

Contract Life-Cycle Management

Contract Management Solutions Are Now a
Critical Competitive Advantage

Enporion, Inc.

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Enporion • 302 Knights Run Blvd., Suite 950 • Tampa, FL 33602

phone: 813.864.8200 • fax: 813.864.8056 • www.enporion.com

INTRODUCTION

The world has changed. Who calls a travel agent to book airline tickets? Who calls a broker to check on stock prices? Does your company still manage its contracts manually? Contract Life-Cycle Management “could turn out to be one of the most important new business applications of the first decade of the 21st century”. (Andrew Bartels, Forrester, “The Forrester Wave: Contract Life-Cycle Management, Q3 2008”, August 2008)

What is Contract Life-Cycle Management (CLM) and how is technology changing contract compliance and management? CLM is applying technology to contract negotiation, execution, and management in order to standardize, streamline, and ensure contract and regulatory compliance. CLM can standardize and extend best practices and strategies for contract management across your organization.

Contracts are the foundation of any business. Contracts are the lifeblood of one’s business, as today, everything has a contract: buy-side, sell-side, employees, consultants, services, and all other aspects of running a business. A typical Fortune 1000 company has 20,000 to 40,000 active contracts, each with pricing variables, service levels, and many other terms and conditions. How effectively and to what level of detail are these contracts managed? Is it possible to effectively manage the contracts on a sustainable basis without the discipline of information systems?

A contract manager software application can help you automate your business processes, ensure contract compliance, capture valuable data, and provide significant, sustainable long-term benefits. This white paper will help you understand why CLM needs to be viewed as a “core competency” necessary to compete in today’s business world.

CONTRACT LIFECYCLE MANAGEMENT AND ITS ROLE IN BPM

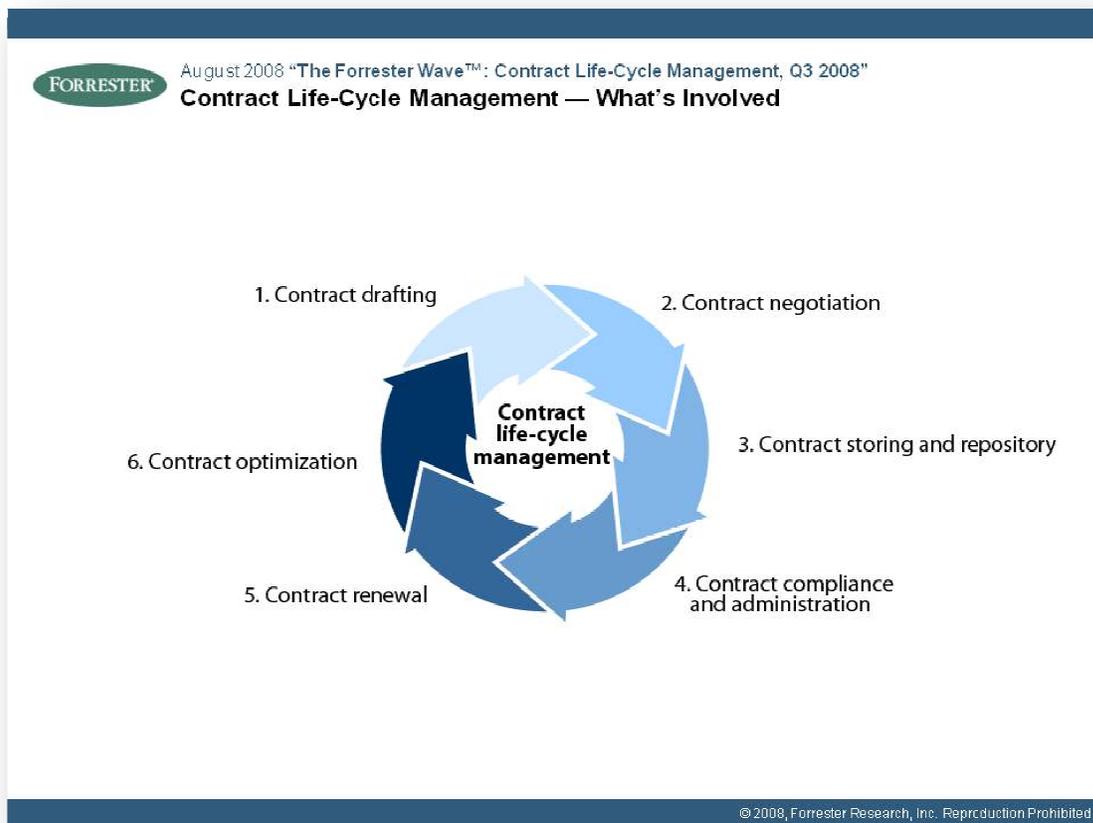
The concept of viewing “contracts” as documents has segued into viewing “contracting” as a “process”. Contracting is the beginning of the process to make sure that the right business partners are chosen, and the outcomes are properly managed and adjusted. All companies have some policies in the various stages of the contract lifecycle, from contract negotiation, to contract creation, legal review, execution, and finally the management and monitoring of the contract at any given time. These policies may be formal written policies, and/or oral policies. The processes enabling these policies may be manual processes, partially automated processes, and be located in various disparate systems. The effectiveness of these processes, which involve “people and technology” are directly related to the success of your company.

