ISBA Agency Contract Compliance Audit Guidelines

Drafted in conjunction with FirmDecisions

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Introduction

Ever stringent corporate governance, an increasingly complex and fast evolving communications marketplace, proliferation of agencies, transparency issues and the desire by brand owners to manage commercial contracts more smartly, has resulted in a significant number of advertisers now utilising compliance auditing to manage their agency contracts.

It's an essential management tool which helps illuminate the reality of how agencies are actually performing against the contract in place and can often provide an early indicator to the health of the financial relationship and importantly should provide direction on how to better manage commercial relationships into the future.

We trust this guide provides useful direction to anyone considering using a compliance auditor and acts as a best practice refresher to those companies already auditing.

This guidance provides up-dated advice on agency contract compliance auditing and replaces the note created in 2013.

Preface

Whilst this guidance is tailored for use with media planning and buying agencies, the same principles apply for all other marketing services providers including full service, creative, digital, PR, direct marketing, events management, research, production and sales promotion agencies, influencer and social agencies etc.

workingtogether

What, Why, Who and When?

What is a contract compliance audit?

- It is an audit to ensure that your agency is complying with the agreed financial and legal terms of your agreement, particularly relating to fees and billings.
- The audit is not about ensuring value is being received (this is left to cost controllers and media benchmark specialists) rather it is to ensure the agency is adhering to the financial agreements in the contract and that any discounts, agency trading benefits and balances are being returned to the client.

Why should I undertake a contract compliance review

- In 2016, the Association of National Advertisers (ANA) published a report on media transparency in the U.S. which highlighted the significant challenges faced by advertisers in the search of a transparent supply chain. This report led to worldwide attention being paid to the contractual relationships between advertisers and their agencies, and a focus on improving processes and practices to mitigate risk for brands. However it's important to remember that ISBA had been working diligently on improving transparency in the UK, tackling some of the key issues of the times by publishing its best practice contract templates, since the early 2000's.
- This focus has resulted in the undertaking of a contract compliance review now being considered standard and best practice. There are so many "moving parts" in most relationships that it is important to verify that they are all functioning correctly.
- Persistent barriers to transparency have included (but are not limited to) the use of Proprietary or Inventory Media, restricting data access, the changing form of AVBs and absence of audit rights in contractual terms. As advertisers have amended their contracts to include clauses to mitigate certain risks, so agencies have changed their trading terms with vendors, created new terminologies for practices and moved the goal-posts in order to ensure compliance, whist not reducing their revenue streams.

Why should I undertake a contract compliance review

- As part of a company's corporate governance a contract compliance review will ensure the effective stewardship of the business. It should be part of the relationship manager's remit and responsibility to ensure that the company's commercial interests are held paramount, and that best practices are being pursued.
- The contract compliance audit process reviews both the agency and the client to ensure that the agency (and client) is complying with the terms of business, otherwise known as the contract or master services agreement.
- Whilst examining the agency's compliance with the agreement, the review should also seek to detect any inefficiency in the relationship on both sides and recommend ways of improving them.
- The process will strengthen the commercial relationship with the agency by establishing transparency, clarity and best practice. A poor commercial relationship can be just as dangerous as a poor creative one. It also enables the agency and the client to air issues in a non-contentious environment which may have been overlooked and not dealt with in the past.
- Although an audit should not be carried out as a means of gathering evidence to justify putting the account up for review, or in the hope that monies will be recovered to assist with budget overspends, it can identify financial efficiencies which can then be reinvested by the client's marketing team.

Who should perform the audit?

- An audit should be performed by a competent and independent company. Given the complexity of the relationship the use of a specialist auditor is recommended and the client should always retain in their contractual terms the right to determine the choice of auditor.
- Consider the benefits of using auditors that have experience of working within an agency finance department as they will have inside knowledge that will enable them to look beyond the numbers and industry jargon and assist in compiling action plans to support the agreement in the future.
- If choosing an external partner, consider that most agency groups now do not allow auditors to perform their services if their remuneration is based on a percentage of recovery, as this questions the ability of the audit partner to be impartial and objective in their findings.
- Alternatively, an audit may be conducted by a member of the client's staff or an internal audit team. In these circumstances, however, you should bear in mind that such auditors may not have such in-depth experience of the workings of media and communications agencies. Additionally, access to vendor deal terms will be severely restricted due to confidentiality, as agencies will not share potentially commercially sensitive information directly with advertisers.

Who should perform the audit?

- The auditor should be prepared to sign a confidentiality agreement and operate under the terms of an agreed code of conduct that assures all parties of their professionalism and integrity. The auditor should agree that any information made available to them will not be used for any purpose other than the proper conduct of the audit. In order to ensure that all parties are clear, consider appending a pre agreed NDA template to the agency contract in order to set an expectation of agreeable terms.

When should I undertake an audit?

