

Effective Contract Management

Most charities will enter into some kind of contractual arrangement for goods or services at some time. Such contracts could take one of many forms and might include service level agreements or other contracts for the provision of charitable services, funding agreements related to charitable activity, specific government grants or agreements with individuals concerning restricted purpose donations.

The effective management of all such arrangements is critical to the effective internal control and governance of any charity. This helpsheet is intended to provide useful suggestions and guidance as to how to make contractual arrangements work in your favour and how to avoid the numerous pitfalls that exist. It should thus prove increasingly useful as we head towards an era of rationalisation in public spending.

The use of the term 'contract' implies a formal and legally binding agreement but this helpsheet is intended to cover any situation in which a charity has a commitment to deliver goods or services of value to another entity.



Map out the extent and nature of the activity

Probably the most important first step in any contractual arrangement is fully ***understanding the terms and conditions***, the specifications included and the impact upon the charities activities and resources. A major risk for any entity is overstretching itself or not fully preparing what is being taken on. Planning is key, but it is not always practical to do this in tremendous detail.

There are a number of ways that this process can be made easier. ***Try illustrating the impact of the contract.*** After reviewing terms and conditions, compile a map of the activity and the implications for the charity. From this map it is also good practice to conduct some risk assessment specific to the contract itself and, where relevant, to update or incorporate this into the charity's overall risk register.

Be clear about the deliverables implied or expressly stated within the contract and ensure that they can actually be delivered. Think about aligning operational objectives/strategic plans with those deliverables. You may also wish to take this a step further and incorporate deliverables into staff's individual work plans/appraisal system to ensure ownership on an individual level.

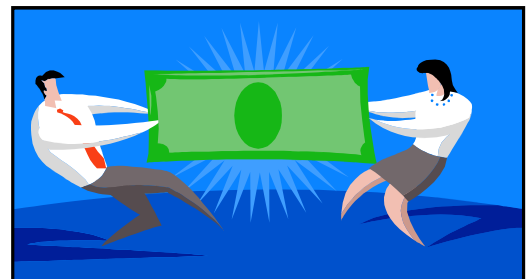
It is also worth spending some time documenting the objectives, motivations, concerns and responsibilities of the contracting body. Remember that the other party to the contract is likely to be increasingly pressured to deliver results (financial and operational) through delivery of the contract. Documenting a clear understanding of this can be effective in influencing negotiations and making sure that you plan effectively for delivery.



Know how you'll measure success

Most critical success factors will be obvious. But it is still very important to **identify and document KPIs at an early stage**. It is usually helpful to be clear about how the charity will actually demonstrate that it has successfully delivered. Failure to deliver on contractual terms can have damaging effects on financial results and future prospects, as well as reputation. Identifying critical success factors and designing performance management arrangements around them, however elementary, will usually have a positive effect on outcomes and reduces the risk of dispute with regard to performance.

Of course, once you have decided how success can be measured you should also **decide how to go about capturing data** to be used as evidence. In most circumstances the answer is to go for the most obvious data and have some elementary (but robust) method of recording results. If you have captured reliable data that demonstrates your fulfilment of agreed terms of conditions, it can be very difficult for the other party to dispute performance. Again, think about incorporating responsibility for KPI's and data capture into individual's personal performance frameworks.



Budget – in as much detail as is practical

One of the most important aspects of planning for contractual delivery is being clear on what activity is included within the terms and conditions and what is not and also what activities are billable as separate items under the terms. **It is crucially important that you understand the overall financial impact on the charity.** Think about whether your own staff truly understand what they are entitled to bill, and what level of service they are bound to deliver, under the terms of the contract and ensure that this information is incorporated into key controls.

Watch out for ongoing commitments - your budget should cover the duration of the contract but should also include consideration of the lasting impact of any changes that have been brought about to deliver the contract. For example, taking on additional staff to deliver increased levels of activity might leave you with surplus human resources in the event that you could not take on temporary staff or utilise temporary contracts. Even capital items which you may retain at the end of the contract might require some ongoing maintenance or security cost.

