

A White Paper by
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The Case of the Disappearing Credits

Why a Fast Start to Credit Recoveries is a Best Practice.



White Paper Features:

- An investigation into why and how your vendor credits vanish
- A look at the financial impact of waiting to identify and claim your credits
- An explanation of what you can do to make sure your credits remain yours

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Executive Summary

While the term ‘time is of the essence’ usually refers to legal matters, it unfortunately applies equally as well to the recovery of vendor credits. For, as the research you are about to read demonstrates, waiting to claim credits from your vendors is a costly course of action. Over time, they simply evaporate.

Anecdotal evidence has long pointed to this phenomenon but now, new data which I was able to analyze through access to the Lavante Recovery platform backs this simple thesis: Time really does matter when it comes to vendor credit recoveries. Waiting a year or two to recover them is expensive. That expense comes not from the time value of money but rather from the vendor finding uses for open credits other than returning them to their customers.

As the research presented in the following pages demonstrates, the bottom line is quite clear. Every company must initiate an ongoing vendor credit recovery audit. For without an ongoing credit recovery audit, versus a traditional project-based payment audit every two-three years, companies are effectively throwing their credits in the trash. As the paper will demonstrate by looking across a host of companies millions of dollars are at stake.

The Case of the Disappearing Credits

Why a Fast Start to Credit Recoveries is a Best Practice

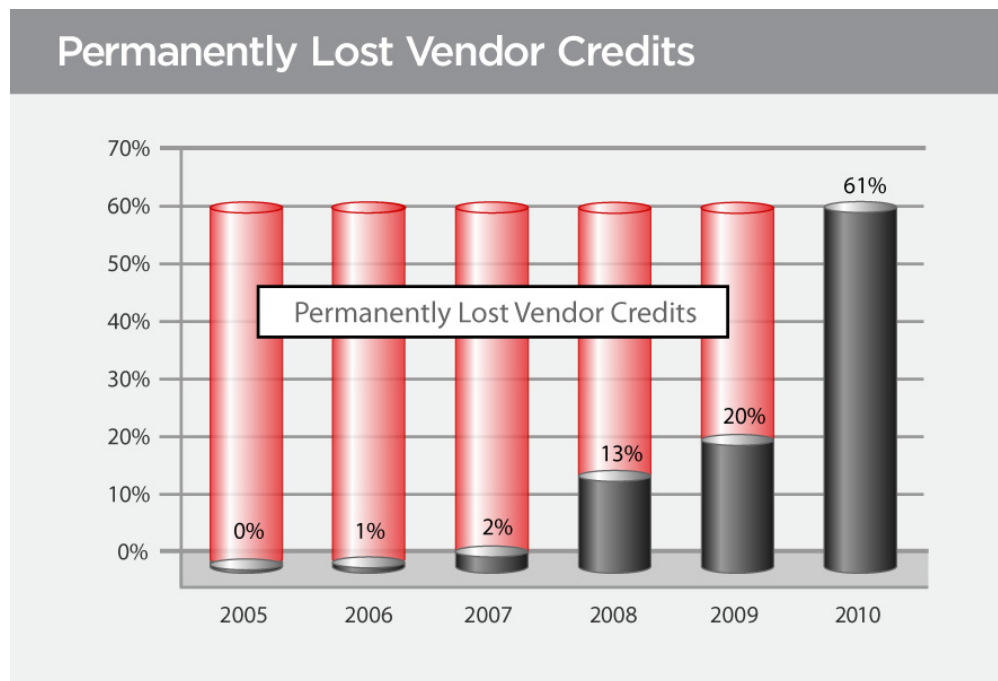
The Time Factor

Anecdotal evidence has been growing recently, showing that vendor credits have a way of disappearing if they are not quickly recovered. Lavante, the statement audit experts, provided me with full access to the Lavante Recovery™ platform, an online solution that provides easy access to recovery results via a comprehensive range of reports and dashboards. One report which was especially useful in understanding the issue around disappearing credits was the “Vendor Credits by Year Created.” It is really this report, which displays for each client every credit line item uncovered by Lavante by the date the credit was “born.” The report, which I’ve not seen in other audit solutions, enabled me to analyze the results of a variety of audits to determine if what we suspect is true, and to quantify the amount of money lost as well as potential exposure should no actions be taken.

