You could be opening yourself up for a multitude of new risks.

Types of contract risk that can erode the value of a contract include poor or perverse incentives, bad planning and demand management, ill-informed buying, deliberate contract manipulation, embedded options, elaborate pricing structures, and miscommunication.

Other areas of risk may include failure to monetize high value services appropriately resulting in revenue leakage and cost overruns, failure of the contract to meet the business needs resulting in scope creep and quality failures, and loss of competitive edge to personal reputation leading to damage to business.

Still other risk may include poorly managed knowledge transfer leading to loss of intellectual property, inability to act as an informed buyer leading to loss of bargaining power, and loss of momentum leading to increased costs, repeated efforts, and loss of momentum. Worst yet your organization may be stuck with a bad deal resulting in a financial burden impacting ongoing organizations.

It is no surprise a fundamental part of managing contract risk is clearly understanding your contract in-depth and getting it right while highlighting what could go wrong (WCGW) as a risk management initiative. You also need to engage with the end users of your contracts to ensure they fully understand the terms of the contract and how it is intended to operate.

But how do you make sure the contract delivers as you expect? The answer comes from the information your capture regarding the terms of the contract and the strategic objectives leading to the contractual relationship in the first place. How often do you review your contracts and what have you discovered? How do you get the information you need to monitor and manage your suppliers? How do you measure the value they're giving you? Although purchasing and invoicing may have been accurate at the start, how do you monitor pricing adjustments, price list additions or other amendments that have altered the original contract?

One of the major functions of contracting is to ensure that risks to owners and contractor are identified and managed in a way that both parties are satisfied with the project outcome. While a contract cannot, of itself, make risk “go away”, it can, and should, determine who is responsible for managing each individual risk, and for the consequences should the risk occur. This starts with the first step in effective risk management which is to identify risks that can arise. This requires the benefit of the experiences of those who have “been there-done that” and the exercise of sound business judgment, since not all risks are equally likely to occur, are treatable in the same way, or have the same impact.

Once risk is identified, a structured approach to managing contract risk moves to the issues of allocating the risk to a party or parties to the contract who is in the best position to control the risk with the least amount of financial exposure. Expert identification and allocation of risk allows all parties properly to price the project, and minimizes the risk of unexpected problems rendering the whole project uneconomic for one or other party (or both!).

There is a lot to consider, but look at the benefits of getting it right: revenue enhancement and cost savings. Improved performances from suppliers. Less time wasted for your business. Above all, knowing how to manage your contracts well so you can hone your procurement strategy and be better placed to consider your contracts in the future.

SEVERAL FACTORS CONTRIBUTING TO AN INCREASE IN CONTRACT RISK:

The irony is, under most corporate risk management structures, contract risks are often not addressed using a systematic approach. The basic expectation of a contract is that each participant will honor their commitments in the agreement.

- Increasing trend toward outsourcing of noncore (and in some cases core) processes causes reliance on third parties for various activities. For example, logistics, manufacturing, payroll, and IT.
Companies licensing patents, copyrights, trademarks and other intellectual property to a host of partners to more fully exploit newly developed technology, rather than developing infrastructure for production and sales internally.

The geopolitical, environmental, and regulatory risks related to globalization causing increased complexity with operational and business risks when developing agreements.

Joint ventures and partnerships to enter new markets or launch new products and services have become commonplace with an ever growing number of business affiliations and franchise businesses.

The static nature of a contract versus the ever-changing business environment.

The increasing speed of change in today's businesses increases the likelihood of non-compliance occurring while the processes, personnel, and controls in place at the inception of the contract have changed.

Procurement/Sourcing departments are looking for ways to maximize business relationships.

The increase in globalization and procurement of international contracts combined with the growth in fraud awareness and the need for stronger corporate governance.

Typically companies face one or multiple issues referenced above causing significant risks related to their contractual relationships. These issues span functional areas of the company, making it difficult for the organization to address them effectively. In addition to these factors, the inherent nature of the contracting process increases the likelihood of non-compliance. Most organizations have strong internal controls around the initiation of contracts. But many of them do not always have a similar focus on the administration and risk management phases of contracts.

During the initiation phase, the finance organization reviews the business terms for accounting and financial implications. Legal departments are required to review terms and conditions to verify no undesired liabilities, legal obligations, or limitations exist. In addition, depending on the materiality nature of contract, an outside auditing firm may also review certain business terms.

Another risk factor is that typically the initiators of contract are usually not the administrators of the subsequent contract. It is typically likely that there is no formal knowledge transition process between the initiators and administrators. This knowledge gap between the initiators and administrators increases the likelihood of non-compliance. As a result, managing the risk of non-compliance with contractual requirements has increased in importance.

