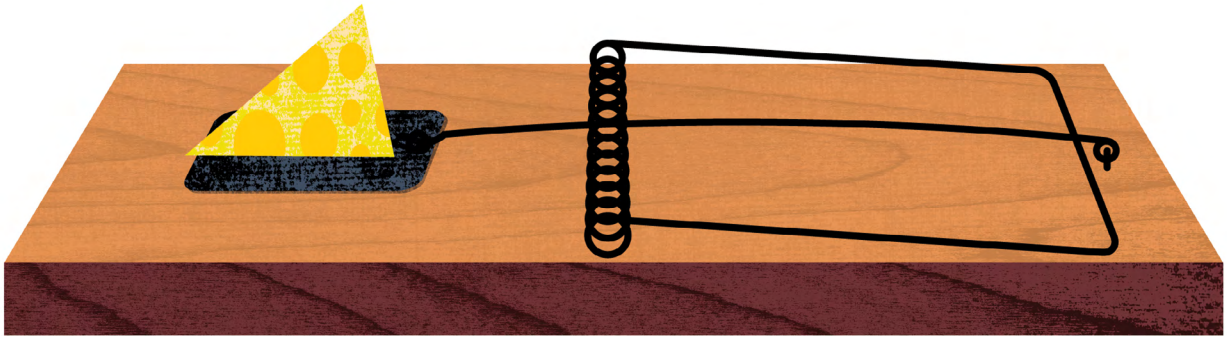

ERP INSIGHTS

Leveling the Playing Field

What to watch out for in standard ERP contracts

BY MIKE MUCHA

In preparation for an enterprise resource planning (ERP) project, governments spend months developing a request for proposals (RFP) with carefully worded questions, writing detailed requirements, reviewing proposals, and interviewing potential consultants. After all of this, a selection is made to award a contract to the "best" ERP vendor or vendors providing software, implementation services, project management, training, and more, along with promises of efficiencies, best practices, and transformation into a modern organization. So, despite this level of due diligence and focus on finding the right vendor, why do so many projects end up failing to deliver on expectations, exceeding budget, or blowing past deadlines for completion?

As we discussed in the February 2024 issue of *GFR*, governments can be at fault. Some governments don't have a project vision, don't understand project management, lack proper governance, struggle with decision making, underestimate the role of change management, or let vendors fail to hold other vendors accountable for poor performance. But even the most prepared governments can be left thinking: Are all ERP implementation projects this difficult? How did we end up with a vendor that is this bad? Did we make the wrong choice? Did our selected vendor misrepresent their qualifications?

The truth is that most governments probably ask themselves all these thoughts from time to time. Most projects can recover from rough periods. For those that run into more significant issues, though, or those with small issues that quickly turn to big ones and then send the project into a tailspin, there seem to be a few common sources of aggravation. In some cases, even vendors with the best of intentions run into bad luck. In others, governments and vendors run into real conflicts and rely on their contract and the details of the statement of work to sort out responsibility and a path forward. This is where governments often run into major problems.

In many cases, "industry standard" contracting terms or practices are stacked against governments—which is not all that surprising. Vendors are aware that these projects involve risk, and their templates for master agreements and statements of work attempt to shift burden of that risk to the government while shielding their own liability. Unfortunately, regardless of what your salesperson tries to get you to believe, ERP vendors and governments are not fully aligned on project success, and this becomes perfectly clear when issues arise.

With a limited number of vendors in the market and huge barriers to entry for new providers, vendors can brazenly push back against public procurement best practices, and they've been able to use their experience and governments' general immaturity in modern cloud software contract standards and implementation requirements to create quite the slanted playing field. In some cases, standard terms in the industry have even been rolled back. For example, ten years ago, most ERP vendors would agree to limitation of liability language that set a liability cap at two times the total value of fees in a contract. Now, despite a cloud model where more risk is transferred

to the vendor, the most common liability cap is set at one times the fees paid over the previous 12 months—a significant decrease. When governments agree to a vendor's standard terms without reading them or are unable to foresee the implications of complex language written to protect interests of the vendor, they put their project in a tough position for resolving disputes without facing costly change orders.