Let’s review results from eight Fortune 500 clients who began vendor credit recovery audits with Lavante in early 2010. Figure 1, *Combined Vendor Credits by Year Created*, shows how much was recovered in that audit by the year that the credit was created for these eight enterprise companies. It should be noted that in some cases, more traditional recovery audits were also being used. In all cases considerable dollars were lost across each of these eight companies.

Figure 1: Combined Vendor Credits by Year Created

Recovery results for eight fortune 500 companies are shown here. The red accounts for the dollars lost by not engaging in a recovery process earlier.



Now, let’s take a look at four specific examples I was able to study using Lavante Recovery results.



Case #1: Fortune 500 Retail Chain

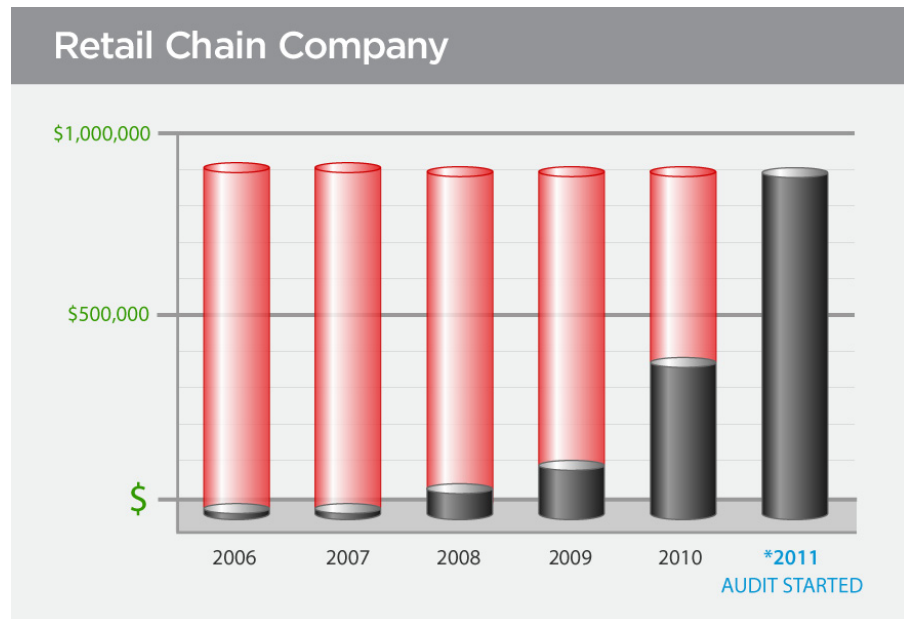
In May 2011 Lavante began a statement audit of a Fortune 500 retail chain with an annualized vendor spend of just over \$9 billion. Figure 2 below shows the recoveries made in the first five months of the audit by year the credit was dated.

You’ll notice that even though the recovery efforts were begun mid-year, most of the credits recovered were attributable to the current year, with the prior year contributing about half the amount and the year prior to that a very small amount. What happened? Was the retailer generating a lot more credits? Discussions with the retailer and comparisons to other companies suggest this is not the case. Rather, the credits are going up in smoke.

As Figure 2 demonstrates, the total recovery for this organization was just under \$1.5 million against an annual spend of \$9 billion. What is particularly interesting about this case is that the company already had a traditional recovery audit performed by another company and Lavante was still able to recover well over \$1 million.

Figure 2: Fortune 500 Retail Chain Credit Recoveries

As in Figure 1, the red portion of the bars for each year, 2006 - 2010, show the lost recovery dollars before the 2011 audit was begun.

