SC&H FOREFRONT CASE STUDY IN BUSINESS FINANCIAL LEADERSHIP

DIRECTLY ADDRESSING INDIRECT SPEND OVERPAYMENTS

How a National Telecom Benefits from Contract Compliance

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Companies invest heavily in procure-to-pay systems and processes. Preferred suppliers are selected, requisitions approved, purchase orders issued, and products or services received. Then invoices are processed and payments are issued. Yet despite the investments, sophisticated controls and business rules, highly reliable contract compliance in large companies remains elusive. Each touch point from requisition to payment is itself a control; nonetheless, approved invoices containing over charges are paid. Procurement, end users, and accounts payable usually do not have the resources to investigate what lies beneath: the contract that defines and details the terms and conditions between the buyer and seller of the product or service.

The buyer and seller have a shared responsibility for ensuring the accuracy of the amount paid, but because of oversights, mistakes and assumptions, errors often go unnoticed. Errors that are unseen or overlooked add up, costing companies millions of dollars each year. Contract compliance audits address these errors, ensuring a company's spend aligns with its contract terms for the products and services received. This kind of thorough review can result in significant recoveries, while establishing the controls to reduce and avoid future non-compliance.

Putting Exceptions in Their Place

With a diligent and professionally administered contract compliance program, large companies can recover millions of dollars in overpayments to suppliers as a result of identifying overlooked contract non-compliance. Companies can also gain insight into their spend, helping them to better manage their supplier budgets and relationships. SC&H clients on average realize a 2 to 4 percent recovery – some as high as 20 percent – of their spend with each contracted supplier that is audited.

A national telecommunications company, with multiple offices and thousands of retail locations nationwide considered a review of its indirect spend with suppliers. The number of contracts made an internal review unmanageable given the limited bandwidth of company personnel and the lack of subject matter expertise necessary to conduct a thorough, targeted supplier contract audit project. The company engaged SC&H to compare its contracts with suppliers of products and services against historical invoices. Although the company engages with thousands of vendors, SC&H began by focusing on the highest risk, indirect spend categories. Fourteen (14) service providers were audited in the first wave, and $7.5 million in non-compliant supplier billings were identified.

As an example, the company retained a security firm to provide armed guards in specific retail facilities. The contract specified an hourly rate, and further stated that that the security firm would neither subcontract services nor mark up costs if it did subcontract. The security firm did not abide by the details of the contract in all instances, resulting in a negotiation with the company to have previously made overpayments returned. Also, the audit identified improper overtime billing. In this instance, the security firm billed for all guards' overtime according to the law of one state, which defines overtime as over eight hours a day. Most states in which the company has a retail business presence define overtime as exceeding 40 hours a week. The company received a substantial recovery of contracted payments by calculating the difference between the amount billed and what should have been paid.

For this client, of the $7.5 million identified during the first wave, SC&H has thus far been able to recover $3.2 million.

Attention to Contract Structure

The structure of a contract between a client and its supplier impacts the risk of overpayments in indirect spend. For instance, marketing and advertising contracts (creative, production, media buying, and events) typically allow the agency to receive an upfront payment based on estimated cost to complete the deliverable. The contract usually requires that the estimated payments be reconciled with actual effort and costs incurred after the service is delivered.

Periodic reporting to clients is routine for an events management agency, a key marketing vendor for many companies. Nonetheless, because of the variety and number of costs incurred during large events – of which travel and entertainment is a sizable part – it is easy for a company's prepayments to the agency managing an event to remain unreconciled to actual costs. These exceptions are often identified by a detailed comparison of actual versus estimated costs in categories such as the number of guests in attendance, on-site entertainment and other activities, and meals and refreshments. What's more, events management agencies often receive a commission from the hosting hotel based on the number of guests and their length of stay for the event. The commission that the events management company receives is often contractually required to be credited to the sponsoring company, which does not always occur, and can lead to a significant recovery.