But governments don't have to face this battle alone or start fresh, trying to overcome an industry with a multiple-year head start in developing one-sided contracts. GFOA's Research and Consulting Center has assisted more than 600 local governments with ERP procurement and implementation over the last 20 years and has collected information on trends in the market. As an advocate for governments, GFOA has also been involved in working to promote best practices in the public procurement for ERP software. The history of one project often helps inform necessary changes to the statement of work to protect the next government from a similar fate.

There is no doubt that ERP projects can be difficult and risky endeavors. There should also be no doubt that vendors and governments should split certain risks on these projects. Where appropriate, governments can even compensate vendors for taking on additional risks. What doesn't work and should be clearly labeled as red flags for finance officers, procurement officials, and government leaders are the one-sided predicaments that governments can find themselves in. Over the last few years, GFOA has observed a significant shift in some standard terms and some egregious examples of one-sided contracting practices.

This article provides recommendations for governments entering into ERP agreements or statements of work, to protect their interests and work to level the playing field. The article also attempts to highlight what to look out for. In many cases, negotiation of these terms starts with setting appropriate expectations in the RFP and properly evaluating (and not short-listing) vendors who attempt to remove these simple and fair safeguards.

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Contract expectations

Despite what some vendors may claim, GFOA still believes that major ERP software and implementation should be awarded through competitive RFPs. The RFP process provides an opportunity to set clear expectations for the project; define goals, scope, and requirements; evaluate proposals and consider the strengths and weaknesses of each; evaluate risks; and properly vet potential firms. Yes, the RFP process used for ERP projects should be different than a standard bidding process used to purchase bulk commodities, and yes, the final contract may need to incorporate special provisions not found in a government's standard template. But governments also shouldn't feel that they're sacrificing their own standards or values in moving forward just to sign a contract with their preferred firm.

Below are ten simple contract expectations that all governments should have, going into their ERP projects, and warnings about other less-than-fair contract terms that governments are very likely to be confronted with during negotiations.

1. Include requirements in the agreement. Including requirements in an RFP that defines scope is not a new idea. This has been a core GFOA requirement for ERP projects for 20 years. And requirements are not specific to ERP projects alone. According to the National Institute for Governmental Procurement's global best practice document on RFPs, the scope of work in an RFP should include requirements. When used correctly, requirements define the scope of the project, provide a method for comparing features and functions from various vendors, serve as a checklist for project acceptance, and provide a baseline for the professional services warranty.

Generally, vendors don't have an issue with responding to the requirements in RFPs. Their response communicates the capabilities of their software and confirms the scope of implementation. Requirements also communicate the scope for pricing unique aspects of the project like interfaces, complex configuration rules, or extended features to include in scope and price. When vendors present an initial statement of work, however, it rarely references those same requirements that were the basis for their RFP response. Without requirements in the contract, there is no way to hold vendors accountable for the promises made during the procurement process. There is also no definition of the scope and no acceptance criteria for the project.

GFOA has experience with vendors resisting the inclusion of requirements for a variety of reasons. It's true that requirements are not specific to the selected ERP system. They shouldn't be. Requirements should define what the system needs to do, not how it goes about it. And yes, the original wording of some requirements may be vague or unclear. When the statement of work is being developed is a great time to clarify those requirements, not eliminate all requirements.

Also, you should recognize that requirements may change during the project. All plans can change as more information is discovered, and when that occurs, it's acceptable to modify requirements and mutually agree with the vendor on the revised scope. If requirements are added, additional costs may apply. If requirements are removed, discounts may be appropriate. Including requirements in the contract and insisting that the vendor warrant the implementation of these requirements is the only way to equate outcomes for the project with the price. With any fixed-fee contract (and all ERP projects

should be done as fixed-fee contracts), requirements are an essential part of defining scope, and they set the baseline for requirements traceability and acceptance during the project.

2. Avoid statements that conflict with requirements. If requirements are included in the scope, they should be the definitive scope for the project. If requirements call for an interface to a time entry system, configuration of purchase requisition workflow, or development of a published budget document, the scope of the project should include all tasks, effort, and costs to achieve those requirements. Governments should clearly be able to trace all requirements through milestone sign offs, and ultimately, the sign off on the entire project should be based on satisfaction of the requirements.