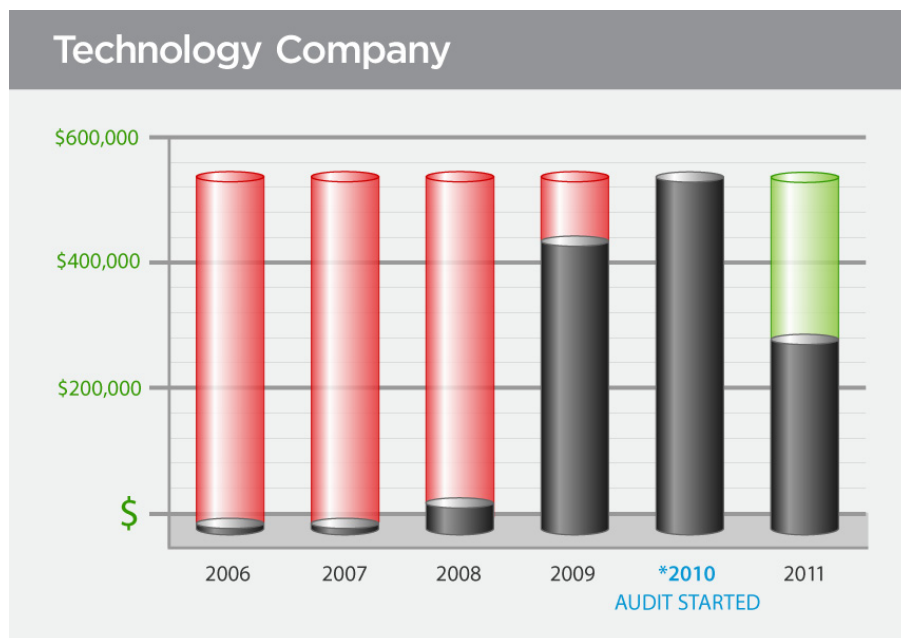


Case Study #2: Fortune 500 Technology Company

This example is a well-known Fortune 500 technology company with an annualized vendor spend of \$2.3 billion. In this case we've got some history as Lavante started its vendor credit audit in early July 2010. Figure 3 shows the results of that ongoing audit.

Figure 3: Fortune 500 Technology Company Recoveries

Here, the red indicates dollars permanently lost, while the green shows how recoveries begin to decrease as the process uncovers issues and corrective actions are taken.



It is quite interesting that the year the statement audit was started is the year with the most credits. This confirms the thesis that over time credits disappear and introduces another concept. Not only does starting the recovery efforts early result in a larger recovery, smart companies learn from their mistakes. They fix the processes that allowed the credits in the first place and moving forward have fewer credits to recover. In this case, one such fix involved identifying process issues in applying co-op advertising dollars which represented hundreds of thousands of dollars in recovered dollars.

As Figure 3 demonstrates, the total recovery for this organization was just under \$1.4 million against an annual spend of not quite \$2.5 billion.

Case Study #3: Global Manufacturer

Let's take a look at another company, a large global manufacturer with an annual vendor spend of \$4 billion. Lavante started working with this organization in March of 2008. Figure 4 shows the recoveries from this ongoing audit by the date the credit originated.

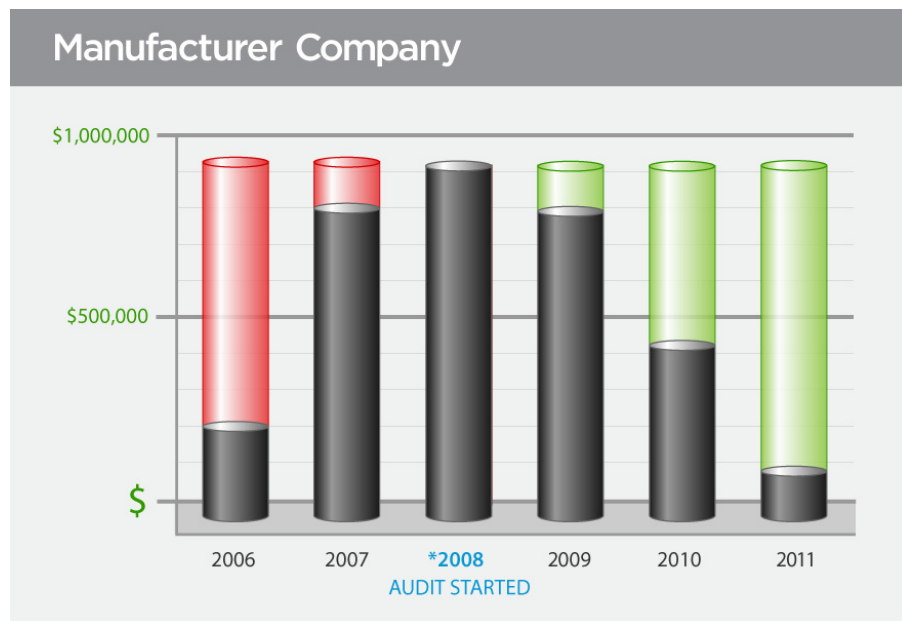
Once again, the year the audit was commenced showed the largest recoveries. As you can see, since the audit was started shortly after the end of 2007, Lavante was able to deliver substantial credit recoveries for 2007 but those amounts dropped significantly for the prior years. This chart also demonstrates just how much a company can save as it takes corrective actions based on what is learned in the audit process. In the first nine months of 2011, the company had just over 10% of the amount of credits it had three years earlier. It is far more productive for an organization not to generate the credits in the first place than to have them and need to recover them.

