Research paper on Contract Management

A Research Paper

Indian Audit & Accounts Department
Regional Training Institute
26/1, Civil Lines, Nagpur
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In relentless pursuit of excellence in our designated areas, knowledge centre for “Revenue Audit” and the centre for the excellence in “Audit of Fraud, Fraud detection techniques and Forensic audit”, Regional Training Institute, Nagpur has developed number of interesting case studies, working papers on both the Fraud and Fraud detection techniques and Revenue Audit.

It was maiden effort made to present Research paper on “Contract Management” indicating, what is contract management, the procedure laid down for managing the different kind of contracts entered into as well as audit objectives and issues arises.

I take this opportunity to appreciate the efforts of Shri S.V.Parwate, Senior Audit Officer/Core Faculty for his maiden presentation of Research Paper in the field of Contract Management.

I hope that the readers would benefit from this. Suggestions, if any, are welcome and would help us in future.

Jaydeep Shah
Principal Director

RTI/Nagpur
June 2015
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Research paper on Contract Management

1. Background

The activity of procurement of stores as well as execution of different kind of works depending upon the requirement/necessity, empowers the authority of Central Government as well as Government undertakings as per the delegation of powers bestowed upon them by General Financial rules (GFR) as well Indian Contract Act, 1872 (Contract Act). Similarly, State Governments have framed their rules and regulation for execution of agreement either for procurement or for the execution of different kind of work.

Rule 203 and 204 of the GFR provide empowerment to the authority, different classes of contract and general principles for contract. Keeping in view the rule position as well as general terms and conditions and special terms of conditions, during the course of audit, it was time and again noticed that violation of rules resulted in avoidable expenditure to the exchequer or loss. The same has been reported in the Audit Reports of Central Government Departments or State Audit Reports of various states. In its Action Taken Report/Note on many occasions, the authority concerned has taken the cognizance suo moto and instructions were issued, which became a part of the general principles.

The study was warranted to elaborate the process of contract till the completion of either supplies and acceptance of stores or execution of work as per the schedule specified in the contract and drawal of completion report. The study of such contract evolves different phases which are a necessity during audit. Efforts have been made to cover all the process.
2. What is contract management?

Contract management or contract administration is the management of contracts made with customers, vendors, partners, or employees. The personnel involved in Contract Administration required to negotiate, support and manage effective contracts are expensive to train and retain. Contract management includes negotiating the terms and conditions in contracts and ensuring compliance with the terms and conditions, as well as documenting and agreeing on any changes or amendments that may arise during its implementation or execution. It can be summarized as the process of systematically and efficiently managing contract creation, execution, and analysis for the purpose of maximizing financial and operational performance and minimizing risk.

A contract is a written or oral legally-binding agreement between the parties identified in the agreement to fulfill the terms and conditions outlined in the agreement. A prerequisite for the enforcement of a contract, amongst other things, is the condition that the parties to the contract accept the terms of the claimed contract. Historically, this was most commonly achieved through signature or performance, but in many jurisdictions especially with the advance of electronic commerce the forms of acceptance have expanded to include various forms of electronic signature.

Contracts can be of many types, e.g. sales contracts (including leases), purchasing contracts, agreements, trade, and intellectual property agreements.

A sales contract is a contract between a company (the seller) and a customer where the company agrees to sell products and/or services and the customer in return is obligated to pay for the product/services bought.

A purchasing contract is a contract between a buyer and a supplier who is
promising to sell products and/or services within agreed terms and conditions. The buyer in return is obligated to acknowledge the goods / or service and pay for liability created.

A partnership agreement may be a contract which formally establishes the terms of a partnership between two legal entities such that they regard each other as 'partners' in a commercial arrangement. However, such expressions may also be merely a means to reflect the desire of the contracting parties to act 'as if' both are in a partnership with common goals. Therefore, it might not be the common law arrangement of a partnership which by definition creates fiduciary duties and which also has 'joint and several' liabilities.