Business Process Management (BPM) is an important concept to understand when implementing a Contract Life-Cycle Management (CLM) solution. BPM models human and machine tasks and the interaction between them as processes. It’s the what, why, where, who, and how business gets done. Peteringar, a futurist and an internationally recognized expert on business strategy, globalization, and business process management points out, in connection with BPM: “It’s about the fusion of business operations and information technology to the point of unity. That transformation is well underway on a scale that can only be called the greatest 21st Century business reformation.”

If you are going to automate your company's processes, it's also time to review those processes and see where the process can be enhanced. Put simply; optimize the way work gets done. How long does it take your company to negotiate and finalize a contract? How many people are involved? What are their levels of authority? Are they using pre-approved templates and clauses?

Maybe your company has great processes, but is everyone actually following the process? An automated process, with roles, permissions, security, and alerts will ensure that everyone is in fact following the process. An automated process can be audited in real time, so violators of the process can be identified easily and early on, and corrective measures can be taken. One of the greatest values derived from BPM is gaining real time information at the right moment so that the right decisions can be made while activities are still in progress—or before they occur. This is a critical step in contract management and where an integrated software application can be invaluable. It is the people behind the processes, and the software that enables them to take control, that optimizes the way work gets done.

Specific BPM components must be in place for end-to-end process execution and adoption to occur. Today's integrated software solutions are challenged to provide a flexible, scalable workflow engine with a workable architecture – one that is adaptable to the technology environment and usable by business managers. The architecture should be extensible and customizable on every level—for every process definition and at every process instance.



STANDARDIZED CONTRACTING PROCESS AND PROCEDURES ACROSS MULTIPLE DEPARTMENTS/ORGANIZATIONS

Does your organization have multiple departments/organizations writing contracts and following various contracting processes and procedures? You are not alone. Many organizations struggle with implementing a standard contracting procedure and a contract management software application can help with this struggle. A contract manager application can create boiler plate templates that would help ensure consistent contract creation that has been sanctioned by the organization's legal department. It can instill contract governance rules so that each type of contract follows a pre-defined or dynamic workflow but always ensures it is within the organization's established conduct.

VISIBILITY OF CONTRACT DOCUMENTS ACROSS MULTIPLE DEPARTMENTS/ORGANIZATIONS

Is your organization one that continues to fill-up filing cabinets with paper contracts, where other departments/organizations may not have access without requiring additional work to copy and scan or mail the contract to the appropriate party? Studies have shown that at least 10% of contracts are lost in many organizations. With a contract management system, the contract is always there, within just a few clicks of the mouse. The visibility of contracts and other related documents is critical for the ability to truly monitor contracts and minimize corporate risk and achieve compliance. The ability for all departments/organizations to have visible access to all contracts can increase the usage and adherence of some contracts since they can be easily searched and filtered by commodity, contract type, supplier name, and many other search options with a contract management software application.