As Figure 4 demonstrates, the total recovery for this organization was almost \$3.7 million against an annual spend of \$4 billion.



Figure 4: Global Manufacturer Recovery Results Over Time

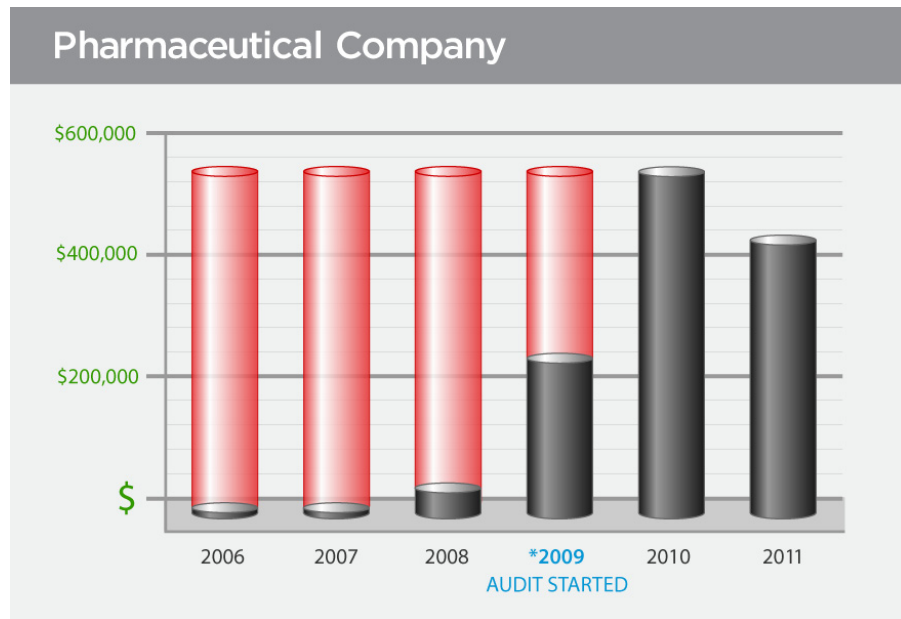
This example shows how much money can be saved through implementing process improvements discovered through the ongoing recovery process.



Every Minute Counts

While there is not a set speed at which credits disappear there is empirical evidence to suggest the degradation of credits begins quite early. Let's take a look at a global 100 pharmaceutical company. This organization had Lavante begin a statement review audit focused on credits towards the end of 2010. As you can see in Figure 5 shown below the lion's share of the recoveries were attributable to the following year. Once again, the company did not suddenly become careless, especially with an outside audit going on. Rather the evidence suggests that the credits began to evaporate almost as soon as they were created. Waiting even a few months can be costly.

Figure 5: Global 100
Pharmaceutical Company
Recoveries



As Figure 5 demonstrates, the total recovery for this organization was over \$13 million against a spend of \$10 billion.



Why Credits Disappear

At first glance, this is a story that defies logic. You may think “well that can’t be; that doesn’t make any sense.” But, as you will see as we go through the data, the facts support the thesis.

In a nutshell, an in-depth investigation and analysis of vendor data combined with anecdotal evidence reveal that the longer you wait to recover your open vendor credits, the smaller they are likely to be, assuming they don’t disappear completely. The older, traditional practice of waiting two years before starting a payment audit is likely to cost your organization hundreds of thousands of dollars if not more. This is money that comes right off of your company’s bottom line.

As astute readers of this paper have probably noted, open vendor credits, in most states, should be turned over to the state as unclaimed property. But, that is not where the money is going for if it were, you could simply recover the funds from the states.

