

**IS YOUR CHARITY MANAGING ITS SUPPLIER CONTRACTS AND  
LICENSING AGREEMENTS IN AN EFFECTIVE WAY?**



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**PRESENTATION DECK FOR CFG CONFERENCE  
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# Today's Presenters

## Introductions



**Milan Vranic**

Contract Compliance Director within HW Fisher's Forensic practice, specialising in commercial assurance, contract improvement & compliance, supplier management and third party risk advisory services.

The key focus of Milan's role is designing and implementing supplier compliance and commercial assurance programmes, and working to add value to clients by identifying financial recoveries, process weaknesses, operational improvement opportunities, and by providing greater transparency through managing third party risk and improving supplier relationship management.



**Martin Smith**

Over 20 years experience in the pharma industry with AstraZeneca as well as a further 10 years in the chemicals industry.

As a finance professional, Martin brings extensive leadership experience and exposure at board and C-Suite level and has operated across AstraZeneca's commercial and research & development organisations.

Brings a very client focused perspective having led a number of complex transformation programs for AstraZeneca and understands how to be effective in different organisational contexts.

In his most recent role at AstraZeneca Martin conceived, developed and led a programme to identify cost saving opportunities across the organisation using a data-led, hypothesis driven approach, utilising innovative analytical techniques to uncover new opportunities. A material level of savings were, (and continue to be) delivered and incorporated a commercial assurance programme including contract and royalty agreement audits.

# What do we mean by Contract Compliance?

1. Identifying ongoing contractual relationships where there may be a gap between the agreed terms & conditions and actual practice.
  2. Employing auditing and detailed data management techniques and overlaying a commercial mindset to identify and value the differences.
  3. Working with both parties to:
    - i. explain the differences identified, providing evidence to justify as well as support the valuation.
    - ii. “correct” the ongoing contractual relationship and to agree amounts to settle the retrospective errors.
- In many companies a contract compliance programme is a routine and accepted part of normal business relationships.

# Contract Compliance

## Why Charities and Not-for-Profit Organisations would benefit from implementing a Contract Compliance audit programme?

1. Help with the increasing pressure on the financial sustainability of charitable organisations.
2. Facilitate enhanced scrutiny on how money is spent, exactly how much is spent and who charitable organisations partner with.
3. Gain greater transparency in contractor relationships.
4. Improve the quality of contracting and providing insight into further operational cost saving opportunities.
5. Identify and recover excess payments to the supplier.
6. Based on the findings, make immediate operational savings in ongoing contractual relationships.
7. Financial recoveries ranging from **0.5% - 1.5% of spend** associated with a 'median / average' supplier, to as much as **2-8% of the total spend** for some candidates selected based on levels of control.
8. Operational improvements stemming from contractual agreements which are better managed, up to date, streamlined, transparent & easy to monitor, ultimately delivering maximum value for your organisation.

# Contract Compliance

## What is involved in a Contract Compliance Supplier audit?

- A thorough supplier audit involves:
  - Detailed review of the contractual documents which govern the relationship and financial terms.
  - Interviewing stakeholders to map out the procurement-to-pay end to end process and identify past issues.
  - Extensive data analysis across all the key audit testing areas (using primarily suppliers' data) to build-up an insightful picture of the trading relationship.
  - Leveraging past experience and insight to identify likely areas for discrepancies.
  - Conducting the audit to quantify errors fully and convert into recoveries & settlements, and in addition, recommending additional process improvement opportunities to improve contract management & service delivery.

# Contract Compliance

## Royalties & Licensing considerations for charities

- Many charities allow companies to make products using their brand through a Licence Agreement.
- For some charities this generates material level of Royalties.
- Typical audit findings include:
  - Incomplete reporting: e.g. misallocation of SKUs, manual extraction of sales data and system set-up errors.
  - Inaccurate reporting: e.g. incorrect royalty rates and royalty report calculation errors.
  - Deductions: e.g. deducting unauthorised discounts.
  - Non-compliance: Sales made out of Territory or Term, Unauthorised Products, Unapproved Products, Products inconsistent with Charity image or purpose.
- This work will ensure that you're maximising your revenue and protecting your brand and charity name