In order to minimize inadvertent or intentional non-compliance, both parties need to establish systems and processes to monitor compliance with contractual commitments and to share information. This compilation, processing and dissemination of contractual information relies on an open and free exchange to capture, analyze, and quantify contract risks which helps each party monitor the status of the relationship and identify areas of potential non-compliance and or risk.

**THE SIX STAGES OF A CONTRACT’S LIFE**

The first step in managing your contracts from beginning to end and ensure that all obligations, milestones, and compliance requirements are met is to Understand the Six Stages Of A Contract’s Life. This simple diagram may make the difference in the ability to avoid costly financial penalties and litigation. As a result, your organization can reduce contract cycle time even as you improve efficiency and mitigate risk.

By treating contracts as information sources rather than text or images, organizations can streamline contract creation from standard clauses, tracking changes, and managing risks. Leading organizations advocate the creation of a centralized contract repository -- with an industrial strength search engine which eliminates rekeying of information and automates, simplify and standardized the contract process.
The Increased Importance of Contracts as a Risk Management Tool

By understanding the stages of a contract's life, management can streamline approvals (e.g., standard terms), protect margins, improve data accuracy, manage contract risks, and promote compliance. Management can also measure key events like change requests, cycle times, approvals, etc., to identify opportunities for improvement.

More customized business contracts may require new software applications to generate, negotiate, and manage them. At ProSidian Consulting, we call these applications contract life-cycle management (CLM) systems because they are designed to manage all the stages in the life cycle of a contract. A typical customized contract goes through six stages in its life, with CLM applications and processes supporting each stage. The Six Stages Of A Contract's Life are as follows:

1. **Contract Drafting.** A contract draft first must be created by assembling typical clauses appropriate for the specific contract from a library of terms and conditions approved by the legal department. It is also important to work with or interview appropriate subject matter professionals and key stakeholders party to the contract to help the user determine which clauses are most appropriate. The draft contract should be a Microsoft Word document (or equivalent), as Word is the most common editing tool used. The draft contract should be approved by both legal and business people.

2. **Contract Negotiation.** Once the draft contract has been prepared, it is then submitted to the counterpart(ies) for feedback, comment, and corrections. This includes exchanges of proposals and counter-proposals to find the right language. This contract negotiation phase involves back-and-forth between the parties to reach mutually acceptable terms and conditions for the relationship. It is advised that both parties are allowed to access the draft contract, identify clearly proposed changes to the contract through redlining, support alternative language, and track and identify who made which proposed alteration. Additionally, the status of each alteration through the series of changes must be available and ready to revert to an earlier language if necessary. In the negotiation phase, parties to the contract are advised to take time to review key elements and work interactively (possibly in person) to negotiate key terms and conditions.

3. **Contract Approval.** A negotiated contract still needs to be approved and signed before it goes into effect. Leading organizations maintain policies and procedures related to obtaining contract approval. These policies provide information regarding delegated authority and the approval process required when entering into contracts, agreements, or Memorandums of Understanding (MOU). The purpose of this policy is to ensure that all agreements that bind the organization are reviewed for legal requirements, conformance to policies, and are reflective of good business practices including risk and budgetary assessments.

There typically are no standard approval levels; however, contracts may only be approved by individuals with specific contract signature delegation while ensuring effective compliance with applicable laws and other organizational policies. Typically, organizations maintain a record of individuals who will be responsible for contract signature and a record of delegation is maintained for alternate signatures.

In some instances, additional approvals may be needed. After the document has been approved, the initiating department may collect signatures from the other parties to the contract and all required departmental signatures. The department responsible for distributing copies to the appropriate parties must deliver a fully executed original document to all parties to the contract and agreement.
4. Contract Storing & Repository. After the contract has been signed by all parties, it needs to be stored. Storage in a filing cabinet may be adequate for a static, standard contract (although that kind of storage is not ideal for any company that wants to keep track of all of its contractual obligations, rights, and responsibilities, in order to optimize the business results or simply demonstrate Sarbanes-Oxley compliance). Leading organizations leverage online storage technology for easy filing and fast retrieval of contracts.

Filing cabinet storage is highly inefficient for customized contract that will govern a complex business relationship. In a CLM product, all the paragraphs and elements of a final contract are exported from the Word document into database-structured contract repository. The CLM product should support the search of all contracts and attachments in the repository; secure access with audit logs; and provide predefined and custom reports on the status of contracts in the repository.

This is also an area where appropriate policies may also help manage risks and enhance operations. When it comes to creating policies for handling sensitive data in an organization, who decides? How are those policy decisions made and kept up to date? These are questions of governance typically addressed under the genre of “Information Governance.” Most large enterprises have established IT security policies, responsibilities and procedures for information and technology governance and specifically for contract and personal data.

