COST RECOVERY

TURNING YOUR ACCOUNTS PAYABLE DEPARTMENT INTO A PROFIT CENTER

RICHARD B. LANZA

Praise for *Cost Recovery*

"Is your company leaking cash without even knowing it? Lanza's easy-to-read book gives practical points on how to increase profits with little or no added cost. This is the corporate equivalent of finding money on the sidewalk; just reach down and pick it up!"

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"Rich pours a great deal of his extensive knowledge into this guide. It is an encyclopedic approach to the hows and whys of cost recovery services. Not only does the reader learn about the basic mechanics of how cost recovery works, but also has access to numerous case studies showing how it works in key areas such as payables, advertising, health benefits, leasing, and telecommunications. The guide may prove to be the masterwork in this field."

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"In an economy where revenue streams are constricted, using Cost Recovery techniques to find money or save money seems like an obvious strategy, but it's perceived as a daunting task for most organizations. Rich Lanza's Cost Recovery guide provides a step-by-step process that's feasible to implement and easy to read."

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"Rich Lanza, the 'Data Magician,' has elevated the art of data recovery audit and analysis to the next level. His passion for applying data analytics to the workplace has defined him as a pioneer in the area of cost recovery. I commend Rich for his thinking outside the box that has pushed organizations to review their approach to data recovery and cost control with the result of saving millions of dollars!"

—Jim Kaplan, CIA, CFE, President/CEO, AuditNet.org, The Global Resource for Auditors

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CHAPTER 21

Utility Reviews

Overview

Businesses are finding that their utility spending continues to increase dramatically throughout the United States. Many markets struggle with a limited number of providers, as deregulated options have shrunk in a challenging economy with regulations that do not always encourage competition. Smaller companies may also have only a few options in pricing plans from their vendors. It seems that the utility area can sometimes be limited in its opportunities although it is generally one of the highest expenses for companies. But there is good news and there are still some opportunities for those that are diligent and will research what is available. As vendors do not always have an objective view of what is best for the company they serve, it is in the best interest of most companies to review options independent of their vendors' advice and to seek objective third-party representation when possible to assist them in navigating the myriad choices in the utility world.

This chapter focuses on some of the savings opportunities that relate to the rules, rates, and regulations that govern the utilities. Utility Reduction Analysts (URA), a firm working in this field, has found many interesting opportunities for companies over the years and will be sharing some of those stories and ideas in this chapter. Possibilities to reduce a company's utility expenses come in the areas of electric, natural gas, water, and waste removal. These opportunities vary by state and vendor so they need to be reviewed more thoroughly on the basis of the specific company's information. There are many opportunities that are available in the conservation area (reducing consumption and usage). But that is not the focus of this chapter. Excellent engineering firms and third-party consultants are available throughout the

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This chapter was written in collaboration with Utility Reduction Analysts, Inc. (utilityreduction.com).

United States who work beyond cost reduction. When these two areas are combined, exponential savings can be achieved.

Anyone owning a company receives one bill or numerous bills from vendors for the following utility services: electric, gas, water, and waste removal. For some companies, water and electric may be provided by a municipality and combined in one bill. Larger companies in metropolitan areas may receive their bill online and have an account executive monitor it with them quarterly or annually.

In years past, many manufacturers had a utility account representative that cared for them and helped in multiple ways. Many manufacturers have seen that service and care decrease, as downsizing has increased across the United States. The utility vendor typically expects the client to monitor its bills closely and immediately bring any errors to the vendor's attention for correction. It is the position of many utility vendors that the client needs to be its own advocate. In light of that, a company needs to thoroughly review its bills, stay aware of market offerings, and bring in additional insight to itself to ensure that it receives the best rates available to them. Lower rates will allow them to use captured savings in other necessary areas.

Case Study 21.1: Fortune 1,000 Manufacturer Cuts Its Utility Costs in Several Ways

A $500 million manufacturer retained Utility Reduction Analysts (URA) to bring savings recommendations to them. It was referred to URA by the director of purchasing because it had met at his previous employer's company, where URA helped realize significant savings. The current company had five locations across the United States and was hoping to save a minimum of 2 percent, or $140,000 a year, based on its annual utility spending of $7,000,000. Bills were compiled for the review (12 months of the water, waste removal, electric, and gas). The staff was very helpful and wanted to be part of the process, offering help at the corporate and plant levels.