# Contract Compliance

## Why are errors, findings & recoveries commonplace?

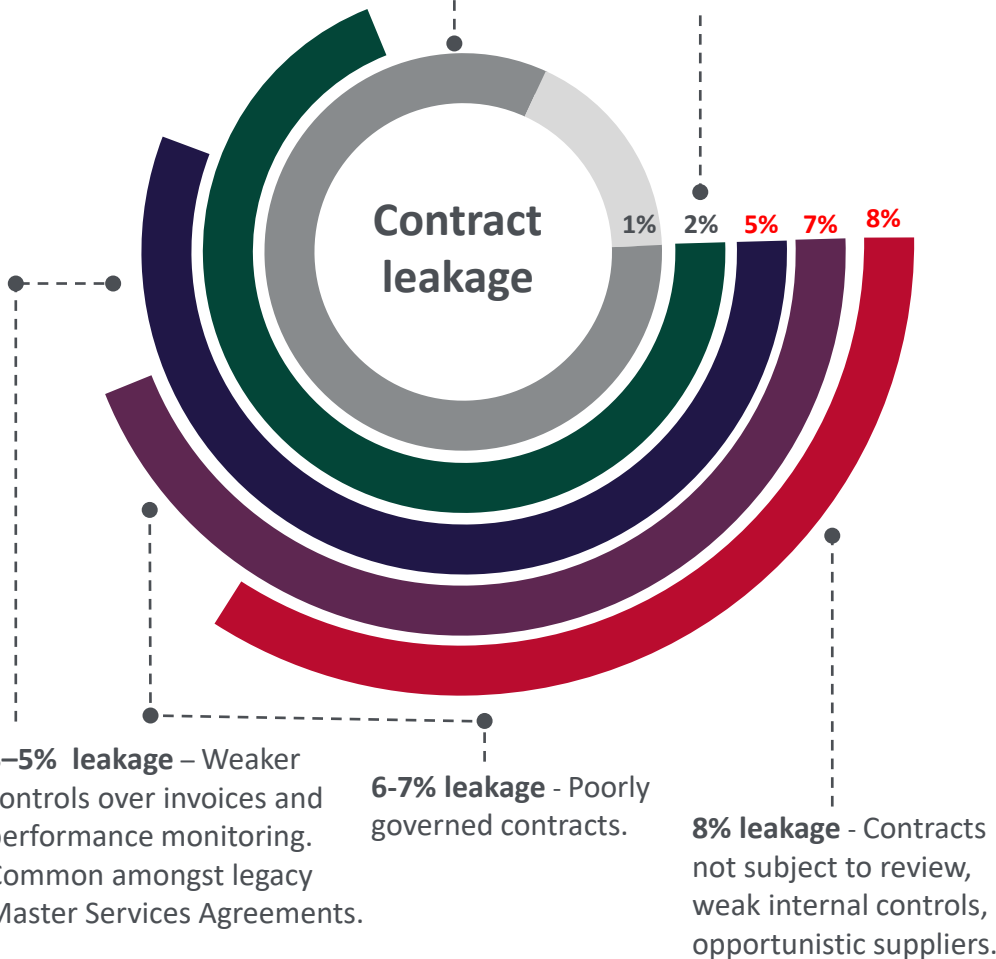
- Most organisations often have dynamic business relationships with suppliers which can outgrow arrangements in place.
- Relationships are often governed by multiple complex contracts & undergo subsequent amendments.
- The contracts can be complex, especially with regards to e.g. pricing structures / rebates / favoured customer clauses.
- The volume of charges and line items which the invoices are comprised of is also very high. High volumes = high risk.
- The contracts often contain a number of grey areas which are open to interpretation. Interpretations = high risk.
- Stakeholders & personnel managing the contract and supplier relationship also change.
- Over the contract lifecycle there is a weakening of appropriate controls & monitoring mechanisms.