Most advertising and marketing agencies create budgets for the total cost of an event, the creative or production job, and/or the media buy. The agency then periodically invoices the client a percentage of the total budget in advance. The estimated prepayments need to be reconciled to actual costs. Media spend can be especially complicated, leading to reconciliation errors if the terms of the buy are not carefully evaluated. Cable, radio, and at times print and interactive buys specify factors such as ratings points purchased or times the ad runs, as well as other contracted details. Reconciling the campaign buy to actual media delivered can result in sizable refunds for overpayments and unrealized credits.

Paper, Pens and Paper Clips

Multiple categories of products, many SKUs delivered to multiple locations, and contracts that can include freight terms, delivery guarantees, and rebates in addition to the item pricing – who would have thought the world of office supplies could be that complicated? And yet it is. Because it is, mismatches between the contracted and actual price paid, rebate earned, and freight charged are missed – often on a repeated basis. Supplies are ordered and received by a large number of company personnel on a daily basis, so the missed opportunities can add up to a substantial sum.

Even though office supply contracts may be complex, they are familiar to those who deal with them every day. The pricing structure may seem simple enough, until the sheer volume of supplies ordered and received under different terms and conditions is considered. Discounts can apply once volume thresholds are achieved or for separate categories of supplies. The possibility for a costly mishap that is repeatedly processed in error is considerable.

As with other reconciliation exercises for its clients, SC&H was able to recover a significant sum from misstated unit prices, unallowable freight charges, and unclaimed rebates in this category for this national telecommunications company.

The results outlined here are for just three categories involving a specific client's recovery of indirect spend overpayments, a small part of the hundreds of contracts SC&H audits each year for companies across the world. For this client, of the $7.5 million identified during the first wave, SC&H has thus far been able to recover $3.2 million, directly impacting this company's bottom line.

Aligning Interests

A contract is between a company and its supplier, not an intermediary – something SC&H has a reputation for understanding in terms of business relationships. The role of a contract auditor is not to stand between a company and its supplier, but to facilitate their relationship in terms of already pre-agreed, mutual obligations without any disruption to continuing business. SC&H works closely with all parties to obtain and thoroughly understand the contractual arrangement. If exceptions are identified, the exact detail shown to our clients is also shown to suppliers.

Although contract compliance audits invoke repeatable processes, no two audits are the same, even within the same spend category. There are specific ways companies can craft, interpret and apply contractual arrangements, different levels of the supplier/company relationship, and thus appropriate strategies to also be identified and exercised in any given contract compliance audit.

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Uncovering contractual non-compliance with suppliers results in increased transparency and educates company personnel. Implementing the lessons learned and recommendations that result from the review can reduce future vendor overpayments, adding to the company's bottom line. Alignment between contractual arrangements and supplier performance eliminates significant financial leakage for companies, but it also leads to greater knowledge, communication, and the kind of accountability that characterizes all healthy business relationships.

SC&H Group's Contract Compliance Audit practice provides clients with highly efficient supplier audits and recovery services that maximize companies' ROI and require minimal company time investment. Our clients are global businesses with offices and operations in over 25 countries. SC&H's unique approach ensures stakeholder buy-in with the supplier compliance audit process, and an identification of the most consequential of non-compliance issues. SC&H Contract Compliance expertly negotiates with suppliers for the most advantageous results, and makes recommendations to ensure future compliance.

SC&H Group is an audit, tax, and consulting firm applying "expertise that works" to minimize risk and maximize value. SC&H Group's practices advise leading companies from emerging businesses to the Fortune 500 on accounting, tax, profitability, and strategy solutions. Clients in all states and worldwide benefit from SC&H Group's commitment to delivering powerful minds, passionate teams, and proven results on each and every engagement.

Disclaimer: Business processes and their results outlined in this case study feature the experience of one client, and are not to be construed as replicable in all instances.

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