2.1 The fundamentals of contract management
When two companies wish to do business with each other, a contract specifies the activities entered into by both organizations and the terms through which they will each fulfill their parts of the agreement. Contracts affect business profitability in a very large way due to the emphasis on revenue and expenses. When a contract is phrased poorly, one organization might lose countless thousands of rupees over a simple technicality they lacked the resources to identify. Effective contract management can ultimately create a powerful business relationship and pave the way to greater profitability over the long-term, but only when managed correctly.

Rule 205 of General Financial Rules provides:
(1) Implementation of the contract should be strictly monitored and notices issued promptly whenever a breach of provisions occurs.
(2) Proper procedure for safe custody and monitoring of Bank Guarantees or other Instruments should be laid down. Monitoring should include a monthly review of all Bank Guarantees or other instruments expiring after three months.

2.2 Elements of successful contract management
It isn't enough that an organization has professionals in place to handle
contract management. Employees must be augmented with the presence of processes and software companions to satisfy increasing compliance and analytical needs. When a contract management strategy is successfully implemented, organizations can expect to see:

The expected business benefits and financial returns are being realized, the supplier is cooperative and responsive to the organization's needs, the organization encounters no contract disputes or surprises, the delivery of services is satisfactory to both parties.

### 2.3 Activities that make up good contract management

The foundation for contract management relies on the implementation of successful post-award and upstream activities. During the pre-award stage, employees should focus on the reason for establishing the contract and if the supplier can fulfill the terms of the agreement. Additional consideration is needed to understand how the contract will work once awarded. Avoiding unwanted surprises require careful research and clarity of purpose in the actual contract.

Contract management requires a level of flexibility for both parties involved and a willingness to adopt contract terms to reflect any changing circumstances. Problems are inevitable, which means organizations must be prepared for the unexpected and be able to adjust contract terms when needed.

### 2.4 Stages of contract management

Contracts play a significant role in the end-of-quarter crunch and are broken up into stages to organize efforts and structure the typical contract process. When done manually, creating a contract can prove quite time consuming. The process includes the following steps:

**Initial requests:** The contract management process begins by identifying contracts and pertinent documents to support the contract's purpose.
Authoring contracts: Writing a contract by hand is a time-consuming activity, but through the use of automated contract management systems the process can become quite streamlined.

Negotiating the contract: Upon completion of drafting the contract, employees should be able to compare versions of the contract and note any discrepancies to reduce negotiation time.

Approving the contract: The instance in which most bottlenecks occur is getting management's approval. Users can preemptively combat this by creating tailored approval workflows, including parallel and serial approvals to keep decisions moving at a rapid pace.

Execution of the contract: Executing the contract ie Agreement, allows users to control and shorten the signature process through the use of eSignature and fax support if warranted.

Obligation management: This requires a great deal of project management to ensure deliverables are being met by key stakeholders and the value of the contract isn't deteriorating throughout its early phases of growth.

Revisions and amendments: Gathering all documents pertinent to the contract's initial drafting is a difficult task. When overlooked items are found, systems must be in place to amend the original contract.

Auditing and reporting: Contract management does not simply entail drafting a contract and then pushing it into the filing cabinet without another thought. Contract audits are important in determining both organizations' compliance to the terms of the agreement and any possible problems that might arise.

Renewal: Using manual contract management methods can often result in missed renewal opportunities and business revenue lost. Automating the process allows an organization to identify renewal opportunities and create new contracts.
2.5 Rule position under General Financial Rules:

Rule 203

(1) All contracts shall be made by an authority empowered to do so by or under the orders of the President in terms of Article 299 (1) of the Constitution of India.

(2) All the contracts and assurances of property made in the exercise of the executive power of the Union shall be executed on behalf of the President. The words “for and on behalf of the President of India” should follow the designation appended below the signature of the officer authorized in this behalf.

Note 1: The various classes of contracts and assurances of property, which may be executed by different authorities, are specified in the Notifications issued by the Ministry of Law from time to time.