So, where are your open credits going? A variety of places; for starters, ask yourself if you have any vendors who charge late fees? You may have a company policy stating your organization doesn’t pay late fees, but that doesn’t mean your vendors haven’t been accruing late fees on their books. When quarter or year-end approaches, and the vendor’s accounts receivable staff reviews your account with an eye towards cleaning it up, what do you think they do when they see an open credit and an accrual for late fees? That’s right; many of them are using your open credits to clean up those outstanding late fees. And your organization is never the wiser.

Along the same lines, consider if you really earn all of those early payment discounts you’ve been taking. Do you sometimes pay a little past the discount date? Vendors are equally likely to use open credits to clean up unearned discounts as they are to get rid of outstanding late fees.

If you don’t have either of those issues, don’t think you’re off the hook. It’s the rare organization that doesn’t have a dispute with a vendor over an invoice at some point or another. Again, those old disputed invoices don’t disappear to invoice heaven, some vendors are using open credits to clean up old disputes.

Here’s a real-life example that would infuriate many readers. What would your reaction be if you learned a vendor was charging you finance charges on payments it deemed late? I’ll bet most of you are saying, “not on my watch.” Well imagine the dismay of one of the Lavante customers when they discovered that was exactly what their vendor was doing with their credits.

If you are wondering how to get your vendors to stop doing this, you’ll be interested in another fact that has emerged from the analysis of the data. Vendors don’t apply your open credits to some of the items discussed immediately. Perhaps the most interesting feature has to do with the “aging” of your credits.

Quantifying the Problem: The Financial Impact on Your Bottom Line

Perhaps you are convinced that waiting costs you money, but perhaps the total amount just isn't that significant. Obviously every organization is different but the data analysis reveals some troubling statistics. Significant amounts of money are at stake. Consider the following:

- There's only a 5% chance a company will recover a credit using their own internal methods if the credit is still open on a vendor's AR ledger after 105 days.
- Few accounts payable staffs have the time or resources to thoroughly audit statements from all their vendors every month or even every quarter.
- Hence, the vast majority of open credits will eventually be lost.

An analysis of the vendor credit data reveals that most organizations will lose 8% per month of their potential annual recoveries. That's \$80,000 per month per \$1 billion of spend. Over the course of a year, that's close to \$1 million per \$1 billion of spend. These are average figures based on the activity of a large number of Lavante clients. Your actual results could be much worse. And remember, those are funds that come right off the bottom line.

To put that figure in further perspective, consider the following. If your organization is operating on a robust net profit margin of 5%, to get that \$1 million on your bottom line, your sales staff would have to generate another \$20 million in sales. If your net profit margin is 2%, the sales staff would have to bring in another \$50 million to offset the lost credits. Isn't it easier to recover the credits than try and generate those additional sales?

Returning to the Fortune 100 pharmaceutical company discussed above, the company calculated that it would need an additional \$50 - \$100 million in annual sales to have the same impact on the bottom line as the funds recovered through the recovery efforts. While this is very important to all companies, it is critical at public companies where pressure to increase their EPS is intense.



The Carnage Associated with Waiting

So, what's going on? Why was the lion's share of the recoveries based on activity in the prior year? What happened? Did the companies involved suddenly become sloppy generating tons of credits? A little investigation reveals that is definitely not the case. Over and over again, across all industries, the data shows the older a credit the more likely it is to erode. What's more, once the credit is gone, it's gone. The loss is permanent.

While no two companies are exactly alike, the loss of credits has proved to be quite remarkably similar. Let's try and get a handle on how much a typical organization might lose in a month because they delayed the start of a credit recovery audit.

Looking at the Fortune 100 retail chain shown in Figure 2, we can see that by waiting until mid-2011 the retailer lost just over \$600,000 from two years earlier (the difference between the \$700,000 worth of credits in 2011 and the reported credits of \$100,000 in 2009 spread over 24 months). Assuming a linear loss, that works out to \$25,000 per month for the credits that were two years old. But, that's not all. What about the credits from the prior year? The loss there is another \$25,000 (The difference between the \$700,000 of credits in 2011 and the \$400,000 reported for the prior year spread over 12 months). That's \$50,000 a month of seepage every single month for this retailer. It's actually slightly larger because there are a very few credits left from three years prior but that amount is minimal.

