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Auditing Contracts: Are You Getting the Value You Expected?

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Time to Review Your Information Technology Agreements

U.S. businesses spend billions of dollars on information technology (IT) annually. A large portion of IT spending is on software licenses, software maintenance and support, IT consulting, and other related IT services (IT maintenance services). According to Gartner, Inc., an IT research and advisory firm, the worldwide IT services market totaled $763 billion in 2009.[1]

IT spending is also increasing in the health care industry, due both to the need to meet evolving regulatory requirements and because IT is viewed by many as a means to minimize costs over the long term. According to a recent report by PricewaterhouseCoopers, health care providers spent more than $88.6 billion in 2010 "on developing and implementing electronic health records…, health information exchanges…and other [health care IT] initiatives."[2] Moreover, PricewaterhouseCoopers predicts that the most significant health care spending trend for 2011 will involve spending on health care IT (HIT).[3]

GROWTH OF COMPANIES PROVIDING IT MAINTENANCE SERVICES

Even in a down economy, companies providing IT maintenance services announced major deals. In July 2010, HP Enterprise Services announced that it extended a multi-year agreement with General Motors Company (GM) valued at over $2 billion.[4] HP will provide GM a variety of IT maintenance services, including "applications development and management services for product development, manufacturing, business services [and] supply chain [as well as] providing managed mainframe services."[5]

Traditional IT vendors also expect growth in the HIT services market and are gaining entry through acquisi-

tions. In 2009, Dell Inc. acquired Perot Systems, a large HIT service provider, for $3.9 billion.[6] Most recently, in December 2010, Dell Inc. announced the acquisition of InSite One, Inc., which provides cloud-based medical archiving services.[7] One of the biggest, if not the biggest, HIT-related deal of 2010 was the acquisition of US Oncology by McKesson Corp. for approximately $2.2 billion.[8]

REVIEW CURRENT AGREEMENTS: STORIES FROM THE TRENCHES[9]

In many companies, expenditures for IT maintenance services account for a large portion of the annual IT budget. Because of this, the review of existing IT maintenance services agreements is an important component in managing an IT budget. Companies unknowingly may pay substantial (and oftentimes recurring) sums for underperforming, and in some cases valueless, IT maintenance services due to changes in personnel, a change in business operations, or simply because no person or job function is tasked with managing IT agreements. A couple of actual experiences illuminate this issue.

Don't You Already Own That Product?

Prior to engaging new IT vendors, businesses should review their current IT maintenance services agreements to ensure that the services are actually needed and are not redundant given existing agreements. A consulting firm, for example, was hired to help a large bank select a new vendor for an enterprise resource planning solution. After investing lots of time and money into the effort, the consulting firm narrowed the search to two vendors. When the firm was discussing the opportunity further with one of the vendors, the *vendor representative* asked why the bank was not simply upgrading its current system.

As it turned out, the bank paid *millions* of dollars to implement the vendor's system years back, but the project had fallen out of favor with bank management. The bank then had a major staff shake up, and the project was forgotten. The bank had not only purchased the system but also paid *up front* for features that were never implemented; as such, they had a *credit due* to them.

Why Are We Paying This Vendor $1 Million Every Year?

In larger enterprises there is a risk that IT maintenance services agreements may be logged into an accounts payable system and subsequent annual invoices paid without any review of the status of the agreement with the affected business unit. Several years ago we were approached by the IT acquisitions director for a large machinery manufacturer to investigate options under an existing IT maintenance and services agreement that required an annual $1.2 million payment.

Through a review of the agreement and interviews with various personnel within the company, we determined that not only were the nature of the services a mystery, but the underlying software product was *never implemented*. We were able to then renegotiate the agreement, saving the company substantial costs over the remaining term of the agreement.

STEPS FOR REVIEWING IT MAINTENANCE SERVICES

Periodic review of IT maintenance services agreements requires a resource commitment but can generate measurable results through a net cost-savings. The following general roadmap, or some adaptation thereof, may be appropriate for your organization.

1. **Inside or Outside?** First determine whether to form an internal review team or to retain an outside professional to structure and oversee the process. Many companies prefer to hire an outside resource to assess the issues because (a) it frees their personnel to perform their core job functions, (b) rightly or not, outsiders are often viewed as being more "expert" in the relevant matter

and thereby obtain greater cooperation, and (c) an outsider can ask potentially difficult questions without the risk of creating friction among staff members.