Note 2: The powers of various authorities, the conditions under which such powers should be exercised and the general procedure prescribed with regard to various classes of contracts and assurances of property are laid down in Rule 21 of the Delegation of Financial Powers Rules, 1978.

Rule 204

Under Rule 204 of GFR (General principles for contract) the following general principles needs to be observed while entering into contracts:

(I) The terms of contract must be precise, definite and without any ambiguities. The terms should not involve an uncertain or indefinite liability, except in the case of a cost plus contract or where there is a price variation clause in the contract.

(ii) Standard forms of contracts should be adopted wherever possible, with such modifications as are considered necessary in respect of individual
contracts. The modifications should be carried out only after obtaining financial and legal advice.

(iii) In cases where standard forms of contracts are not used, legal and financial advice should be taken in drafting the clauses in the contract.

(iv) (a) In respect of Works Contracts, valued between ₹ one lakh to ₹ ten lakh, where tender documents include the General Conditions of Contract (GCC), Special Conditions of Contract (SCC) and scope of work, the letter of acceptance will result in a binding contract. (b) In respect of contracts for works with estimated value of ₹ ten lakh or above, a Contract document should be executed, with all necessary clauses to make it a self-contained contract. If however, these are preceded by Invitation to Tender, accompanied by GCC and SCC, with full details of scope and specifications, a simple one page contract can be entered into by attaching copies of the GCC and SCC, and details of scope and specifications, Offer of the Tenderer and Letter of Acceptance, (c) Contract document should be invariably executed in cases of turnkey works or agreements for maintenance of equipment, provision of services etc.

(v) No work of any kind should be commenced without proper execution of an agreement as given in the foregoing provisions.

(vi) Contract document, where necessary, should be executed within 15 days of the issue of letter of acceptance after remittance of Performance Guarantee and Security deposit. Non-fulfillment of this condition of executing a contract by the Contractor or Supplier would constitute sufficient ground for annulment of the award and forfeiture of Earnest Money Deposit.

(vii) (a) Price Variation Clause can be provided only in long-term contracts, where the delivery period extends beyond 18 months. Where a price variation clause is provided, the price agreed upon should specify the
base level viz, the month and year to which the price is linked, to enable variations being calculated with reference to the price levels prevailing in that month and year, (b) A formula for calculation of the price variations that have taken place between the Base level and the Scheduled Delivery Date should be included in this clause. The variations are calculated by using indices published by Governments or Chambers of Commerce periodically, (c) The price variation clause should provide for a ceiling on price variations, particularly where escalations are involved. It could be a percentage per annum or an overall ceiling or both. The buyer should ensure a provision in the contract for benefit of any reduction in the price in terms of the price variation clause being passed on to him.

(viii) In contracts where government property is entrusted to a contractor either for use on payment of hire charges or for doing further work on such property, specific provision for safeguarding government property (including insurance cover) and for recovery of hire charges regularly, should be included in the contracts.

(ix) (a) The terms of a contract, including the scope and specification once entered into, should not be materially varied, (b) Wherever material variation in any of the terms or conditions in a contract becomes unavoidable, the financial and other effects involved should be examined and recorded and specific approval of the authority competent to approve the revised financial and other commitments obtained, before varying the conditions, (c) All such changes should be in the form of an amendment to the contract duly signed by all parties to the contract.
3  Different stages of Contract management.

After elaborating the background and the interesting elements of contract management, in this research paper, efforts have been made to compare the procedure involved from sanction of work, execution of work and drawal of completion report in two different scenario ie in Indian Railways (Civil Department) and Public Works Department of State of Maharashtra. Being a vast topic, study has been confined to Construction work contracts.
Life cycle of the contract management in two different scenarios:

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<th>Action in Railway</th>
<th>Action in Public Works Department (Maharashtra)</th>
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<td>Investment decisions relating to the Creation, Acquisition and Replacement of assets are processed through the annual “Works, Machinery and Rolling Stock Programme” on the basis of the estimate of the plan funds requirement giving in detail the justification (Abstract Estimate) for creation of assets duly vetted by the associate Accounts Officer. The programme thus will be approved at Railway Board and incorporated in the annual budget for approval by the Parliament. Consequent upon approval and allotment of funds, under the competent authority's sanction, Detailed Estimate of the work to be executed is prepared. Detailed estimate is required to be prepared in sufficient detail to enable the competent authority to make sure that the abstract estimate sanctioned is not likely to be exceeded. Sanctions to the Abstract Estimate and to Detailed estimate are termed as Administrative Approval and Technical Sanction.</td>
<td>For every work (excluding repairs) initiated by, or connected with, the requirements of a department it is necessary to obtain the Administrative Approval of the department concerned (including Public Works Department) to execute the work according to the need and amount required for execution. An Administrative approval should indicate a preliminary report, an approximate estimate, site plan along with necessity of the work for obtaining competent authority's sanction. On approval of Administrative sanction, no work can be executed without preparation of detailed estimate and approval by the authority, termed as Technical Sanction.</td>
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Different kind of estimates prepared:

**Abstract Estimate:** is prepared in order to enable the authority to give Administrative Approval to the expenditure of the nature and the magnitude contemplated, to form a reasonably accurate idea of the probable expenditure and such other data sufficient to gauge adequacy of the financial prospects.

**Detailed Estimate:** consequent upon sanction of the Abstract Estimate, detailed estimates of work is prepared in sufficient details to enable the competent authority to make sure that the abstract estimate sanctioned by higher authority is not likely to be executed.

**Supplementary estimate:** should be prepared for any work, which ought to have been included in the first instance in an abstract estimate sanctioned, but not included, or necessitate the inclusion at later stage, could not met out of contingencies such inclusion of item in the estimate will be in the same form and the same degree of detail of an Abstract Estimate

**Revised estimate:** as soon as it becomes apparent that the expenditure on a work or project is likely to exceed the amount provided in the detailed estimate, a revised

**Supplementary estimate:**
Any development of a project thought necessary while a work is in progress which is not fairly contingent on the proper execution of the work as first sanctioned, must be covered by a supplementary estimate accompanied by a full report of the circumstances which render it necessary. The abstract must show the amount of the original estimate and the total of the sanction required including the supplementary amount.

**Revised estimate:**
A revised estimate must be submitted when a sanctioned estimate is likely to be exceeded by more than 5 per cent either from the rates being found insufficient, or from any cause whatever, apart from the reasons mentioned in the supplementary estimate. It must be accompanied by a comparative statement and a report showing the progress made to date and explaining the cause for the revision.

When excess occurs at such an advanced stage in the construction activity and found necessary the submission of a revised estimate, may be used as completion report.
estimate is prepared in the same form and the same degree of detail of an Abstract Estimate and should be accompanied by a comparative statement showing excess/savings under each sub-head of account.

**Completion estimates:** Completion estimates, which involve any material modifications in a project sanctioned by the Railway Board, or an excess over the estimate beyond the powers of sanction of General Manager should, after verification by the accounts officer, be submitted for the sanction of Railway Board

**Tendering Process**

**Tendering Process**

Following forms of contract are primarily for application to works contract:

**Lump-sum:** is a contract under which the contractor engages to carry out a work or effect supply as specified and within a given period for a fixed total sum,

**Schedule contract:** Schedule contract is a contract under which the contractor engages to carry out work or effect supply as specified and within a given period, at a fixed unit rate or prices for each of the various items comprising such work or supply. The amount paid to the contractor will depend on

Contracts are of two types ie. Lump sum and Schedule. In the lump-sum contract, contractor agrees to execute the work with all its contingencies in accordance with the drawings and design for a fixed amount where as in schedule contract, contractor undertakes to execute the work at fixed rates, the sum received being dependent on the quantities and kind of work done.

All public works are either executed departmentally or by entering in to contract with the registered contractors. For entering in to contract, tenders are invited by giving wide publicity. There are five
the material supplied or work executed.