One consequence of the growing body of laws, regulations, standards, and contractual requirements dealing with protected categories of personally identifiable information (PII) is a heightened awareness of the importance of establishing effective internal governance mechanisms.

In many cases, contract and personal data are mapped to personal data compliance and risk management requirements, which are monitored by a somewhat different group of people, from management beyond procurement and legal departments. Unless contract and personal data privacy is addressed as part of the internal governance process, the organization – and the individuals that deal with it -- may be exposed to some nasty surprises.

Organizations in both the private and public sectors are increasingly held accountable for the proper handling of sensitive or potentially dangerous PII such as health records, Social Security Numbers, bank account and payment card details, credit reports, and background checks. The organization needs to be clear on who decides, and how, key questions such as these:

- Which kinds of PII should be collected in the first place?
- Which categories of PII require particular safeguards or treatment, either legally or because the information is considered especially sensitive by customers and employees, or by the organization itself?
- How should PII be secured?
- Who should be given access to PII, and for what purposes?
- How are individuals informed of events (such as business changes and security breaches) and options (such as opt-in or opt-out choices) that affect their privacy and personal security?
- How should PII and the contract itself be disposed of at the end of its useful life?

Adding privacy to the organization’s governance structure, with constant reference to evolving privacy rules and standards, is one way to avoid costly mistakes and arm the organization with legal defenses in the event of a security breach or a serious privacy complaint. Otherwise, it is ultimately a matter of finding what best fits your organization’s leadership culture – although it may be helpful to compare models from other organizations with similar needs.
5. Contract Compliance & Administration. A contract by itself is good to have; an enforced contract is invaluable. Integration between the contract repository and various transaction applications (such as pricing, configuration, and quoting engines in a CRM application, or procurement and purchasing applications in a supplier relationship management product set) allows these applications to act in accordance with the contract’s terms and conditions.

The best approach to Administration is for the Contract Administrator to become familiar with requirements and obligations and generate a checklist for each of the major tasks identified in the contract. It is safe to say that the best tool currently available to assist the Contract Administrator is a checklist for of key attributes, requirements, tasks, and deadlines detailed for each contract. This checklist provides a baseline for project monitoring and scheduling and serves as a simple reference sheet indicating the status of the contract for efficient and effective contract administration. Options available to implement the "check List" system include loading key attributes in a CLM system or Microsoft Suite (Access) which is available on all computers, and using automatic reminders via email.

The email may also link to all possible contract deliverables and provide automatic posting of final report dates to the contract closeout milestone schedule. Each contract should have a unique id such as a contract number consistently implemented across all the organization's contracts.

By providing appropriate tools for contract administration, the organization can secure better service to our customers and provide more efficient pre-award, post-award, and closeout milestones. Effective Contract Compliance & Administration provides clear and concise documents of contract administration for quality records and a guide of key points to monitor with a checklist individually tailored to each contract.

6. Contract Renewals & Optimization. Contract compliance & administration is the pivot point to assist in contract Optimization, closeout, and possibly Renewals. This stage provides informative data on receipt of various deliverables and/or outstanding issues which links milestone schedules to closeout milestone schedules automatically. Most contracts have time limits and will at some time need to be renewed and renegotiated.

The contract administrator works with key internal stakeholders to keep track of expiration dates, provide alerts ahead of time, and initiate the process for determining whether to renew the contract automatically, renegotiate it, or cancel it. Because a contract defines a business relationship, it helps to understand how that contractual relationship turned out.

Purchasing should conduct post reviews of contracts to insure conformance to policy and to ensure adequate indemnification against possible liability which could occur because of changes in the business climate. Leading organizations establish Semi-Annual Contract Assessment Reviews and report with performance assessments utilizing some color-based (green, yellow, red) scheme. These reports typically highlight variances in cost, schedule, or performance, previously reported contract value, and expiration dates regardless of cause. Explanations regarding variances are provided.

These reports contain a summary of all contracts across key business units KBU’s, and contain a contract description, counterparty names, contract number, Effective Date, Previous Value, total Contract value / % Variance, Total Expenditures/revenues, total remaining balance, and total project cost to complete. Lastly the Contract Assessment Reviews and report provides an assessment using a color-based (green, yellow, red) scheme of Cost, Schedule, Performance, and an overall assessment with discussions based on summary assessment.

It is also important to assess, improve, and monitor risks which may exist in contracts and address any changes which may impact the contract since it was originally put in place by the parties to the agreement. Most Contract Lifecycle Management (CLM) products have analytical tools to help user clients determine whether the contract produced the desired business results. These tools also identify ways that a contract could be changed to produce a better outcome, either on an individual case basis or through general edits to the terms and conditions.
used in multiple contracts.