AUTOMATED ALERTS FOR TRACKING KEY CONTRACT METRICS

Does your organization have a system for tracking key contract metrics other than the “good ole calendar”? For example, how do you keep track of contract automatic renewal dates? Are you alerted to these key metrics automatically or is your notification when you flip the calendar page? Contract management software can provide automatic notifications when contract tolerances are exceeded. These alerts can relate to spend amounts, minimum and/or limit quantities, pricing and other factors important to your organization. Alerts can also provide automatic notification of expiring contracts, renewals, certificates of insurance and price adjustments and can even be set to escalate when necessary.

AUDITABLE PERMISSIONS FOR WHICH CLEARED OR APPROVED EMPLOYEES SHOULD HAVE ACCESS TO CONTRACTS AND RELATED DOCUMENTS

If someone from another department or organization requests to view a contract, who monitors that the person is cleared or approved to view the contract? Since not everyone in an organization should need access to every type of contract, a management application can provide access to authorized users. To accomplish this automatically, and include the ability to audit for compliance, numerous “role(s)” can be established and privileges assigned, based on user level, department, organizations, etc.

AUTOMATED APPROVAL PROCESSING AND COLLABORATIVE ABILITY

How are contracts approved and signatures obtained on contracts in your organization? Are they manually routed for signature? Is it difficult to keep track of who the next reviewer is and when the contract gets “stalled” unintentionally? How do you conduct internal and external collaboration? An automated solution will allow users to mark contracts as approved, modified, or accepted, define tasks (accept, review, reject, etc.) and indicate whether the contract is current, expired, or pending. It will allow users to redline

documents, both internally and externally during negotiations; all while tracking each version for a complete auditing cycle. Signatures are obtained electronically to eliminate manual processing.

THE ABILITY TO CONTROL MAVERICK SPEND

How is maverick spend controlled in your organization? What are the excuses you hear from your biggest offenders? With a contract management system, one can immediately determine if a contract exists, who the contracted suppliers are, and what the contracted prices are. No longer are “I didn’t know we had a contract” or “I didn’t know I wasn’t supposed to do that” valid excuses! The fact alone that all contracts are now visible to your organization will help reduce maverick spend and with a rich search and reporting function, users will be able to quickly locate a contract and view the pricing and scope of the contract to see if it will meet their needs.

The ability to share contract information across the enterprise enables employees get the information they need quickly, do their jobs more efficiently, and inherently maverick spend is reduced. Why? Because maverick spend usually occurs when employees can’t find the right information fast enough, so any route of purchasing is considered to get the goods and services in a timely manner. ¹

INTERNAL AND EXTERNAL COMPLIANCE

One must think of contract management holistically, not just supply chain contracts, but all corporate contracts. However, targeting supplier contracts is obvious, as an Aberdeen study reports that nearly half of every dollar that a company earns is spent on supplier contracts for goods and services.²

Procurement’s priority is to procure the goods and services for the company in a timely and cost effective manner. As procurement folks know, that is a very difficult job. Another and equally important aspect of procurement is the management of the contracts with a focus on compliance. What is the point of expending all the energy and resources in the procurement of goods and services, if one does not monitor and manage the contracts to ensure compliance? A contract management application provides the tools to monitor and manage contracts for compliance. Being out of compliance can be very costly to companies in the form of unauthorized contract terms, contract leakage, and regulatory penalties.

There are three (3) categories of compliance:

- Operational Compliance
- Supplier Compliance
- Regulatory Compliance

¹ Aberdeen Group, in an August, 2008 report, notes that Best-in-Class companies using CLM see 86% of purchasing transactions compliant with contracts versus only 7% compliance for laggard companies.

² Vishal Patel, Aberdeen Group, March 2006 report, “The Contract Management Benchmark Report: Procurement Contracts – Maximizing Compliance and Supply Performance”

OPERATIONAL COMPLIANCE

Management has a vision and direction, and they have specific policies that are integral to the success and control of the direction of the business. To maintain the standards necessary, the directives must be available, included in contracts, and monitored. Standardization and policy are positive tools for risk management and risk reduction efforts.

How does the company know if employees are acting in their roles in a way that complies with strategic business objectives? The internal standardization of contracts and business processes, together with the internal visibility of the contracts to authorized personnel, will ensure compliance with internal operational policies and procedures. An automated process with roles, permissions, security, and alerts will help confirm that not only is everyone following the company's internal policies and procedures, but that they are following the same process.