Once the initial analysis had been performed and all data were thoroughly reviewed, URA found that the client had a few savings opportunities in the area of electricity consumption. There was a possible rate change that would yield modest savings ($7,000 per year) and a few possibilities for deregulated markets that did not currently have an offering. The rate change appeared to be a possibility, so the project manager ordered a demand meter be placed at the company site to confirm their findings. This would take 90 days to confirm the data and the rate's appropriateness. In regard to deregulation, URA would watch the market to see when an opportunity would arise. It could save $10,000 to $20,000 but that would depend upon the offerings at any given time. The project manager would watch for a market decrease in costs, allowing for a realistic electric bill savings to result (3 to 5 percent).

There was a tax refund possibility at one site as well. The analysis department spoke with the controller for that location and it worked together to confirm what percentage of manufacturing went on in that location, so an industrial processing tax exemption could be discussed with its vendor and applied for through its state. After the analysis was performed, URA worked with the client to complete the proper forms for the exemption. This took numerous calls and a site review was done by the controller. The equipment needed to be assessed for times used and production information. After this lengthy process, the electrical audit was sent to the state for review. In four weeks, the state called the company and began to discuss the request for the $50,000 refund. After many conversations and defending the calculations and equipment usage information, a check was confirmed by the state. URA's client also received savings of more $15,000 a year going forward.

The URA project manager reviewed a spreadsheet of the client's waste usage across its five locations. Two locations were experiencing a higher cost than seemed reasonable. She investigated and began to compile market information from other vendors. She initiated a request for proposal (RFP) and spoke with the vendors, explaining that they could gain the business of this notable company in their town. Several quotes were received from the vendors and she reviewed what was best for the client. The current waste removal vendor (the largest in that area) was also asked to participate and to reprice its services. The project manager explained that she wanted them to be able to stay with the incumbent's firm if its pricing was in line with the market. The pricing came back more favorable from an alternative vendor who wanted to work hard for its business, so a transition took place. This change allowed the client to save $40,000 a year on its services (hauling and recycling).

In total, the manufacturer was able to save $110,000 a year and to receive a $50,000 refund in the first year. Additional opportunities were still being reviewed in the beginning of year two, as upcoming savings appeared to be available (based on market opportunities). The manufacturer was not only pleased with URA's work but with the improvements it received in understanding what it was spending. URA provided it with a weekly project report and quarterly meetings to assess progress.

Case Study 21.2: Hospital Water Cost Leak Plugged

URA was retained by a 600-bed hospital in the Midwest. The hospital's goal was to reduce utility expenditures ($200,000 in total) because it felt it was paying too much in several areas. URA met with the hospital's executive director to sign paperwork and initiate the project. URA met with the accounting and operations staff to gather utility bills and the data necessary for the review. Twelve months of gas, electric, and water bills were copied to ensure a thorough review could be performed. This information was sent to the analysis department, where it compiled spreadsheets comparing costs with relevant tariffs. Several hundred bills were reviewed because there were multiple gas, water, and electric meters. There were many meters at this location and a meter audit was conducted to ensure that the hospital was paying only for its meters. Errors in billing can occur and companies, in rare cases, can be paying for a neighboring company's meter. The meter audit showed no such errors in billing. Although there were numerous meters at the hospital, only a few savings opportunities were detected. There was a deregulation opportunity in electric but the hospital said it could not take part in it because it had purchased its electricity as a group with other like facilities. Although it was losing money in this area, it was obligated through agreements and the relationship with the other locations to be part of the pool. There were no significant savings found elsewhere in gas or electric, which is interesting, as these are generally areas in which savings are often detected. The most significant opportunity, surprisingly, was found in the area of water.

A site evaluation was performed to confirm what water meters were in place. It was uncovered that the hospital was being billed for a 6-inch meter when only a 2-inch meter was in place. This resulted in an overbilling of $3,000 a year for the past 7 to 10 years. URA discussed this with the hospital management team. The team approved that it wanted URA to pursue correction and a refund for the hospital from the City Water Department. URA proceeded by compiling the data necessary to prove the overbilling and coordinate a meeting with the city water department. URA met the water department representative and discussed the findings. The water department was shocked that the hospital thought it was owed a refund and appealed to URA not to pursue the refund because the water department was a community servant as well. The city contended that it was the responsibility of the hospital to correct overbilling. They seemed willing to continue discussions, but were unwilling to take responsibility for the error.

URA met with the hospital and further reviewed past data and the city's relationship with the hospital. It was uncovered in the meeting with the hospital that the city had installed the meter 10 years earlier and blueprints of the project were in the hospital's possession that stated only a 2-inch meter was needed. The blueprints also had the city water department's information all over them as well and showed that it was actively involved in the project. This formed a critical connection between the city and hospital and proved that the city was involved with the error from the beginning. URA took the blueprint and additional dialog from the hospital back to the water department and discussions continued. In the end, the hospital was awarded a $17,000 refund and decreased billing of $3,000 a year.