- Time frames vary from company to company but on average it is good practice to undertake an audit of larger spending markets annually. For smaller markets every two years during the life of a contract is advisable, however if an audit highlights significant non-compliance, an advertiser may decide to pursue an audit the following year to ensure these have been rectified. This ensures continuity, that best practice is maintained and prevents poor practice creeping in as a result of poor communication or staff turnover.

- It is advisable to conduct a closure or exit audit upon termination of a contract to ensure that all loose ends both contractually and financially are resolved. Additionally, the learning's acquired from an exit audit may be implemented to establish a platform of best practice for the start of your new relationship. To that end, performing the exit audit as soon as possible before contracting with a new agency is advisable, as negotiation on contractual terms can often take time.

- An engagement audit should be considered at the start of a new agency/client relationship, so that best practice may be implemented from the beginning and an audit timetable agreed. Such new relationships should be audited at the end of the first year of business to fine tune the commercial aspects of the contract and ensure that best-practices are being followed in-line with the contract. By undertaking these steps, it is hoped that problems will be prevented in the future.

When should I undertake an audit?

- Although audits could find monies owing to the advertiser, it is advisable to ensure that an amount to cover the cost of an audit is built into the budget planning cycle, and that there is not an expectation of recoveries going into the audit in order to fund the exercise. We encourage all advertisers to discuss the potential scope of an audit with the compliance auditor in order to be provided with a indicative figure for budget planning purposes.

Getting started

- Firstly, the client should determine the scope of the contract compliance audit, which areas and agencies require a review, and for which specified period of time.
- A typical audit will take between ten to twelve days to complete over an eight to ten-week period, from kick off meeting with the agency to the final presentation of findings.
- A clear written brief should be given by the client to the auditor. Your auditor of choice should be able to provide you will a framework to work with and guidance of what to include.
- The agencies to be audited should be given sufficient prior warning that an audit will be carried out; two or three weeks should be sufficient, but they may require longer depending on the amount of paperwork that has been requested.
- Consult your agency contract to determine if you agreed to reimburse the agency for the time taken to prepare for the audit.
- The audit should commence with a review of the client's controls and records and should include all records for the audit period.

Getting started

- A sample across all activity should be selected from the records to ensure high coverage, not just in value terms, but also in terms of variety of activities.
- The agency should be informed of the sample and provide the information requested upon the arrival of the auditor. The results should be discussed with the agency and a report issued.
- The resolution of audit issues should take place as soon as possible after the audit so that the relationship is not impaired in any way.

Relationship Implications and Outcomes

The report

- The audit report should:
- **Contain a summary of the findings of the financial audit.**
- **Provide ratings of importance to the findings, to ensure the client can prioritize areas for discussion or review.**
- If multi-market audits are being delivered, these ratings should be consistent across markets to ensure messaging is consistent and comparable.
- **Quantify any over/under charges that have been detected in the audit.**
- **Provide recommendations that highlight improvements in the procedures or processes between the agency and the client.**

- The audit report should be validated with the agency prior to publication through discussion of the issues identified. This shortens the period between the audit and the closure meeting and helps strengthen the relationship between client and agency.

- The agency comments should be included in the report even if the auditor does not agree with them to ensure a fair representation of the audit findings.

- The auditors should attend the client/agency audit closure meeting and act as arbiter, sounding-board and fact provider. They may also agree settlements where appropriate.

Dealing with the findings

- A common outcome of an audit is the detection of monies being owed to the client. Often this is a result of either having been billed to the client in contravention of the agreement or not returned back to the client when it should have been. It remains the client's prerogative to seek monies due back once the total value has been agreed between parties.
- It is critical that any results are viewed in a positive light by both parties concerned, even if they reveal shortcomings in the agency and/or client controls.
- The results should be used as an opportunity to build or develop new processes and control mechanisms for the future, and not for recriminations.

Building on the audit

- With the air cleared in the relationship, it is vital that both parties build on the results of the audit to improve future performance. Areas could include clearer definitions of terms and guidelines on billing, accurate scopes of work, matching of resources to fees, appropriate processes, stronger business relationships and controls to prevent any future slippage in compliance.
- Once the negotiations are complete, the agreement modified and the recommendations agreed between agency and client, the final step should be to ensure that the people working in the relationship are aware of and understand their respective responsibilities under the terms of the agreement.
- It is advised that the client/agency contract be regarded as an extension of the agency brief and that all parties involved in the running of the account are familiar with the key terms and obligations under the agreement.
- A training session could be a good way of ensuring that all the relevant parties on both the client and agency side are fully aware of and understand the new processes, the terms-of-agreement and how they may best work together in the future.
- A timetable for future audits should be agreed so that both parties are clear.

What are the implications?

- An audit should be entirely positive. The agency is provided with the opportunity to show its stewardship of the client's assets and the client is given the opportunity to prove its due diligence.
- Any issues which come to light should be dealt with quickly without affecting the quality or performance of the work for the client.
- Through gaining clarity in the commercial arrangements, the quality of the overall relationship should improve.
- Any weakness in the contract or procedures (highlighted by the audit) should be removed and the contract updated to reflect this. It is important that all parties involved in the running of the account play a full part in this process so everyone is fully aware of the changes and how their implications affect the day-to-day management of the account.