Implementation of a contract management solution will also give you the tools necessary to view and monitor the internal policies and procedures and discover if the intended operational and financial results are actually being achieved. For example, have the internal policies and procedures really sped up the CLM time frames, or are there bottlenecks to be addressed, and streamlined? Have the appropriate revenue recognition clauses been inserted into the contracts, and has the company reaped the financial reward it intended?

SUPPLIER COMPLIANCE

Supplier compliance can be enhanced by a contract management application. There is organizational pressure to “drive cost out of the supply chain” while complying with internal and external policies, procedures, and regulations. Without the necessary automated tools, it is an overwhelming undertaking. Interestingly, studies have reported that Procurement organizations believe that 70% of negotiated savings are actually realized, whereas Chief Financial Officers (CFOs) view savings with only 35% realized.

It is crucial to know if the organization is buying from the right supplier, (for example the “preferred supplier”), at the right times, in the right quantities, and at the right prices. Are your contracts being monitored to ensure that there is no overcharging by the supplier, or that all discounts are being applied? Have your rebates been redeemed? If the contracts are not managed in real time, there will be “contract leakage”. **Saving money is an immediate benefit of implementing a contract management solution.**

Has that supplier complied with its deadlines? Has the supplier complied with the heavily negotiated service levels? Is the company's spend with that supplier in accordance with the contract terms and the projections made by the company? When one's spend visibility is generated in real time, then corrections and adjustments can be made in real time. New savings opportunities may be identified, and contracts may need to be renegotiated. The information can be produced not at the end of the quarter, but now, when losses can be minimized or when gains can be maximized. Suppliers can be notified of its breaches, and be brought back into compliance, or be terminated. A contract manager application can assist your company in overseeing supply chain integrity. In today's world, well-managed supplier relationships play a critical role in business success and profitability.

REGULATORY COMPLIANCE

Every company faces a myriad of evolving operational, environmental, and financial regulations. While the alphabet soup of regulatory bodies (FERC, DOT, IRS, FDA for example) may vary from company to company, the current granddaddy of regulatory compliance which is applicable to all public companies is the Sarbanes Oxley Act of 2002 (“SOX”), also known as the Public Company Accounting Reform and Investor Protection Act of 2002. The SOX legislation was enacted to improve corporate governance of American public companies as the result of corporate scandals and fraud in publicly held companies. A couple examples include Enron and WorldCom, among others. The regulatory law was designed to protect investors by improving the reliability and accuracy of the corporate disclosures required by the securities laws. It is one of the single most important changes in securities laws ever made. **The most pertinent SOX sections related to compliance are the following:**

OFFICERS OF PUBLIC COMPANIES ARE PERSONALLY RESPONSIBLE: SOX SECTION 302

Section 302 is the internal controls certification. It requires that the signing officers are personally responsible for establishing and maintaining internal controls, and that the internal controls are designed to ensure that material financial information is made known to such officers. It holds them personally accountable for any financial misstatements. It requires continuous monitoring and reassessment of financial risks and controls to close any loopholes that could potentially lead to misstated financial statements. An automated contract management application provides the necessary tools to periodically evaluate and test the effectiveness of the disclosure controls and processes. It also ensures that the right persons are notified in a timely manner through alerts, ensuring that the right people are made aware of the critical material information and that the notification is documented and auditable.

Failure to comply may expose the company signing officers personally to harsh financial penalties, as well as criminal penalties. Executives convicted of violations of SOX, such as signing off on misleading or inaccurate financial statements, will be subject to fines up to \$5 Million and a sentence of up to 20 years. To grasp the gravity, just think of Enron’s Jeffrey Skilling, now in a Minnesota prison, pursuant to a 25-year sentence.

REQUIREMENT TO REPORT ON INTERNAL CONTROLS OF FINANCIAL INFORMATION: SOX SECTION 404

Section 404 addresses the scope and sufficiency of internal controls. The company must report to the Securities and Exchange Commission (SEC) in its annual report management’s assessment of the quality and effectiveness of its internal controls over its financial reporting. The report covers the policies and procedures for maintaining accounting records, authorizing receipts and disbursements, and safeguarding assets. The contracts of a company on both the buy-side and sell-side, have a significant effect on the financial reporting of a company. An automated application provides a single repository for all company contracts, making search and retrieval easy. Processes change and/or reassignment to different process

owners can be shown through audit trail, and assist management in its assessment of the company's internal control structure and procedures.

