Fear Not

Auditing an Alliance to Improve Performance and Reduce Risk

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No one likes to hear the words, "You are being audited." For some, it might recall unpleasant experiences with the U.S. Internal Revenue Service. For others, it might evoke feelings of being put under the microscope and grilled with a stream of tough questions. Next thing you know, your eye is twitching and your palms start sweating. No matter how you feel about audits, they are part of corporate life.

Why audit? We believe that auditing helps organizations understand and reduce alliance risk, which in turn can improve alliance performance. The three types of risks that interest us are the business risk, human risk, and the legal uncertainties created by an alliance. (See "High Risk to High Reward: Using the Skills and Tools of Servant Leadership to Manage Risk," *Strategic Alliance Magazine*, Q4, 2011.) Alliance managers may not realize it, but those who administer alliance health checks are performing a type of audit as well. Health checks such as Lilly's Voice of the Alliance™ survey provide an opportunity to audit the human risk in an alliance and use the output to proactively address issues that are likely affecting the relationship.

An alliance audit, if performed properly, offers a snapshot in time and can be a great tool to help improve the overall health and performance of an alliance. Improving alliance performance and reducing alliance risk are great examples of how alliance managers can add value, so don't let the momentary discomfort or fear of what is uncovered stop you from getting the most out of an audit experience.

This article is designed to help alliance professionals understand the key components of an audit with the goal of gaining a more holistic view of how an alliance is performing. The audit may be part of a broader corporate audit, or it may be one that the alliance manager has requested. In this article, we focus on the type of self-audit conducted by an alliance partner to evaluate its own team's performance. (Triggering a financial audit of your alliance partner is an entirely different subject and should be considered very carefully prior to initiating.) Regardless of the audit trigger, our recommendations cover how to achieve maximum benefit from any internal alliance audit.

The Importance of Context

Audits don't occur in a vacuum. The context that surrounds an audit makes conducting the analysis either easier or more difficult. To maximize the value of a self-audit, it is best to conduct the audit during the "steady-state" phase of an alliance lifecycle. (See "Steady as She Goes: How Focus, Discipline Help an Alliance Stay on Course," *Strategic Alliance Magazine*, Q1, 2013) If possible, choose a time that will have the greatest likelihood of accurately capturing data and will not detract from the performance of an alliance. For example, conducting an audit during a product launch would not be advised, for obvious reasons. Work closely with your corporate audit group, if you have one, to get the most from their experience dealing with contextual issues.

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As you're considering the timing of your audit, it's also a good idea to consider your alliance partner's situation. Can your alliance audit be conducted at the same time as your partner's? If it can, which parts of each respective audit can be shared with the other party for the purpose of improving the alliance? (An experienced corporate attorney can provide advice on corporate context and what should and should not be shared with a partner.)

Making the Most of an Audit

The simplest way to audit an alliance is to break it into its components and audit each component in a traditional way. For example, an audit team could look at a single company's financials and contractual obligations. This satisfies many organizations because it follows a common and well-recognized business process. For some, this may be enough. However, this simple method trades off the difficulties of quantifying how well the cultures of the two companies are meshing, how aligned the companies' strategies are at a given point in time, and how well the operations of the alliance are functioning from a human perspective.

It is understandable that corporate audit groups might find alliances rather puzzling as they contemplate how to appropriately audit them. Alliances are unique by their very nature. They are one part contract law and interpretation, one part cultural fusion, one part evolving vision for the parties that created the alliance.

So while auditing the financials and other contractually bound numeric information may be enough to satisfy a corporate audit, it is unlikely to be enough for the alliance manager or the owner of the alliance if the goal is to use audit data to help improve the alliance's overall performance. High-performing alliances focus both "minds and hearts" of alliance participants on achieving the alliance's goals. A well-written and consistent alliance health survey such as our Voice of the Alliance™ survey is a good way of digging deeper to understand what is going on in the heart of the alliance.

Auditing to Reduce Business Risk and Legal Uncertainties

Generally, company-sponsored audits are guided by internal standard operating procedures (SOPs) or generally accepted finance/accounting/business practices. The auditors will compare the actual business practices occurring in the alliance against those SOPs. Alliances, however, can be somewhat of a conundrum for corporate auditors, as alliance business practices should be aligned with the contractual obligations between alliance partners, not necessarily aligned with internal business practices. Internal auditors need to first understand the alliance contract before initiating any assessment of the alliance team. Alliance managers should work with the internal auditing team to highlight key differences between internal SOPs and practices specified by the contract. During the audit, any difference between what is stated in the contract and what is observed by the audit team represents a finding that needs to be addressed.