Let's investigate what went on at the Fortune 500 Technology company shown in Figure 3 above. The audit started in mid-2010 showed credits attributable to the prior year disappearing at a rate of \$6,666 per month (The difference between \$520,000 and \$440,000 spread over 12 months). But look what happens to the credits lost two years earlier. The credits have dissipated at a much faster rate. The company lost \$16,666 per month based on the attrition of \$400,000 (difference between \$520,000 and \$120,000) spread over 24 months. That's a total loss of just under \$25,000 per month simply because the organization did nothing.

Both these organization could have hired several people to work on this or brought in a contingency audit recovery firm for a lot less than the monthly loss. Whatever courses of action the firms chose, there really is no excuse for doing nothing. It's akin to leaving all the lights on when no one is home; it's just needless waste.

What becomes crystal clear from the data is that no organization can afford to wait when it comes to the recovery of their open credits.

Your Cost: What Does Minimal IT & AP Involvement Really Mean

The issue that often holds organizations back when it comes to any sort of recovery effort is what involvement will be required on its part. This is especially critical when it comes to coveted IT resources needed for the implementation, but it also includes AP staff time. The typical answer is that minimal IT involvement will be needed.

But everyone's definition of minimal is different. Is minimal two hours, two days or two weeks? We asked Lavante to give us some ranges; specifically, what the average time their clients' IT & AP personnel spent to get Lavante the data it needed for one of its vendor statement audits. What I found out was that compared to a standard, more traditional recovery audit process, Lavante requires very few items to begin the recovery process -- known credit file (so they focus on finding only unidentified credits) and a list of all active suppliers (Lavante's automated outreach means they can connect with and identify credits from a majority of a company's vendors vs. a small sampling). In some cases, IT does get involved in creating these files depending on where the files are pulled from (i.e. from an ERP system, etc). But because Lavante is responsible for all outreach to vendors to request statements, and in the process updates all contact information, there is no need for accounts payable or accounts receivable to collect vast amounts of payable records, as is true of a traditional recovery audit process. This is a sharp contrast to a traditional, non-automated recovery process.

In most cases, Lavante customers spend just hours to prepare the files and send them via email to their Lavante account manager. And, because the Lavante Recovery solution is SaaS based, there is no involvement from the customer's IT department to deploy.

Concluding Thoughts

It should come as no big surprise to those who have read this paper to learn that a concentrated vendor statement recovery audit is something I strongly recommend. For most companies, resources are stretched and completing the audit with staff is not a feasible option. A third-party audit firm specializing in statement audits is their best option, and one like Lavante that performs the audit as an ongoing process means the maximum credit dollars can be recovered in a timely basis.

As was demonstrated earlier in this paper, these audits need to be started early and should be ongoing. Every day you wait results in money being siphoned from your bottom line. So, don't wait. Either get your staff started or pick up the phone and find some to recover your credits NOW!

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About Mary S. Schaeffer

Mary Schaeffer has the inimitable ability to find accounts-payable-related solutions that really work—without making a major dent in the bottom line. Armed with a degree in math and a graduate degree in finance, she takes a “roll up your sleeves and dig into the details” approach to finding solutions to those problems that cause migraines for CFOs, controllers, and managers.

Fifteen years spent researching and writing about payment issues gives Mary Schaeffer a unique vantage point. Combine that with an almost equal amount of time spent in the corporate trenches of several large finance and treasury departments and you’ll see why she’s become known as America’s leading accounts payable expert.

A wide variety of institutions have taken advantage of her unique expertise: John Wiley & Sons has published over a dozen of her books; CRYSTALLUS, Inc. (www.ap-now.com) relies on her know-how to direct its professional publication, training, and consulting business; and the AICPA features her articles in its Corporate Finance Insider. Let’s not overlook the long list of organizations that have turned to her for best practice guidance of their accounts payable function and training of their accounts payable staff.*

About the Sponsor, Lavante, Inc.

Lavante is the leader in on-demand supplier management solutions, including recovery audit and supplier information management applications. Built with advanced, patented technology, Lavante delivers to the financial arena a new standard in efficient, technology-driven solutions that allow companies to quickly drive dollars to the bottom line, improve supplier communications, and assure the highest level of supplier data quality. Lavante solutions are deployed across Fortune 1000 enterprises including the retail, hospitality, entertainment, manufacturing, transportation, and medical industries. For more information about Lavante please visit www.lavante.com or call 1-877-LAVANTE.

Please visit www.lavante.com/WP-recovery-statement-audit to download a complimentary version of this industry white paper.

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