As contract litigation costs rise, and technology advancements take precedence - wireless, e-signatures, SaaS, a good defense will be the best offense. Increased accountability and a better understanding of the stages of a contract with responsibilities assigned for contract lifecycle management to help protect the brand.

KEY ELEMENTS OF A CONTRACT RISK FRAMEWORK

Leading organizations take broader view of their contractual environment and are work to identify their contract risks within a formal framework. Therefore a formal framework and a structured approach to managing contract risk should be implemented across all contracts maintained in a central repository. The framework is a good practice guide for managing a broad range of contracts. It is particularly relevant for contracts where services are delivered over a long period (five years plus) where customers need to ensure that service levels and value for money are maintained over the duration of the contract. The framework will provide the foundation for guidance on better contract management.

The focus of the framework should be activities to be undertaken during the operational phase of the contract, i.e. after the contract has been awarded and once the service is up and running. This framework has particular relevance to service contracts (covering information and communications technology, facilities management and business processes) where service levels and value have to be maintained and improved often over long contract periods.

The following framework proactively addresses contract risks, by prioritizing the most important risks, providing recommendations for control and process improvement, as well as aligning the proper monitoring procedures.

ELEMENTS OF A CONTRACT RISK FRAMEWORK

Work with key stakeholders to Co-Develop Expectations and have a clear vision of the future state of the contract life cycle. Don’t skimp on support and follow-up training. Key questions to answer include What should Contract Risk Management do for us? Involve all stakeholders in laying out procedures and develop a template for contract review based on each team’s needs. Make sure key members of the organization understand the process to ensure a realistic adoption path.
THE INCREASED IMPORTANCE OF CONTRACTS AS A RISK MANAGEMENT TOOL

Our experience shows that it is not always the largest contracts that should be reviewed or that may have the greatest associated risks. Throughout the process, don’t ignore the impact of effective change management. Clearly communicate the “What’s In It For Me?” to each KBU or stakeholder group that may be responsible for contracts within their sector of the organization. A contract risk review begins with a Risk Assessment with key stakeholders involved to understand the key legal and business risk factors associated with each party and contract type and identify the areas of focus.

A risk assessment approach covers both financial and non-financial contract provisions and typically identifies areas of high impact while considering the likelihood of occurrence. To appropriately evaluate the portfolio, all contracts and associated amendments need to be identified.

This includes both revenue and expense related contracts. It also includes contracts entered into by divisions, business units, foreign subsidiaries, functional area, or any other entity within the company. If there is no contract administration function, or centralized contract repository, a good starting point is the legal department.

There are a variety of options that can be used to evaluate these risks. Higher risk weighting can be assigned to those contracts where the most dollars change hands, or can be assigned to sales versus supply contracts. Ultimately, the appropriate assessment approach will depend on the particular company and the industry.

As the assessment is performed, processes and controls are compared to leading practices to identify improvement recommendations. Often, these Improvements may be implemented immediately and, in many cases, result in revenue enhancement or cost reduction.

To effectively mitigate the risks identified in the assessment phase formal Monitoring Procedures should be implemented. The sheer volume of contracts will preclude the ability to monitor the entire contract portfolio. Instead, it is necessary to weight the risks and allocate monitoring resources appropriately.

For each contract reviewed, it is important to develop and perform compliance verification procedures through systems reviews, data extraction and data analysis. The intent of this step is to verify accuracy, relevance, and completeness of reported information, as well as identify issues and concerns for further testing. The types of analyses will vary depending on the type of contract under review.

As the last step, Communicate Results of the review to key stakeholders such as contractual associates, management, and legal counsel. These results typically include any compliance or monetary findings as well as a summary of improvement ideas.

With many contracts, there may still be inherent risks that cannot be covered directly by company personnel due to lack of transparency or cooperation from the contract party. In those cases, having a robust Contract Risk Management and Compliance program implemented by an independent party to address these risks may serve to reduce these risks to a tolerable level.

GETTING IT RIGHT & OPTIMIZING ON CURRENT STATE

A fundamental part of managing contract risk is to clearly understand the contract in-depth. You also need to engage with the end users of your contracts to ensure they fully understand the terms of the contract and how it is intended to operate.

But how do you make sure the contract delivers as you expect? How often do you review your contracts and what have you discovered? How do you get the information you need to monitor and manage your suppliers? How do you measure the value they’re giving you?