FAQ's

How should I pay my auditor?

It is recommended that the auditor should not be remunerated by way of commission as a percentage of any recoveries that may be detected as a result of the audit. This practice is aggressive and potentially destructive to the client/agency relationship and will encourage the auditors to concentrate only on recoveries at the expense of the relationship and procedural efficiencies and improvements. A negotiated fee is advisable.

Many client / agency contracts and Master Services Agreements (MSAs) now strictly forbid the remuneration of the auditor to be based on recoveries and most agency holding companies do not allow access if it is established that the auditor is remunerated in this way.

The right to audit – what can I review?

Your client/agency agreement should contain a clause giving you (the advertiser) the right to audit the agency. (Please refer to the ISBA media framework agreement and other ISBA/IPA joint industry contracts for details)

The key controls are:

- **The ability to audit stewardship of the client's money throughout the buying chain.**
- **The ability to audit contract compliance and as a result such information will allow the auditors to reach a conclusion on how well the agency looks after the client's money.**
- **The ability to audit agency remuneration and other income streams like production etc. associated with client spend**
- **The ability to audit agency related parties' records where they are involved in servicing an account**
- **The audit clause should continue post termination. The ISBA media framework and ISBA/IPA standard contract for creative and digital services includes clauses that allow for an audit to take place in the twelve months after the termination of a contract. Some contracts may have a longer term, but realistically auditing after two or three years of a termination is difficult, due to staff turnover and archiving.**

What should an audit review?

This is dependent on the type of review that is being undertaken and what has been outlined in the brief but could contain one or a variety of the following.

Production Billings/Media Billings

- To ensure that all client monies spent by the agency on behalf of the client are properly documented and managed in accordance with the contract, e.g.:
- **Job reconciliations have been performed and unspent monies returned to the client.**
- **Where relevant, commissions have been calculated correctly.**
- **Costs charged correspond with the approved estimate or budget and any credits have been issued for reconciled campaigns/projects where estimates were higher than actual spends.**
- **Balances have not been transferred from one job to another to cover over and underspends on jobs.**

Discounts and Agency Trading Benefits

- To ensure that all discounts and rebates are shared with the client and paid as due, in accordance with the contract. Retained discounts and rebates can create conflicts of interest. Particularly in the evolving media landscape, rebates can now take many forms (cash, media value, SLA income, etc.) so ensuring this scope covers any benefits which fit the definitions in the contract is key.

What should an audit review?

Fees

- Any reconciliation of fees is prepared in accordance with the contract and that time sheets are kept properly and reconciled to the fee charged (if defined as such in the contract). Any variables, such as staff costs or overheads that are not considered fixed are verified.

Payment (Performance) by Results

- Validation of the targets achieved for performance related payments.

Non-Disclosed Activity

- With more agencies dealing in inventory or proprietary media, which is often sold on a non-disclosed basis, ensuring that the client is aware of all such sales and that they appropriately approved in accordance with the contract will help limit conflicts of interest

Procedural Analysis

- An important by-product of a compliance audit is a procedural review, which highlights the areas of inefficiency in the relationship between the client and the agency.
- Experienced agency compliance auditors should be able to detect and recommend improvements in the working relationships that should ultimately lead to cost savings or at the very least, more efficient operations.

Why would I audit my agency/agencies?

- The marketing budget is often one of the largest expense items within a company's profit and loss statement. Bearing this in mind, it is good corporate governance and business practice to ensure that this money is being used to ensure maximum value for money. Non-compliance of an agreement at any type of agency be that media, creative, design, influencer, PR, social etc. is rarely intentional, but errors tend to arise as a result of:
- **Staff turnover on both the agency and client side, leading to a lack of knowledge of the terms of the agreement and obligations.**
- **Too many client contracts being managed by too few people within the agency finance department.**
- **Lack of checking or vetting systems.**

Am I able to audit my agency even though I don’t have a signed contract?

Yes, although it would require the agency’s permission as opposed to you having the right to audit. It would be foolish of an agency to deny a client access to its records because it would raise suspicion.

I have just terminated the relationship with our agency, can I still audit them?

Yes. The ISBA standard contract includes a clause that allows for an audit to take place in the twelve months after the termination of a contract. It is preferable to notify the agency that you may still wish to carry out an audit when you inform them officially of the termination.

Does ‘Sarbanes-Oxley’ require me to audit my agencies?

If any of the ‘risk controls’ within your marketing department are reliant on controls in place at your agency, then those controls at the agency must be assessed for compliance.

Will the audit interfere with day-to-day operations of my account

No. The audits generally only require limited involvement from the client at the start of the process and then to discuss the findings and develop any action plans required. Most agencies now are familiar with the audit process and many even have separate compliance teams to cover the limited workload.

With thanks to FirmDecisions for their expert input into drafting this guide.

For further information on their compliance auditing services please go to www.firmdecisions.com

or

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