2. **Define the Scope of Review.** The scope of review should be clear to the reviewer(s). Determining the scope will allow the reviewer(s) to focus on proper targets and minimize the possibility for the project to become unmanageable. A simple mechanism might involve reviewing all IT maintenance and service agreements requiring an annual expenditure in excess of a certain dollar amount. In general, all IT agreements should be reviewed, including maintenance agreements, licenses (particularly for use of all seats licensed), and consulting services.

3. **Everyone Must Be Invested.** Agreement auditing is a team effort, and anyone with insight into the way a particular product is used within the entity should be available to the auditor(s). It should be made very clear that top management is supporting the contract review effort and that any failure to cooperate will be viewed negatively.

4. **Relevant Issues.** Issues for discussion should include, among others, (a) who is using the software; (b) how often are they using the software and is it performing a needed function; (c) whether the software implementation was completed in a manner consistent with the agreement; (d) whether the software is performing in accordance with its specifications and the company's expectations; and (e) whether the vendor met its maintenance and support obligations under the relevant agreement.

5. **Set a Time Table**. The auditor(s) should set a time table for completing the project to ensure that the contract auditing process does not take longer than necessary. Here, it is again valuable to have an outsider who can devote the attention necessary to successfully and quickly complete this project.

6. **Authority to Renegotiate?** The company should determine whether it wants to give the auditor(s) the authority to renegotiate agreements. It is not enough to find problems; they must be resolved as well. The company should select an individual who it trusts to resolve these problems on its behalf.

Conclusion

Companies are always looking for ways to save money and to use their existing resources in a more productive manner. Reviewing IT maintenance services agreements is a value-creating task because it has huge potential for savings. Additionally, this process lends itself to the possibility of eliminating inefficiencies and corporate waste.

Endnotes:

1. Press Release, Gartner Says Worldwide IT Services Revenue Declined 5.3 Percent in 2009, Gartner, Inc. (May 4, 2010), *available at* www.gartner.com/it/page.jsp?id=1363713.
2. PricewaterhouseCoopers LLP, Top Health Industry Issues of 2011 (2010, *available at* www.pwc.com/us/en/health-industries/publications/top-issue-01-hit.jhtml.
3. *See id.* IT maintenance services are very profitable for vendors. According to Oracle's 2010 10-K report, for example, software maintenance and product support represented 49 percent of total revenues of which 85 percent was profit and represented 80 percent of the company's total profit. *See* Oracle Corporation, Form 10-K for the Fiscal Year ended May 31, 2010, 34, *available at* www.oracle.com/us/corporate/investor-relations/financials/10k-2010-152558.pdf.
4. Press Release, Hewlett-Packard, General Motors Renews $2 Billion HP Enterprise Services Agreement Supporting Vehicle Design and Production (July 21, 2010), *available at* www.hp.com/hpinfo/newsroom/press/2010/100721a.html.
5. *Id*.
6. Press Release, Dell to Acquire Perot Systems for $3.9 Billion, Creating Comprehensive, Customer-Focused IT-Solutions Company, Dell Inc. (Sept. 21, 2009), *available at* content.dell.com/us/en/corp/d/secure/2009-09-21-Perot-Systems.aspx. See also Eric Wicklund, *Dell to Buy Perot Systems for Almost $4B*, HealthcareITNews.com, Sept. 21, 2009, www.healthcareitnews.com/news/dell-buy-perot-systems-almost-4b (noting that acquisition announced two weeks after DELL launched its own electronic medical records platform).
7. Press Release, Dell To Acquire Insite One, Dell Inc. (Dec. 22, 2010), *available at* content.dell.com/us/en/

corp/d/secure/2010-12-ilu-release.aspx.

8. Bernie Monegain, *McKesson Completes Acquisition of US Oncology*, HEALTHCAREITNEWS.COM, Dec. 30, 2010, www.healthcareitnews.com/news/mckesson-completes-acquisition-us-oncology.
9. The stories were shared with the authors and have been modified to protect the organizations and those sharing their experiences.