Once again, the answer comes from treating contracts as information sources rather than text or images. By optimizing on the current state of your organization’s contract risk management and compliance programs organizations can streamline contract creation from standard clauses, tracking changes, and managing risks. The biggest question is “Where in the continuum of the maturity of your contractual processes do see yourself?” If as they say “You can’t manage what you don’t measure”, it is imperative you first assess the stage YOU are today and optimize your position based on your organization’s current state of contract lifecycle management.
The Increased Importance of Contracts as a Risk Management Tool

Continuum of Mature Contractual Processes

State of Contractual Processes

Inhibiting
- Ad hoc Rate
- History of surprises
- Limited standard processes
- Missing contracts
- No Acct. review
- No CRM tool
- No formal policies
- Paper Based Approvals
- Using 3rd party Paper
- Verbal contracts

Enabling
- Basic Repository of Legacy Contracts
- CLM Tool in Place
- Contract Files Incomplete
- Minimal Acct. Review
- No Controls Exist
- No Signature Authorization Policy (SAP)
- Security Based Access
- Significant Legal Review

Optimizing
- Ad hoc Acct. review
- Search capable Repository
- Amendments are not filed
- Business Intelligence Capabilities
- Contract Authoring & Clause Libraries
- Electronic Approvals
- Informal controls
- Interview Based Or “Wizard” Authoring Approach
- Min. compliance w/ SAD
- Significant Legal review
- System based Standard Contract Workflows And Approval Processes
- Word Integration

World Class
- All Contracts (Buy/Sell Side) Contracts A Single Repository
- Automated workflow
- Compliance w/ SAP
- Control Testing/Monitoring
- Integration With Spend Analysis
- Near Paperless Environment
- Online contract repository
- Policy & Procedures
- Supplier Portals / Collaboration
- Timely Acct/CLM review
- Wireless Compliance & Support Technology

Best In Class
- Audit / Revision History Capabilities
- Auto-matching Of Invoices And Contracts
- Contract Analytics Enabled
- Cycle Time Tracking
- Integration With Sourcing
- Milestone Based Alerting And Automated Workflows
- Redlining And Documenting Comparisons
- Refined Templates - Legal Shocks Focus To Exceptions Only

What stage are YOU at today?

A lot to consider, certainly, but look at the benefits of getting it right: revenue enhancement and cost savings. Improved performances from suppliers. Less time wasted for your business. Above all, knowing how to manage your contracts well so you can hone your procurement strategy and be better placed to consider your contracts in the future.

Presumably all contracting parties have entered into a mutually beneficial relationship; otherwise, there would be no contract. Even long-term contractual relationships can benefit from a periodic objective review. There is also the common issue that contractual terms negotiated between two parties must be based on trust in each other’s integrity, systems, interpretations and calculations. In this case, one would expect that the other party has taken some steps to be compliant.

However, trust cannot replace good corporate governance. Relying on trust may put organizations in the undesirable position of having to defend against claims suggesting management failed in its responsibilities by trusting an outside party instead of performing due diligence and implementing proper monitoring controls. It is unlikely that key stakeholders will accept as justification that management trusts the other party.

Overall, effective Contract Lifecycle Management inherent in a contract risk management strategy helps you manage the process, assess inherent risks, and measure if our transactions match contract obligations. The concept drives the process, enables Sarbanes Oxley (SOX) compliance, and in most cases is simple enough to automate. The goal is to drive operational effectiveness within a framework of risk and controls to gain competitive advantage.

Good Practice Contract Management Framework

The ProSidian Framework incorporates key activities to be undertaken under each of the 11 contract management areas are set out below. The numbering is not intended to indicate that the activities should be executed in a sequential manner. Indeed, many of the areas and activities are relevant throughout the contract
management phase.

We offer professional contract management guidance. In our process developed, or identified from external sources, it’s also important to note that not all of the 11 areas may be equally relevant to all contracts.

Generally, the developmental and strategic areas and activities become increasingly important the higher the contract risk and the greater the opportunity to add value. The “Contract Management Framework” shown outlines our point of view on how companies should manage their contract portfolio.

**POINT OF VIEW ON QUESTIONS TO CONSIDER**

**STRUCTURE AND RESOURCES**

- Are contract management processes aligned with wider organizational governance processes and risk structures?
- Do regular assessments and evaluations take place to ensure that the cost of contract management activities are justified and proportionate to the benefits obtained?
- How many contracts does your company have and how many different types does your company use? (E.g. Licensing, royalty, distributor, supplier, agency, etc.?)
- Is overall ownership of contract management across the organization clear?
- Is the contract manager role clearly defined and well defined processes in a clear contract management plan?
- Is contract ownership clear, with budget holders, senior responsible owner (SRO)? Can there be continuity of governance?
- Are there planned transitions from tendering/contract award to contract management phases with handover to contract manager?
- Preparing for contract management and providing oversight?
- Who has responsibility for driving organization-wide contract management performance?