GFOA has noticed an alarming trend with ERP contracts over the past few years. Vendors have begun inserting limits to the scope or configuration caps that conflict with their responses to the requirements. Using my previous example, the vendor will state that each requirement will be met; however, the "small print" of the statement of work will also state that the statement of work assumes no interfaces that don't conform to pre-established templates, workflow may only include one level of approval, or report development is limited to a set number of hours. Each of these conditions on the scope runs the risk of leaving the government without the requirement being satisfied, but also with a vendor that feels like it has met the obligation of the agreement.

More concerning, GFOA has witnessed select vendors attempting to qualify their entire configuration effort with hundreds of conditions that very vaguely and arbitrarily define configuration limits in the system. Most RFPs will set expectations that the required solutions fully deploy the software to meet business needs in a variety of functional requirements, further defined by specific functional requirements. Conditions inserted into a statement of work by select vendors, like those listed in Exhibit 1, limit configurations for items like: security groups, compensation rules, pay types, leave rules, locations, business units, calendars, and more. It's impossible for a government to comprehend if the maximum quantity listed is sufficient. Almost all of these caps are based on terminology used within the system and for which the government has very limited knowledge of. Second, all of them have the potential to conflict with requirements. Third, the quantities are either set without knowledge of unique aspects of the scope, or they're entirely based on the vendor's assumptions, which, again, is impossible for the government to verify, and the only assurance is often the vendor saying "trust me."

The only purpose of such scope-limiting tables is to reduce the level of effort from the vendor and creates significant risk for change orders. Even more problematic is that if a government doesn't come close to the configuration limit for certain categories, the price won't be reduced; however, if the cap is then exceeded on others, there is a potential for the price to be increased. In reality, adding these scope tables significantly changes the actual scope of the project and in GFOA's view has the potential to make the vendor's proposal (and contract) non-responsive to the RFP.

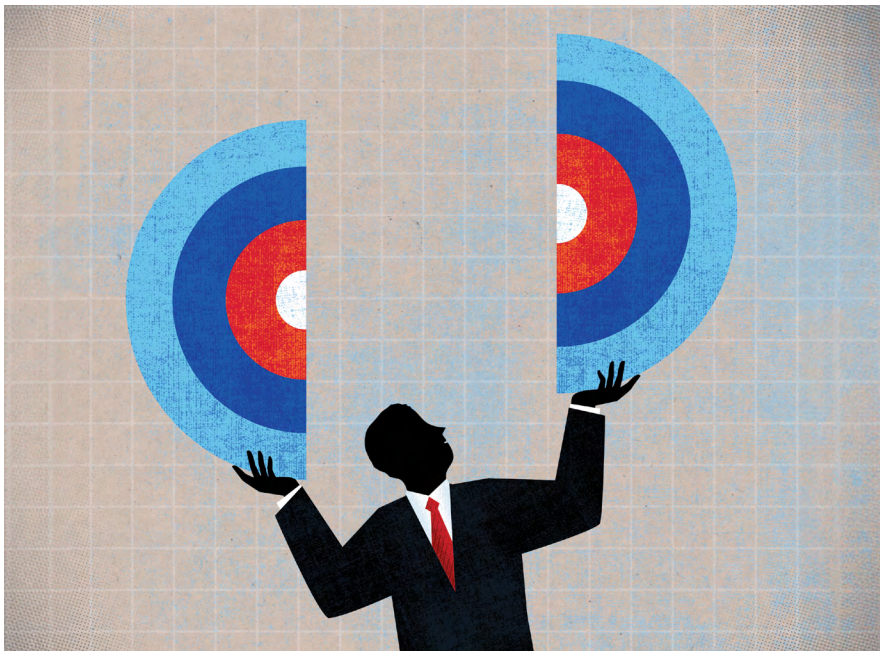
3. Require traceability and system acceptance based on meeting requirements. Governments can spend a significant amount of time developing requirements that lay out what the new system will need to be configured to do across functional areas (accounting, project accounting, procurement, accounts payable, capital assets, human resources, payroll, and more). Vendors then provide a fixed price for meeting all those requirements. So, how is it possible for projects to go live (on-budget), but still fail to implement major sections of the scope?

