

An **Auditrax** White Paper



1971 East Beltline NE
Suite 207
Grand Rapids, MI 49525
(616)726-0982
www.Auditrax.com

Benefits of a Procurement Audit
for Private Equity Firms & Portfolio Companies

July 1, 2011

Contents

Introduction	2
Problem Statement	2
Previous Options	3
Auditrax Solution	3
Implementation	5
Results	Error! Bookmark not defined.

Introduction

Private equity firms are constantly looking for ways to increase the profitability of portfolio firms to eventually lead to a higher sales price when the time is right. Their portfolio companies look to them as a resource for valuable revenue increasing and cost savings measures. Unbeknownst to many firms, there are actually lost profits locked up in the procurement process as a result of vendor errors, process breakdowns, ERP system migrations, and complex procurement environments. Auditrax provides a unique, risk-free solution that audits the procurement process of clients over a historical period to identify lost profits by exposing the process breakdown, recovering the capital from vendors, and preventing future errors through actionable recommendations. A procurement audit can quickly increase the value of portfolio companies, making them more attractive to potential buyers, and more profitable for their equity group.

Problem Statement

Every company that engages in procurement transactions is losing nearly .5% of its' yearly revenue, regardless of the size, complexity of internal controls, or quality of staff. Some vendors erroneously bill their clients as a mistake, and some do so intentionally to increase profitability. ERP systems often miss duplicate payments, and the increased reliance on technology has taken the human review of invoices out of the equation, leading to increased losses.

Companies today continue to allow their profits to escape by avoiding outside audits of their payable transactions. Many believe that the audits done by CPA firms will catch these types of errors, or that their internal audit department is sufficiently capable of catching any errors that might occur. Despite these perceptions, the profits continue to escape.

Previous Options

Accounts payable firms have been around for decades. Recently there has been a significant shift away from recovering the greatest potential of lost profits for each client. Currently, these firms use a skimming technique to recover easily identifiable errors, while avoiding more complex in-depth techniques to uncover larger recoveries. These companies use weekly recovery quotas to dictate when the audit team will be removed from the client site and the audit terminated, leaving potentially significant un-recovered lost profits to slip away forever.

Auditrax Solution

The Auditrax solution to this problem is a procurement audit with 3 distinct features to increase the profitability of clients firms without adding expense:

1. Non-Intrusive – Once the sales meeting has taken place and an agreement has been reached, our audit team will work independently to recover lost profits without burdening management or staff.
2. Contingent – By billing only for claims collected in the form of a check or credit memo, Auditrax does not add expense to the client without adding a real benefit.

3. Comprehensive – Auditrax provides the industry’s most in-depth audit by using proprietary software and over 20 different forms of audit.

Benefit 1

Identify

All audit firms will return erroneously made payments to clients, and many are very effective at doing so. However, Auditrax does not use weekly quotas that dictate when the audit is closed down. Instead, our auditors use over 20 proven audit reports and techniques on our proprietary software to identify any and all erroneously made payments for our clients. This includes a manual audit of every invoice during the audit period that allows for recoveries missed by electronic audits.

- | | |
|---|---|
| <ul style="list-style-type: none">• Supply Purchasing• Pricing Rebates• Omitted Cash Discounts• Price Discrepancies• Statement Credits• Discounts Taken at Wrong Date• Tax Charges and Percentages• Contract Compliance• Allowances• Cash/Trade Discounts• Telecom Billings | <ul style="list-style-type: none">• Vendor Returns• Vendor Programs• Duplicate Payments• Quantity Discounts• Credits Not Taken• Cost-Price Differences• Sales & Use Tax• Contractual Misbillings• Vendor Master Review• IT Cost Optimization• Freight Rate & Traffic Compliance |
|---|---|

Benefit 2

Recover

Once erroneous payments are identified, our auditors will gather supporting documentation that proves the validity of the claim. We will then contact the vendor, provide them with the information gathered, and ask that they work with us to resolve the issue to the satisfaction of both parties.

By using our audit team to recover funds for our clients, we are able to avoid adding to the workload of your staff, and ensure that our billing only represents the actual collected amounts we have recovered for your firm, after the check or credit memo has been received.

Benefit 3

Prevent

Through our Profit+ audit reports, we are able to summarize the errors made during the audit period, identify the root cause of the errors, and make actionable recommendations for improvement to prevent these errors in the future. The audit wrap-up meeting typically includes the financial management team, along with Accounts Payable staff and leadership.

This meeting allows all members of the organization to learn about problem identified and to begin the process of improvement towards more sustainable financial practices for their company.

Implementation

Private Equity firms can share this type of service with their portfolio companies as an additional resource to improve the processes of their portfolio companies and increase their bottom line.

The implementation of a recovery might be the most time and cost effective project your company has ever undertaken. The project simply requires the secure download of the payables and purchasing data for the specified audit period, a process that typically takes an IT staff member about 1 hour. After the data is received in its unaltered format, the audit team will use proprietary techniques and software to format the data and run it through custom reports to generate recovery possibilities. Auditors will validate that an error occurred and gather supporting documentation that will be sent to the vendor when requesting the refund. Following the audit and collections process, Auditrax will present actionable recommendations to the client's management team to prevent similar errors from occurring in the future, leading to a sustainable bottom line for the client.

Results

Over the lifetime of Auditrax, it has been observed that all companies are losing between .1% to 1% or more of their profits through process breakdowns. While 1% may not seem significant, that translates into \$1 million for a company with revenues of \$100 million.

Private Equity firms have been excited about this service because of the direct link it can provide to a higher valuation for portfolio companies and the higher sales price they can command. Recoveries decrease the expenses of clients and increase EBITDA, although the returned profits sometimes feel like a new revenue stream to some CFO's. Using the rough estimate valuation method of 5 times EBITDA, \$1 million in recoveries could lead to a \$5 million increase in the sales price for your company.

With the common practice of CFOs being asked to buy-in to the companies they manage, many are excited about the increased personal return they receive from this service.