**Area 1: Planning & Governance**

- Are hard copy contracts stored, logged and easily accessible when required?
- Are the right people are in place to carry out the contract management activities?
- Are there mechanisms in place for handling administration around contract closure or termination?
- Are there mechanisms in place for identifying key contract ‘trigger points’, such as notice periods?
- Do contract personnel have accurate job descriptions, roles positioned at an appropriate level and salary, and a career path staff?
- Do contract personnel have appropriate delegated authority to manage the contract effectively?
- Does the contract manager have continuity (ideally through involvement during the tendering/contract award processes)?
- Does the contract manager have detailed knowledge of the contract and other relevant issues?
- Does the contract manager have the appropriate skills (specific to contract management & more general commercial expertise)?
- Is a summary and/or contract operations guide typically produced for contracts?
- Is contract management adequately resourced, in proportion to importance of the contract (primarily but not exclusively its costs)?
- Is relevant ongoing contract management information and documentation is retained and managed?
- Is the contract management team balanced with an appropriate range of skills over the life of the contract to meet specific needs?
- Is there regular and ad hoc reporting of contract management information?
- Should there be contract management software for recording key information, to give, for example, search capability
- When managing the physical contract is there a timetable for making key decisions.

**Area 3: Administration**

- Are changes in user requirements captured and considered as part of formal change and contract management processes?
- Are key stakeholders are involved in contract management processes where appropriate?
- Are problem resolution processes well defined and used, and are designed to ensure minor problems do not escalate and cause relationship issues (for example, with a ‘relationships charter’ or similar document)?
- Are service levels agreements in place linked to business needs, understood by the supplier, and monitored by the contract manager and/or end users?
- Are there clear expectations and an understanding of the contract and the services/performance to be delivered (for example, through newsletters or briefings)?
- Are there clear processes in place to handle operational problem resolution and resolve issues as quickly as possible?
- Are there formal performance reviews with suppliers, with documented improvement plans agreed where necessary, covering both operational issues and adherence to key contractual requirements?
- Are there regular structured and informal communication routes between the contract manager and counterparties to the agreement?
- Are there strong internal and external relationships that facilitate delivery?
- Is counterparty/supplier performance assessed using clear, objective and meaningful metrics, linked where appropriate to a ‘Contract Risk Assessment Framework’ for monitoring suppliers?

**Area 4: Managing Relationships | Area 5: Managing Performance**

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- Is service management well structured; are baselines understood by both parties, and suppliers understand the service they are required to deliver?
- Is the performance management comprehensive, objective and provides incentives for the supplier to meet or exceed agreed performance standards?
- Is there a performance management framework in place when the contract is signed?
- Is there a structure for reporting as far as possible on a 'by exception' basis, with supplier self-measurement and reporting where appropriate (with independent checking mechanisms) to alert performance issues?
- Is there regular and routine feedback given to suppliers on their performance?
- Where appropriate, is user compliance with the contract monitored and managed to ensure maximum operational effectiveness and value for money?

Area 6: Payment & Incentives

- Are payment mechanisms documented and well understood by all parties (i.e. incentives, penalties, and non-standard charges)?
- Are payment processes well defined and efficient; appropriate checks and authorization processes are in place for paying invoices?
- Are the costs of the services delivered and contract management costs mapped against budgets and allocated appropriately?
- Are there incentive structures (financial or non-financial) and do they relate to desired outcomes?
- Are there incentive structures and are they well managed and governed, with appropriate checks and approval mechanisms?
- Does your organization perform benchmarking / market testing using contractual provisions to validate and demonstrate value?
- Who ensures payments made in line with the contract and that appropriate incentive mechanisms are in place and well managed?
- Who is responsible to ensure the organization avoids being 'locked in' to onerous commercial terms or embedded options throughout the contract period, such as price escalation or 'compulsory' maintenance payments?

Area 7: Risk Management

- Are contract risks formally identified and monitored regularly, with mitigating actions developed and implemented where possible?
- Are dispute resolution processes are in place, including agreed adjudication procedures, mediation, and arbitration?
- Are there contractual terms around security and confidentiality which are understood and monitored by the contract manager (i.e. issues relating to the security/confidentiality of personal data)?
- Are there contractual terms around termination which are understood and monitored by the contract manager?
- Are there contractual terms around warranties, indemnities and insurance which are understood and monitored by the contract manager?
- Do you conduct contract risk assessments, if so do you tailor your review process based on these tailors?
- Do you conduct contract risk assessments, if so have you categorized the complexity and risks of your different contracts?
- Do you conduct contract risk assessments, if so how many of these contracts would you consider financially material?
- Do you conduct contract risk assessments, if so what is the income, or cost, associated with these contracts?
- Do you conduct contract risk assessments, if so you consider contract risks in designing your audit plan?
- Do you receive contract reporting on a timely basis? What is the source of these reports?
- Does the contract manager monitor the supplier’s compliance with contractual ‘non-performance’ issues (for example, on tax and sustainability targets)?
- Does the contract manager monitor the supplier’s financial health and business performance (including using credit rating agencies)?
- Does the organization include in contractual terms exit strategies to be developed and updated through the life of the contract?
- Does the organization have contingency plans developed to handle supplier failure (temporary or long-term failure/default)?
- Does the organization have contractual/supplier risk management is in place with clear responsibilities and processes?
- Does the organization have escalation and reporting routes in place for risk governance?
- Does the organization identify who is best placed to manage risk and supplier involvement where appropriate?
- Does the organization have a contractual and supplier risk register?
- If you audit your contracts, do you implement process improvements tailored to your audit findings?
- If you audit your contracts, how do you know you have control and are maximizing the effectiveness of your controls?