If the statement of work doesn't require a process for requirements traceability or system acceptance based on requirements, it's easy to see how the scope can be redefined or the finish line that defines success for the project moved. For example, before going to the grocery store, I make a list of the items that I need to make dinner. For this example, let's assume that I'm making pasta and need noodles, sauce, and garlic bread. When I go to the store, I bring my list to make sure that I don't forget to purchase any of the items. When I check out, I'm charged for the noodles, sauce, and garlic bread, and I get a receipt showing that I paid for each item. When I get home, I can verify that I have each item. This is what should happen with ERP requirements traceability. I make the list (requirements). I bring the list to the store and check off items as I put them in my cart (traceability). I then receive a receipt showing I paid for and received the items (system acceptance). Now, if for some reason, I didn't end up getting the garlic bread, I shouldn't have to pay for the garlic bread. This is common sense. Unfortunately, that's not the experience of ERP projects.

EXHIBIT 1
EXAMPLE OF SCOPE LIMITATIONS

If the level of effort necessary to configure the system is significantly increased because of government decisions that require any of the following quantities listed in the table below to be exceeded, a change order may be required. *(Note: This list extracts elements to provide an example of scope limitations. The actual table often contains hundreds of items and can extend for 30 pages or more.)*

Legal entity	1
Supervisory organization hierarchy	1
Cost center	200
Business units	20
Allocation rules	5
Asset books	2
Invoice templates	2
Project accounting templates	5
Unions	2
Bargaining units	5
Pay groups	8
Job profiles	250
Job families	100
Salary plans	1
Hourly plans	1
Allowance plans	1
Accruals plans	5
Management levels	7
Modified workflows	2
Security profiles – easy	5
Security profiles – moderate	5



Without requirements in the contract, there is no way to hold vendors accountable for the promises made during the procurement process. There is also no definition of the scope and no acceptance criteria for the project.

Without clear requirements traceability, ERP vendors are able to change the definition of project success from satisfying the requirements to simply going live and using the system. Going back to our example, this would be the same as the store charging you for all three items because you completed the trip to the store. While the price was based on getting the three items, the government is forced to pay for the "trip" regardless of how many items actually made it home.

When projects often run into challenges, vendors will propose delaying functionality, removing functionality from scope, or simply not get around to configuring all that was promised. At the same time, milestone payments are rarely reduced to account for the gaps in what was delivered. To prevent this, governments should insist on requirements traceability as part of the design process to make sure that all requirements are included in the plan for the system and that the system acceptance process validates requirements at both go live and a period after go live. Final payment should then be based on this post live validation, which is often referred to as project close out or final acceptance.

4. Resist urges to "accept" incomplete milestones. It may seem unnecessary to say that you should only sign off on milestones that are complete, but this has been an issue on past ERP projects. The purpose of an acceptance process is to provide a quality assurance function to verify that contract requirements are met. Signing off on milestones is validation that work has been performed that meets requirements. It also often triggers payments in a milestone-based contract.

When projects get off track, GFOA has witnessed vendors putting pressure on governments or individual project managers to sign off on incomplete milestones that will enable the project to move forward. They can recommend signing off "while noting exceptions," which defeats the whole point of the sign off process and often quickly leads to bigger problems. In some cases, vendors have also used this against governments to support their case for change orders when governments later request additional work to resolve issues. For example, if design is not properly signed off on, the project should not proceed to configuration or testing while these lingering issues exist—or the government risks a change order to later modify that configuration. ERP projects should have clear expectations for sign offs, and sign off shouldn't happen until each issue is met. Final acceptance shouldn't be granted until all requirements for sign off are met.

5. Set clear expectations for deliverables. Within an ERP project, "deliverables" are the work products the project team provides outside of the system. These work products are often used for quality assurance purposes or to organize the overall project effort, and they can include project plans, design documents, business process recommendations, test scripts, training materials, and more.

Since deliverables have an important quality assurance role, acceptance criteria must be set for each deliverable. For example, the statement of work should clearly define the scope, format, and purpose of each deliverable, along with roles and responsibilities for creating it. GFOA uses a template called a deliverable expectation document to set these expectations for deliverable acceptance. It is also a good practice to meet with your consultants before working on a deliverable to discuss expectations for producing the deliverable and how it will be used.