**TIMELY DISCLOSURE OF MATERIAL FINANCIAL IMPACTS:
SOX SECTION 409**

Section 409 mandates disclosure of material changes of financial conditions or operations that may have an impact on the company's perceived market value, which material changes must be reported to the SEC within 48 hours. Time is of the essence, so an automated process and notification system is a must to ensure compliance with the Section 409 urgent disclosure requirements. A contract management application can also provide a template from previous disclosures, which can be modified for a quick response to an emerging issue that requires a release.

**ALTERING DOCUMENTS IN AN ATTEMPT TO INFLUENCE LEGAL ACTIONS:
SOX SECTION 802**

Section 802 provides criminal penalties for altering documents. A person may be sentenced to up to twenty (20) years in prison for altering documents with the objective to block or influence a legal proceeding. An audit trail is needed to prove the integrity of documents, should it become an issue. There are restrictions of access based on users' rights and roles, but in addition, a time-stamped audit trail will identify anyone who creates, modifies, or deletes an electronic record, when the action occurred, and the changes made to the record.

An automated contract manager application will help mitigate the regulatory risks and assist in compliance with SOX and the other multi-regulatory environments in which today's companies must operate. The complexities of SOX, urgent disclosure requirements, mandated certifications, personal accountability, and civil and criminal penalties, require the adoption of technology for a business to properly and efficiently comply.

Operational, supplier, and regulatory compliance can be leveraged through technology automation. The efficiency and accuracy necessary bolsters the need for the benefits of management information systems, i.e. software implementation. The controls and data capture provided by the software provide the underpinnings necessary to meet these business requirements.

WHY CLM IS A COMPETITIVE ADVANTAGE

Studies have shown that for each dollar earned by an organization, as much as 80 cents of that dollar can be lost to procurement costs. Coupled with the fact that most of those costs are external expenditures, typically governed by purchase agreements, or contracts, the strategic importance of contracts becomes immediately apparent. Besides the dollars detailed in purchasing terms, there are also risks and liabilities tied to non-compliance with contract terms that could be extremely costly to an organization. These costs are especially damaging, as they can manifest long after a contract has been executed. With all of this business critical data that is contained within an organization's contracts, it is clear that contracts are no longer just an administrative formality or strictly the domain of the legal department. There is significant and valuable data that is often buried and lost within a contract document, and by implementing a contract manager application, this data can be easily extracted in Real time to assist with contract compliance and provide real savings opportunities during renegotiation. More importantly, most of these savings gained through proper contract management are hard dollar savings due to rebates or supplier discounts. With no visibility into the contract documents, this is money that is literally thrown away due to poor contract management.

As spending categories have become more complex, so have the agreements. Agreements can contain terms governing such areas as charges, rebates, discounts, deadlines, penalties, and more. Even more bluntly, these contracts determine how much a business gets paid (or, vice versa, how much it has to pay) and when - fundamental business data. Surveys have indicated that approximately 67% of company revenues were based on contracts. The same survey found that revenue leakage, estimated at 5-9% of revenues, was at the top of the list of concerns driving these organizations toward improved contract management. This is a significant percentage of revenue that businesses believe they are losing because they are not properly managing their contracts, the very documents that are the point of record for this type of information. In order to take advantage of this information it must not only be visible, but readily accessible. If there is a deadline to avoid financial penalty, this information does no good after the fact. The best way to manage information is by capturing critical data electronically so that it is quickly retrieved and can have automated tasks operate on the data, such as automated triggers and alerts.

LEVERAGING SUBSETS OF DATA TO DISCOVER AND APPLY PROCESSES TO FIND MORE SAVINGS OPPORTUNITIES:

With increased visibility of contract terms, a company may discover sets of terms that are only applied to one type of agreement. There may be opportunities for further savings when these terms are applied to other types of contracts. Consider a \$200M spend agreement which offers a 10% discount on contract spend. Reducing maverick spend in this case by just 10% yields \$2M in real savings - a sizable return on a contract management investment. If you wonder if such savings opportunities exist within your organization, consider that spend analysis reports found that only 42% of spending is visible at the contract level. On the flip side is the issue of supplier compliance, that is, meeting certain targets or milestones in order to achieve a discount or rebate. A 2% discount on \$100M spend is \$2M of real dollar savings. Again, these types of savings more than offset the cost to implement a contract management solution. We can easily construct negative examples as well, that is, the failure to comply with contract terms. And, these are generally, in order of magnitude, more significant than the percentages associated

with discounts and rebates. Failure to comply with legally binding terms, may not only result in lost revenues from lost business, but may also result in significant legal costs, damages and a tarnished image. For these reasons, increasing contract visibility is generally regarded as a low risk, high reward proposition.