Area 8: Contract Development | Area 9: Supplier Development

- Are processes in place that clearly lay out the governance of contractual change – who needs to approve what and how it will happen – with a focus on effective and prompt change implementation?
- Are there clear processes for the management of minor changes and contract variations that focus on the cost/effort being proportionate to importance and value of change?
- Are there dispute handling processes are in place to handle change related issues?
- Are there dispute handling processes are in place to handle different types of change?
- Are there more rigorous processes to handle major contractual changes, including clear approval mechanisms and accountabilities, and controls?
- Are there processes in place for benefits measurement and capture to ensure supplier development is focused on continuous improvement and achieving value for the organization?
- Are there processes in place that clearly set out how supplier development activities will be planned, managed and governed?
- Does the organization provide a clear understanding of the arrangements for any extension of the contract (both scope and time) and related issues?
- Does the contract provide processes to handle commercial (financial) changes to the contract in a fair and structured manner?
- Does the organization effectively use mechanisms such as benchmarking, competitive tendering (for example, for major additional works), or other techniques to test value for money?
- Does the organization have a green and sustainability sourcing plan as part of Contract development and Supplier development? If so, how is it managed and how do you track green and sustainability sourced items?
- Does the organization have a supplier diversity plan as part of Contract development and Supplier development? If so, how is it managed and how are diversity suppliers identified?
- Does the organization have a supply chain development plan (for example, the development of second/third tier supplier performance)?
- How are supplier improvement activities tracked and shared across the organization?
- Is the contract is regularly reviewed as part of Change processes (with a view to updating where necessary) to ensure it meets evolving business needs?
- What is the plan for improvement activities such as supplier operational performance improvement (for example, ‘Lean’ and ‘6-sigma’)?
- What is the plan for joint working or shared activities between the two parties for the benefit of both the supplier and customer (for example, process improvement, shared training, task forces or joint project teams)?
- Where appropriate, are there processes to cover the introduction of new services under the contract, including market testing where necessary?
- Where appropriate, does the organization perform value for money testing of existing services through benchmarking or other processes?

Area 10: Supplier Relationship Management

- How do you verify that contract obligations are fulfilled?
- How do you address non-compliance with contractual terms?
- Are there board level supplier/customer organization interfaces and relationships planned and managed in line with overall supplier relationship management objectives?

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- Does the organization have a program for managing and developing relationships with suppliers?
- Does the organization have a supplier relationship management program that is planned and structured with appropriate governance and senior ownership?
- Does the organization have a supplier relationship management program with benefits realization plan in place for supplier relationship management?
- Does the supplier relationship management program consider all the supplier’s interactions across an organization? (or by division/department only)
- How are knowledge management issues addressed, including knowledge capture from suppliers?
- Is there a clear sense of what value is to be generated for both parties in the supplier relationship management program?
- Is there a focus on capturing innovation from the supplier where necessary or valuable?

Area 11: Market Management

- Does the organization have a plan for analyzing the capacity and capability of potential suppliers?
- Does the organization have a plan for and an understanding of issues such as switching and bidding costs?
- Does the organization have a plan for managing the wider market issues that impact on the contract, but lie beyond the supplier? (i.e. commodity costs)
- Does the organization have a plan for market intelligence to maintain an understanding of the market and of alternative suppliers (to inform benchmarking, contingency planning and re-competition strategies)?
- Does the organization have a plan for market making where appropriate to stimulate competition and ensure the requirements can be delivered by the market?
- Does the organization have a plan to evaluate and review options around delivering services in-house or outsourcing?
- Does the organization have a re-competition strategy and plan is put in place in a timely manner
- Does the organization have a re-competition strategy where the contract manager feeds into strategy development of ‘new’ procurement process?
- Is there and ongoing evaluation of emerging technologies and practices, and identification of opportunities from both immediate and parallel market sectors?