Getting your apportionment bases right is also likely to be key. You need to establish at an early stage what your direct costs are. That's the easy bit (usually). The more subjective matters involve apportioning other costs in such a manner that they accurately reflect a fair and reasonable charge for utilisation of those activities and resources. Apart from anything else, this apportionment is needed for the purposes of drawing up your SOFA and related notes, but it is also critical from the point of view of weighing up whether the contracted activity is financially viable from the charity's point of view. Of course, we all acknowledge that activities are undertaken not just with a simple view of financial viability, but in the current environment, detailed budgeting is likely to be increasingly important in understanding the true cost of contracts compared to the benefits and the charity's strategic objectives.

Watch out for penalties and other charges included within terms and conditions. Think carefully about how you will avoid them. If there is a real risk that any of these might be incurred then this fact should be clearly incorporated into budget sensitivity analysis and the charity's overall risk register (if material in potential outcome).

Funding for capital items can sometimes create an administrative burden that needs to be considered. Most capital funding agreements will include some kind of requirement to properly record the assets in your books and records and to demonstrate that it has been used for the approved purpose. Your fixed assets register will need to be updated. Remember too that technically speaking, funding for capital assets is often required to be accounted for as a restricted item. Many charities therefore capitalise the asset in the balance sheet matched by a restricted funds balance which is written down each year by the depreciation charged to the SOFA. While this is in compliance with the SORP it is not the only option available and creates an unnecessary administrative burden. SORP 2005 allows the asset to be transferred to unrestricted funds once purchased, as long as there is no ongoing restriction as to its usage.

And finally, but by no means least, **ensure that your cash flow forecasting is fully updated to include the impact of the contract.** This will involve a thorough examination of contracts for proposed payment profiles as well as any hidden items that give right to withhold cash payment in any eventuality.

You should also keep the contract under continuous review. You need to know whether it is working for the charity. This will help you to identify whether, and when, remedial action is necessary and whether any lessons need to be learned for future contracts. It might, in extreme cases, also let you know that the charity is not able to continue with the contract if the terms and financial impact are detrimental to other areas of the charity's responsibilities.



Control billing and debt recovery

We have noted above that knowing what you are entitled to bill under the terms of the contract is key. **Operational and finance staff must understand what activity they are entitled to bill for** and ensure that a full audit trail is documented and retained. There is usually a good reason why bad debt balances arise, and often it is simply a case of poor communication and lack of understanding and agreement over what is being billed. The stronger your records are, the stronger your grounds for challenge are.

Stay on top of aged debtors. Don't let them accumulate! Investigate the causes of unpaid invoices immediately. Apart from being critical to your cash position, it lets you know and understand why problems are arising so that you can make important internal changes to avoid this in future – it may even alert you early on to the potential of financial failure of the other party. By staying on top of your debtors in a professional and helpful manner you can make life very difficult for those who might otherwise wish to 're-negotiate' certain terms once contractual activity has already been delivered – particularly when the passage of time has blurred any understanding of what might have been agreed (but perhaps not documented) between the parties. Enhanced monitoring of debt recovery is now more important than ever.

You might also **think about seeking feedback on a regular basis.** This also makes life difficult for any would-be disputer of contractual terms and entitlements but also allows you to indentify any potential difficulties at an early stage.

Conclusion

"Less from more" - that appears to be one of the new phrases in common use within all sectors, not least the charitable sector; and it's likely to have increasing significance for charities as all sectors prepare for cuts in public spending. This increases the need for all of us to think smarter in terms of the contractual arrangements we enter into with other parties. More detailed review of terms and conditions, more detailed risk analysis and budgeting as well as enhanced monitoring and control are just some of the tools we can use to try to make our contractual relationships work in our favour.

Tell me more...

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