Examples of contractual topics impacting business risk likely to be covered in an audit of a development/commercial alliance include:

Tracking of financial processes (including timing): up-front payments, performance-based milestone payments, variable payments (e.g., royalties based on net sales), operating expense sharing and reimbursement (including development, marketing, and sales expenses), profit sharing, budget review and approval process, and internal resource (full-time employee) tracking.

Tracking of general business obligations: customer contact by sales representatives, delivery of customer education programs, and work product delivered per the contract (e.g., clinical trial reports, marketing materials, etc.).

Timing of other obligations: Is the alliance following the contractually obligated timing requirements for publishing financial and other relevant information? Are there any work streams defined in the contract that are no longer required and should be discontinued?

Examples of contractual topics impacting legal uncertainties likely to be covered in an audit of a development or commercial alliance include:

Adherence to the alliance governance process: Has the alliance established committees, task forces, and other structures as outlined in the contract? Are all of the governance committees outlined in the contract functioning per the contract? Are the governance committees convening according to the timing outlined in the contract? If not, has the contract been modified to allow for such a change? Are governance meetings documented properly? Are meeting minutes formally approved? Who maintains the final approved version of the meeting minutes?

Adherence to alliance contract or amendments: How are contract changes made and where are new versions or amendments kept? Is there a single designated keeper of the contract who has the latest version and is known by the organization to have that version? If not, are there issues with contract version control across the company?

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Adherence to decision-making and dispute resolution processes: How are committee decisions documented? How are disputes resolved and resolutions documented?

Adherence to information and documentation control policies:

A. Are confidential alliance documents controlled appropriately?

B. What safeguards are in place to control intellectual property relating to or generated by the alliance?

Adherence to your own company's standard operating procedures with regard to the alliance compliance, publications, etc: If you aren't following SOP, do you have the appropriate exceptions documented and in place?

Auditing to Reduce Human Risk

While the focus of this article is on the elements of a corporate or financial audit, we would be remiss if we didn't highlight the opportunity to reduce human risk via routine alliance health checks. Alliance health checks have been a tool in the alliance management toolbox for many years. We rarely refer to such a check as an "audit" given the negative connotation of the word; however, health checks are essentially an audit of the relationship between alliance partners. Gaining an insight from alliance members on issues such as communication, leadership, trust, conflict management, role clarity and flexibility can provide the alliance manager an opportunity to proactively intervene to mitigate human risk-related issues. Given that our experience with the

Voice of the Alliance™ survey spans more than a decade, we will be elaborating more on it in a future article. In the meantime, minimize human risk following a health check by considering the effectiveness of your alliance communications and leadership. These key elements have tremendous impact on the alliance's progress.

Are alliance communications meeting the needs of members relating to decisions impacting alliance members? Can members access information required to perform their jobs?

Do alliance members from both companies receive consistent messages from leadership? Are alliance team members empowered to make decisions at the appropriate level—and are those decisions revisited only when data supports doing so? Do alliance team members have a clear understanding of what is expected of them?

Conduct a comparative analysis: Assess how health survey results compare by geography, by working team, and by team member level in the organization. Finally, ask whether health survey results have improved after implementing interventions.

Results from such "human risk audits" are used differently than results from corporate or financial audits. Health checks are administered across both companies in an alliance and the results are reviewed jointly. Interventions that result from health checks can significantly reduce the possibility that relationship factors contribute to issues in the alliance.

The Audit is Over. Now What?

Most corporate audits will culminate with a detailed report of findings, often with varying degrees of severity. The credibility and authority that your company's internal audit department brings will provide added influence to help you implement necessary changes. Internal audits are a great way to proactively identify risks and enable the team to implement corrective measures before the risk is realized. Audit results should initially be shared with internal alliance leadership, and then with the broader internal team. We have found that sharing a relevant list of audit findings with the alliance partner can be beneficial, particularly when corrective measures involve alliance processes. Positioning the audit, any relevant findings, and the discussion with the alliance partner should be done in a non-threatening way that highlights the benefits of reducing alliance risk.

Just as few people look forward to undergoing a complete physical exam, few alliance managers look forward to an alliance audit. Neither activity is particularly "fun." Both activities uncover risk. Yet the goal of a physical exam is to find ways to enhance your health and well-being. Similarly, a good alliance audit can help you take steps to improve the overall health of an alliance. With a solid understanding of the purpose and the processes involved, we can all move closer to viewing audits as a way of improving alliance performance and reducing alliance risk. As alliance managers, these are goals we all share. ■

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