ABOUT PROSIDIAN CONSULTING

ProSidian Consulting, LLC is an integrated consulting services firm focusing on providing value to clients through tailored solutions based on industry leading practices. ProSidian provides strategically diversified business and technical services focused Risk Management, Energy & Sustainability, Compliance, Business Process, Program/Project Management, HR Talent Management and IT Effectiveness (Information Technology/Staff Augmentation).

Linking strategy to execution, ProSidian assists client leaders in maximizing company return on investment capital through design and execution of operations core to delivering value to customers. Our Services are deployed across the enterprise, target drivers of economic profit (growth, margin and efficiency), and are aligned at the intersections of assets, processes, policies and people delivering value.

We bring a deep understanding of strategic business operations. Together with our expertise and that of our strategic alliance partners, ProSidian's insight leverages the capacity to quickly discern the unique nature of the client's needs and deliver results through a structured approach to tailored client solutions. Whether there is a focus on the Back Office requirements, implementing performance evaluation parameters, or streamline processes, ProSidian's client delivery teams help provide solutions that match strategies & results while providing sustainable & profitable returns.

Our approach differentiates us from other consulting organizations and helps us mitigate project risk with a single point of accountability for ProSidian Consulting projects. We understand the business of our clients and work with them to develop and deliver custom-made, innovative solutions that help ensure the smooth and efficient running of their everyday processes by enhancing management capabilities.

ProSidian clients represent a broad spectrum of industries to include but are not limited to Manufacturing, Banking & Financial Services, Consumer Products & Retail, Energy & Utilities, Federal State, & Local Government Agencies.

OUR KEY STRENGTHS INCLUDE:

Our Team - Dedicated resources provide in-depth industry knowledge with contract risk management experience. These professionals focus on the identification of root causes and providing recommendations for corrective action, while being respectful to existing relationships between buyer and supplier. Most of the leaders of this service have been hired from industry and “speak the language” of contracts.

Global Capabilities - ProSidian Consulting utilizes experienced resources that understand the intricacies of contract risk management across multiple industries. With our dedicated Contract Risk Services professionals nationwide, we are able to minimize project delays that are caused by taking time to identify resources needed in multiple locations.

Experience - We have worked with many different companies. Leveraging our experience eliminates re-inventing the wheel and helps us focus on the most significant risk areas. Our personnel are all experienced in
The Increased Importance of Contracts as a Risk Management Tool

operational processes and controls. When findings are discovered, we determine the root cause of the issue and recommend improvement ideas to address the cause. We have seen leading practices and use that information to help improve your processes. We also have a specialized forensic / investigative and dispute resolution.

**Leading Practices** - The use of leading practices and data analytics improves our ability to identify the issue and the root cause to avoid the problem in the future. We have worked with many suppliers in obtaining key data electronically. We have auditors that have experience performing data analytics which allows us to identify areas that will potentially yield the most findings. We have worked in industries ranging from federal Government, Fortune 1000, Military Organizations, and Non-Profit. A perspective that is uniquely suited to add value to your organization’s contracts Risk Management initiatives.

**How ProSidian Can Help**

Effective contract management has emerged as a crucial function to improve profitability, support compliance and manage risk. Yet, many organizations continue to struggle to locate their existing contracts let alone manage them. And onerous legal procedures and shifting regulations make it difficult to create best-value agreements that simultaneously maximize profits and minimize risks.

Our clients typically face multiple issues and significant risks related to their contractual relationships. The issues span functional areas of the company, making it difficult for the client to address them effectively. Some organizations are able to obtain positive results from their revenue enhancement or cost-saving initiatives by addressing and reviewing their contract base and looking for common errors.

We help our clients take a broad view of their contractual environment to identify all contracts. Our experience has shown that it is not always the largest contracts that have the highest risks associated with them nor should they be the only ones considered for review. By conducting a risk assessment, we can identify risk criteria to help create a robust compliance program to mitigate these risks.

Contact Risk Services (CRS) typically focus on reviews of our client’s contract portfolio and one or more counterparties on behalf of our client. With support for all agreement types, online authoring and negotiation features, and automated performance tracking, contract risk assessments, contract lifecycle management strategies, and reporting capabilities, ProSidian helps maximize the value of contractual agreements and improve compliance.

*The ProSidian Consulting Contract Management Solutions Are Designed To Help You Overcome These Challenges By Providing Full Visibility Into Contracts, Enhancing Compliance And Reporting, And Streamlining The Contracting And Administration Processes.*

**CONTACT US**

Do you need any additional resources/information to help with your contract efforts?

Contact us today. Our firm offers a range of options to meet the needs of our consultants and clients.

Our vision is to be recognized as the trusted business advisor to clients in the markets we serve.