6. Beware of statement of work assumptions or statements that suggest future change orders. Contractual agreement and more specifically the statement of work for an ERP project defines the roles and responsibilities of the government and vendor. ERP projects are ultimately

collaborative efforts, with both parties contributing resources and completing tasks. GFOA considers the inclusion of statement of work assumptions to be highly problematic. These are often listed at the end of the document and provide overarching statements that conflict and offer broad statements that are often one-sided and lack any logical next steps if not met. For example, if the statement of work requires that the government provide a full-time project manager, the expectation is clear. If the requirement is not met, the statement of work provides a remedy process that may include discussion at steering committee meetings, dispute resolution, and the opportunity to cure. But if the statement of work states an assumption that the government will provide a full-time project manager, what happens if it doesn't?

If the entire proposal was based on this assumption, is the vendor relieved from all their contractual obligations? Often, assumptions are not as clearly defined as my example and can include items like assuming adequate staffing, timely reviews, staffing key positions with consistent and skilled employees, or other vague concepts—any of which could unravel the entire statement of work if not met.

Even if vendors don't take the position that an unmet assumption will relieve their own contractual requirements, it is almost always included as an opportunity to initiate a change order. For example, assumptions to implement "a vendor's best practices" is problematic because this language is extremely vague and potentially conflicts with statutory requirements, public-sector best practices, or other current requirements (like bargained memorandums of understanding).

To GFOA's knowledge, no vendor has defined a clear set of best practices that anyone in government would actually describe as a set of best practices, so what this actually means is open to interpretation and debate later. While there is nothing wrong with going into a project with the expectation of using a system as it was designed, this may not be possible for all functions—especially if the system has limitations. An assumption like that is simply an invitation for change orders for any unexpected complexity. In general, the entire statement of work should be carefully reviewed for suggestions of future change orders or vague expectations.

> As a general rule of fairness, governments should insist that requirements and contractual provisions apply equally to both the government and the vendor.

Another potential risk of increased fees is related to the limited license that vendors provide to use the ERP software. Most vendors have moved to an enterprise model for ERP software subscription costs, which are then based on a metric. For example, annual costs are established based on number of employees (not number of users). The RFP governments release should provide basic information about the organization and list how many employees it has.

But employees can be counted in different ways. Governments often express employee counts as full-time equivalents, headcount, W2s processed, or as counts of full-time, part-time, and seasonal employees. Based on the definition selected, numbers can also be different. And vendors often have their own, much different definition of an "employee" for purposes of calculating license costs. For example, vendors can include contractors, volunteers, retirees, or individuals paid very infrequently (like jurors or election poll workers). Governments need to be clear about the definition of an employee or similar metric used in the contract to avoid a scenario where it finds itself out of compliance and owing huge expansion fees in subsequent years of its license contract.

7. Set realistic timelines. One driver for ERP implementation cost is the length of the project. For example, a nine-month phase will generally require fewer vendor resource hours than a 14-month project. While the level of effort for some resources would be unchanged regardless of length, that is not the case for all projects. For example, project management fees will almost always be more the longer the project. If not managed correctly, this creates an incentive for the vendor to propose overly aggressive timelines that are based on a very favorable set of assumptions and consideration only for ERP system configuration tasks—and to then protect themselves against risk of not meeting the unrealistic schedule by requiring change orders for any extension.

ERP projects often involve more than system configuration tasks and, when done correctly, involve process change, policy refinement, user training, or even considerations for change management—all of which takes time. Governments need to properly plan and set realistic timelines for accomplishing their goals and project requirements, rather than simply go live on the most basic system functions. Governments should also avoid establishing project management fees as monthly charges and instead define project management costs for the entire project. This helps provide for a more honest estimate of schedule initially.