Piece work contract: a contract under which only unit rates or prices for various kinds of works or materials are agreed upon, without reference either to the total quantity of work to be executed or materials supplied, or to the total quantity of work to be done or materials supplied within a given period

Different class of tenders are:

By advertising (open tenders)

By direct invitation to a limited number of firms/contractors (limited tender) and

By invitation to one firm/contractor only (single tender)

A-1 tender percentage contract for piece works
A-2 tender item rate contract for piece works
B-1 tender Percentage rate tender for Major works
B-2 Item rate tender for major works.
C-tender Lump sum contract (Where contractor agrees to execute a complete work for fixed some as per design given by department or contractors design accepted by the department)

D tender For supply of stores and equipment

E tender Transportation contract With all tender papers terms and condition clauses of tender are enclosed. Tender paper also appended with schedules.

Tender notice and finalization of tenders received

Consequent upon approval of technical sanction, tender inviting notice in a prescribed format is issued by giving wide publicity in local as well as national newspaper with a aim of healthy competition, duly approved by the competent authority depending upon type of types of contract as under.

Issue of tender inviting notice is more or less similar to the procedure followed in Railway Ministry.

Evaluation of the offers received is carried out by the authority depending upon the value of the work to be executed (As per schedule
work and expenditure involved.

Evaluation of the tenders received is carried out by the Tender Committee constituted by the Head of the department consisting of Technical member, who is normally known as convener, Finance member a member from Associate Finance and third member from any other technical department.

On evaluation of the offers received in all respect as per the rules and regulations, instructions issued from time to time by the Railway Board, tender committee submits the briefing along with the recommendations to Accepting authority (As per schedule of powers) for acceptance/rejection/negotiation. On acceptance by the authority, letter of acceptance is issued to successful bidder for entering into the agreement on behalf of government in a prescribed period. Till execution of agreement, letter of acceptance is a legal document.

In the agreement to be executed General terms and conditions of the contract as specified under contract Act for safeguarding the interest of government as well as special conditions if any are mentioned of powers prescribed). In PWD no committee is being formed to evaluate the tenders and it is being evaluated by Superintending/Chief Engineer/at Government level as the case may be.

After the competent authority has communicated the decision regarding acceptance of tender to the Executive Engineer, the latter officer will intimate the contractor the decision regarding acceptance and after getting the contract documents completed in all respect, execute the contract on behalf of government. In the agreement to be executed General terms and conditions of the contract as specified under contract Act for safeguarding the interest of government as well as special conditions if any are mentioned.
Execution of work and payment process

The supervising Engineer depending upon the jurisdiction of the work to be executed, will supervise the work by visiting the site and variations if any noticed will be recorded in the site registers for compliance by the contractor. Instructions if any will also be recorded for compliance by the contractor. The variation could be conditions of the contract, rates or items, variation in quantities of any item/items. This variation will be reported to competent authority duly vetted by the associate finance for action if warranted.

The payment to the contractor is arranged on submission of running account bill duly scrutinised by the technical supervisor and signed by the authorised engineer for payment. In the associated accounts (Divisional Accountant), bill is checked before releasing the payment, for the mathematical accuracy, rates applied and recovery towards taxes and advances if any.

Execution of work and payment process

Engineers and their subordinates are responsible that the terms of contracts are strictly enforced, and that no act is done tending to nullify or vitiate a contract. Cases involving commitments of appreciable extra expenditure in respect of the provisions in the contract agreement which are not explicit or where there is some sort of ambiguity about the interpretation shall be invariably referred to government before taking action.

Executive Engineers are authorised to sanction the execution of and the rates to be paid for, extra items of work, not provided for in regular tenders accepted by higher authorities, by themselves, or by their subordinate officer, subject to conditions specified in the Public Works Manual.