# Contract Leakage & Risk Areas

The extent of contract leakage is strongly linked to the strength of internal controls, management of complex contracts and existing levels of contractual risk

**0% leakage** – No contract complexity, no errors in invoices.

**0.5–2% leakage** - Well governed contracts. High degree of control over supplier payments.



We typically examine the following high-risk areas within contracts to identify overcharges and errors:

1. Rates not aligned with prescribed rate/pricing schedules
2. Application of discounts and eligibility of bonuses
3. Foreign currency conversion / inflation clauses
4. Missing credit notes
5. Failure to comply with most favoured pricing clause
6. Inappropriate application of volume rebates
7. Cost plus terms not complied with
8. Advanced / estimated payment mechanisms
9. Subcontractor & other pass-through costs overstated
10. Inappropriate SLA / KPI reporting



# Case Studies

Martin Smith designed & implemented a supplier audit programme for a global pharma as part of a company wide finance transformation initiative – initially piloting a series of audits which ultimately delivered recoveries and future savings in excess of \$50M. Below we set out real-life, actual examples of errors and findings, within supplier categories both in the R&D & commercial space.

Detailed Case Study	Shipping, Logistics & Distribution Audit
<b>Audit focus</b>	<ul style="list-style-type: none"> <li>Two distinct levels in the agreement – 1. Master Services Agreement (MSA) and 2. numerous Statements of Work (SoW).</li> <li>No finding auditing Invoices to SoW (traditional approach).</li> <li>Many material findings auditing invoices to MSA.</li> </ul>
<b>Exchange Rates &amp; Currency</b>	<ul style="list-style-type: none"> <li>Average vs. spot vs. bank reference rate inconsistencies.</li> <li>Invoicing currency variations.</li> </ul>
<b>Inflation Rates</b>	<ul style="list-style-type: none"> <li>Timing of applying agreed interest rate / price increases.</li> </ul>
<b>Pass through costs from 3rd parties</b>	<ul style="list-style-type: none"> <li>Over-reported / non-contractual pass-through costs charged.</li> <li>Volume discounts retained.</li> <li>Insufficient records maintained to allow verification of charges.</li> </ul>
<b>Pricing</b>	<ul style="list-style-type: none"> <li>Detailed reconciliation to price lists, volume rebate agreements.</li> </ul>
<b>Most Favoured Customer</b>	<ul style="list-style-type: none"> <li>Accurate at the time of original contracting but quickly became out-of-date.</li> </ul>
<b>Operational decision transparency &amp; outcomes</b>	<ul style="list-style-type: none"> <li>Examples include choice of transportation method (air v road), 3rd party contractors used, stock-holding levels etc.</li> </ul>

Supplier spend categories	Examples of Contract Compliance recoveries
<b>Facilities Management</b>	<ul style="list-style-type: none"> <li>Reactive maintenance charges are inaccurately applied.</li> <li>Non-contractual material mark-ups are applied to costs.</li> <li>Limited control over who is able to authorise FM spending.</li> <li>Sub-contractor mark ups not consistent with contractual terms.</li> </ul>
<b>Outsourced Services</b>	<ul style="list-style-type: none"> <li>Incorrect reporting of KPI's and non delivery of service levels.</li> <li>Incorrect calculation of fees charged.</li> <li>Recovered fees are not passed on appropriately.</li> </ul>
<b>Staffing Agencies &amp; Providers</b>	<ul style="list-style-type: none"> <li>Inconsistent application of staffing rates</li> <li>Inaccurate input of hours.</li> <li>Incorrect calculation of commission of agencies.</li> <li>Volume rebates/discounts not applied by the agencies.</li> </ul>
<b>Logistics &amp; Distribution</b>	<ul style="list-style-type: none"> <li>Incorrect calculation of driver time, mileage and vehicle depreciation.</li> <li>Non contractual fuel fees applied to costs.</li> <li>Inaccurate allocation of head office costs.</li> </ul>
<b>IT Services</b>	<ul style="list-style-type: none"> <li>Variable support costs may be calculated incorrectly.</li> <li>Unsupported and unauthorised hours charges.</li> <li>Ambiguous agreement expiration terms and conditions create costs.</li> </ul>

# Contract Compliance

## Next steps: how can you identify supplier opportunities and contracts for audit within your organisation?

- Identify the longlist of key suppliers your organisation uses in each category and determine the materiality of historical spend (spend by supplier by category by year).
- Determine the scope of services provided & geography.
- Find out if any previous audits have been undertaken, if at all.
- Identify stakeholders managing the contract and managing the supplier relationship.
- Identify any in-flight activities (e.g. contract due to be renegotiated / put out to tender / terminated).
- Determine the business criticality of supplier / contract & if there is any sensitivity to performing a review.
- Select a portfolio of contracts to audit: simple / complex, commercial / R&D, short / longer timelines.



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