8. Insist on consistent staffing from key resources. Vendors often take the position that they must have complete flexibility on resources assigned to the project. GFOA completely disagrees. Project continuity should be maintained, and governments should seek contractual protections barring vendors from swapping resources. Without such protections there are two types of project team changes that can cause disruption on a project. First, vendors will have a more experienced consultant conduct analysis meetings and develop configuration designs or recommendations. That resource is

then swapped out during configuration activities. This can be especially problematic when the two consultants don't agree on the best strategy or where neither has full understanding of actual requirements or current environment. Second, vendors want freedom to shift consultants to other projects. While there is generally nothing that can be done for project team changes resulting from reasons outside of the vendor's control, like a consultant leaving the firm, going on medical leave, or experiencing changes in their family situation that may limit travel, vendors shouldn't be able to swap out resources and redeploy at higher profile or more profitable projects.

Any change in the project team is disruptive and will require an onboarding process for the new resource and additional effort by the government to build relationships and transfer knowledge to the new resource. Not only does this add significant risk, but it also adds cost to the project and delays to the timeline. GFOA recommends contract language that does not allow for project team changes without approval of the government and without the vendor compensating the government for any additional costs.

9. Define the role of the project manager. The vendor's project manager serves a critical role on the project, so the statement of work should clearly define that role and how it provides value for the entire project. GFOA cautions governments against vendor project managers who interpret their role as protecting the interests of the vendor. That role should be more than scheduling resources, collecting sign off, and communicating change orders. The tasks of an effective vendor project manager should include developing and maintaining a project plan, managing an issues list, drafting status reports, proactively managing risks, taking a lead with project communications, and building relationships with team members. The project manager can also serve an important quality assurance function by ensuring that deliverables meet acceptance criteria before the government reviews them.

In addition, project managers serve an important role in coordinating the activities of the entire team and working to ensure proper communication between consultants. One of the most frustrating experiences on an ERP project is when two consultants disagree with each other or point fingers, claiming that they don't have knowledge of another module. ERP systems are not designed to be siloed, and ERP project teams should not act as though they perform in a silo. An effective project manager can help reduce the risk and ensure a project culture focused on collaboration and problem solving.

10. Make the statement of work reciprocal. As a general rule of fairness, governments should insist that requirements and contractual provisions apply equally to both the government and the vendor. In GFOA's experience assisting with contract negotiations, it is surprising how often that suggestion is met with resistance. For example, standard vendor contracts explicitly call for increased fees if a government causes the project to be delayed, but they include no offer of reduced fees or penalties if the vendor delays the project. Similarly, one vendor insists on penalty language if meetings are cancelled by the government, but no such protection if meetings are cancelled by the vendor. Surprisingly, vendor agreements sometimes include non-solicitation language to prevent a government from hiring a consultant, but no reciprocal language if the vendor hires a government staff member, despite this being far more common—and more detrimental to the party losing the employee. GFOA has also witnessed vendors insist that governments adhere to vendor security standards that are undefined or have potential to change, while no more than five minutes later claiming they can't do the same for a government's security protocols without fully vetting them in advance. Where possible, and where the vendor is using certain statement of work or contract terms to open the door for change orders or increased payments, those provisions should be made to apply equally to both parties.

Conclusion

We've all heard that "insanity is doing the same thing over and over again and expecting a different result." We know that government ERP projects don't have the best track record for success. We also know that when ERP projects face challenges, vendors often have significantly more leverage to impose change orders and increased fees, which at times can be near or equal the initial cost of the project. While ERP horror stories that feature cost overruns of 300 percent or more are rare, they do exist. For all projects, the nature of the relationship between the government and its ERP vendor will put the government at a disadvantage. It's a fact that while the vendor primarily risks money and its reputation, the government risks the same along with far greater risks associated with business continuity. To help level the playing field somewhat, governments should not continue accepting these one-sided, vendor-developed contract terms.

None of the suggestions made in this article are new, and vendors have proven they can be profitable and successful when fair protections are in place. In some cases, select vendors even welcome these protections as a way of demonstrating sound project controls and developing a mutually beneficial partnership. But our recent experience shows that is far from being the norm. GFOA would caution governments that experience difficult negotiations with vendors that are unwilling to meet in the middle or that insist on poorly worded or one-sided contract templates to consider what it's like working with that vendor later and facing similar negotiations over costly change orders while you have even less leverage than you do now, before the project starts.

Mike Mucha *is deputy executive director for GFOA and director of GFOA's Research and Consulting Center.*