The payment to the contractor is arranged on submission of running account bill duly scrutinised by the technical supervisor and signed by the authorised engineer for payment. In the accounts (Divisional Accountant), bill is checked before releasing the payment, for the mathematical accuracy, rates applied and recovery towards taxes and advances if any.
Drawal of completion report

Those accounts of work which were in progress at the time of closing of construction of Abstract estimate should be got completed and the accounts of the project should be closed as soon as possible. Executive engineer in charge of project should therefore take prompt action to bring to account all charges and credits pertaining to project, liquidate all outstanding liabilities, clear suspense balances, and pay up all outstanding contractors' claim and dispose of all surplus stores and tools and plants returned from work.

A completion report will be submitted to the authority who accorded administrative approval only after due verification by the associate finance.

The purpose or aim of the completion report is to isolate the booking of expenditure under capital head as the payment of dividend to general revenue on completion of work and its handing over to user department becomes unwarranted. Since the project cost is capital and maintenance cost during use will be revenue expenditure.

Drawal of completion report

A consolidated completion statement in the standard form prescribed under manual is required to be prepared monthly of all completed works.

When buildings or roads forming part of a project are physically completed and put into use while the remaining items are still in progress, similarly where part of an irrigation project is physically completed and put to use while remaining items are still in progress, the accounts of such work are required to be closed provisionally and the necessary completion report in the prescribed format should invariably submitted in duplicate to the authority who has sanctioned the original work.

The work executed on behalf of other department, completion certificate is required to be submitted to the authority concerned.
4  Audit Objectives and Issues:

From the research paper on the contract management, following audit objectives and issues emerged which are illustrative and not the comprehensive in nature.
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<th>Issues</th>
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<td><strong>1)</strong> Whether there exists a well defined system of contract management in the organisation and the system is working effectively?</td>
<td><strong>1)</strong> Whether the organisation has a policy for project appraisal and to what extent it is applied?</td>
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<td><strong>2)</strong> Whether the system provides for preliminary assessments of the options available to meet the identified needs together with broad indications of their likely costs?</td>
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<td><strong>3)</strong> Whether the feasible options are ranked in order of preference, taking into account such matters as cost, disruption and timing and such ranking documented?</td>
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<td><strong>4)</strong> Whether tender notice invitation is in accordance with the project's approvals and the requirements of the detailed brief?</td>
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<td><strong>5)</strong> Whether Financial and operational appraisals of contractors have been carried out as prescribed under the rules and regulations?</td>
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<td><strong>2)</strong> Whether the methods for the selection of contractors invited to tender is effective?</td>
<td><strong>1)</strong> Whether the organisation's policies state the methods to be adopted for the selection of tenderers?</td>
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<td></td>
<td><strong>2)</strong> Whether Exemption procedures</td>
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exist for emergency work and single source?

3) Whether the selection of contractor is based on financial and technical appraisal? Whether such selection is properly recorded

3) Whether the system for regulating the tendering procedures and the letteing of contracts is functioning efficiently and effectively?

Whether the organisation has a set of policies or procedures concerning tendering and the letteing of contracts and that they are formally reviewed periodically taking into account technical, legal and financial advice?

The process involves receipt of tenders, custody of tenders, opening of tenders, recording of tenders received, tender evaluation, and acceptance of tenders.

4) Whether the system for providing financial information enables costs to be adequately controlled including reporting procedures?

1) Whether the system provides for written monthly reports on contract and project expenditure to the organisation?

2) Whether the contract report by the engineer covers expenditure to date and a projected final value compared with the original contract sum?

3) Whether the procedures for the receipt and evaluation of contractual
5) Whether the system ensures that when the final account is produced, it is complete and accurate?

1) Whether the final account is supported by detailed documentation showing how the final account is built up?

2) Whether the variations are valued in accordance with the contract, day works being supported by daily agreed records of labour, plant and materials?

3) Whether any retention amount or outstanding obligations under the contract are allowed for in determining any final amounts payable?

Reference

1) Indian contract Act, 1872
2) General Financial Rules
3) Code for the Engineering Department, Ministry of Railways
5) Practice guide for Audit of Contract Management
6) Material in connection with Contract Management available on internet in public domain