CONTRACTS HARBOR CRITICAL DATA THAT MUST BE TIED TO REAL DOLLARS

Contracts are strategic documents. This whitepaper illustrates the intrinsic value of a contract as a strategic document by showing ways in which real dollars can be buried within its terms. Therefore, the concept of contract data visibility becomes critically important. If an organization wants to take advantage of the discounts and incentives detailed in contract terms and avoid penalties, people must be actively aware of what is contained within those terms. In fact, in order to reap the real benefits of contract management, an organization must be pro-active – data in the contract must be tightly linked to daily operations. Savings can be had through pro-active supplier management techniques. A software-based contract management solution is the best tool for enhancing a pro-active approach. One of the most important aspects of a software-based contract management solution is a central, searchable repository of all contracts. Given our previous examples, it is easy to see why this one feature is at the top of everyone's list. Being able to perform electronic searches on contract terms or other, indexed information, provides immediate access to the types of data such as that required to verify if a discount should be applied or if a buyer is eligible for a rebate. When the functionality of a searchable repository is combined with an automated tracking or notification system, email alerts, for example, the benefits increase exponentially. Now, users can have the necessary lead time to respond to upcoming events, such as contract renewals or purchasing deadlines, and be armed with critical, relevant information—not caught off-guard.

ENHANCED CONTRACT CREATION TO OPTIMIZE TERMS FOR THE BUSINESS

Contract management software can also assist in several other areas of “pro-active contracting”. Going back to the benefits of increased visibility, it becomes much easier to standardize terms and conditions when the existing contract language is easily accessible for comparison and editing. Rules can also be used to enforce the use of particular language or clauses during contract creation. Using pre-approved clauses significantly reduces contract creation time. Another benefit of being able to access and compare contract documents is that consolidating multiple contracts becomes much easier. When contract information such as expiration and renewal dates become searchable, indexed information, major contract events such as expirations and renewals can be more strategically scheduled and handled.

As with other integrated business applications, a contract management solution has become a necessity for most organizations. The need to capture corporate contract data, whether on the buy-side or sell-side, is practically mandatory with the enactment of the Sarbanes-Oxley Act of 2002 and is critical to achieving hard dollar savings.

CONCLUSION

An organization's proactive management of the creation, execution, and analysis of its contracts, will increase its financial and operational performance, while reducing risks. CLM will be the key to success in the 21st Century. Clearly with a CLM application, contract processes can be streamlined through standardization and visibility. Automation makes the auditing and approval process more efficient. Operational, supplier and regulatory compliance can be noticeably achieved and the impact of capturing critical data from unique agreements can be astounding.

Whether an organization chooses to implement an extensive, robust or basic CLM system, one of the many benefits of a CLM solution is that the savings, benefits, and resulting good governance will be sustainable because of the discipline provided by the CLM application. Incremental savings can be obtained throughout the implementation. Long-term sustainable results are the outcome of a successful CLM implementation.

Contracting as a process through which outcomes can be measured and monitored that will help your company deliver the results needed. Today's highly competitive world demands that CLM become a core competency within your company. The effectiveness of your CLM is directly related to the success of your company.

"Now, companies can enter into thousands of unique business relationships with customers, suppliers, or partners, with CLM solutions keeping track of the unique products to be bought or sold, unique services to be delivered, unique prices to be charged, and unique requirements of each deal. These changes shift CLM products from process automation tools to core managers of business relationships." – Andrew Bartels – Forrester Research

**ANDREW BARTELS, FORRESTER, AUGUST 2007,
"CONTRACT LIFE-CYCLE MANAGEMENT ATTRACTS
NEW ENTRANTS"**