Case Study 21.3: Small Town Manufacturer—Electric Refund

URA was retained to serve a respected manufacturer that employed a large amount of workers in a small town. The CFO had been very skeptical of hiring a third party to interface with their vendors because it was a family-owned business and relationships were key to its success. The manufacturer valued all relationships: clients, staff, and vendors. This was appealing for URA because it enjoyed working with companies that had high values and strong relationships. URA found companies like this to be more honest and ethical to work with and serve. Although initially hesitant to commit to an engagement, the CFO finally signed an agreement after URA had met with the owner, then the CFO, and then the key managers.

URA reviewed the client's gas, water, and electric bills. In the area of electricity, URA ran reports to confirm the client's rates were correct with the local municipality. It was discovered the client was not on the correct electric rate with it municipality. It was still on a temporary rate offered to it when it had built its location many years before. That building rate was supposed to be temporary (three to six months) but somehow had been missed and had resulted in $50,000 a year overbilling. Now, three years later, the excessive billing had reached an estimated $150,000. Believing the client would be overjoyed at the finding, the analysis staff discussed the refund opportunity and projected decreased costs with the CFO. He was disappointed that the company had overspent, but he was also concerned about the finding because his company was the largest manufacturer and employed a significant number of people in the small town where the plant was situated. Because the electricity was supplied by the municipality and the company was a key provider of employment in the community, he wanted to tread lightly and not upset any relationships and trust in place. There are many benefits to working with the local government and community for the good of all and this client weighed those seriously.

The CFO took time to review the data and responded to URA with the following instructions. He wanted URA to coordinate a refund of less than 20 percent of the estimated refund due. He had accessed records and found that the city had helped the company years earlier in significant ways and he did not want to damage their relationship. So, URA went back to the city representative and requested a refund for $24,000 and corrected the billing going forward. Although URA would have loved to collect the whole amount, it is bound by their agreement to only share in 50 percent of the savings or refunds received by its clients. It also did not want to press the issue any further because it could damage the client's relationship with the city.

Case Study 21.4: Entertainment Company with Multiple Locations Chooses Deregulation for Select Sites

URA was retained by a multiple-site retail location offering entertainment throughout several cities. Its industry had experienced increased costs in many areas and it wanted to be sure it was being fiscally responsible in reviewing its utility expenses as its margins got tighter. It wanted to make sure the bottom line was as healthy as possible, so URA was given the initiative to review the gas and electric and to find opportunities to cut costs. It had 30 sites and had received quotes from alternative energy providers that claimed they could reduce their electric costs substantially if they participated in an electric deregulated program.

Electric deregulation is a savings opportunity that should be assessed but only activated after thorough research and much caution. In the past, regulated utilities offered electric supply to their customers: generation, transmission, and distribution. Deregulation allows a company to purchase their electricity from a different company although it receive its electricity over the same power lines. This allows competition that will hopefully lead to reduced costs and improved customer service. Deregulation has continued to become available in a growing number of states. Although available, savings and satisfaction levels vary by company. Some companies have found substantial savings when choosing a solid provider and locking in a price that delivers margin compared to their regulated electric vendor. URA proposes that clients enter into a deregulated option only if the margin is high enough to insulate the company from losing money if the program changes down the road. You may have seen news reports on companies that entered the electric deregulation program and suffered great losses when the program changed and their nominal savings became hundreds of thousands of dollars in losses once the margin in savings was gone. The reviews on deregulation differ greatly by state and supplier. Although the results of deregulated programs vary, it is still a viable option that should be thoroughly researched for high-usage companies.

Although suppliers were assuring URA's client that they could certainly save significant dollars, URA moved ahead with caution. URA had heard similar claims from vendors and always reviewed the numbers in comparison to the regulated utility's costs to compare the alternative opportunity in direct comparison to the client's current services and costs. After all locations were reviewed, the initial savings presented were found to be generous in comparison to URA's findings. In fact, the client would have only broken even if it had signed on with the alternative provider. The provider's numbers did not include additional fees, line items, or costs that make up the total cost of electric service that the client would have to pay. Independent sales agents for suppliers are typically paid on a percentage of the volume of the sale, so they are benefited by the total volume they secure. In contrast, URA is paid only on shared savings, and its motivation is to bring only the best bottom-line services and price to the client.

Reviewing the individual reports, the analysis staff found that only three of the client's locations would benefit from the electric deregulation opportunity. The client would save 15 percent if the three locations were the ones that elected to go into the program. If it had put all of its locations into the program, its savings would have been close to zero. With only three locations, it would save $100,000 for the term of their three-year contract. The client was surprised that the vendor's quotes and sales presentation was not accurate in several ways and he was relieved that URA had guided him to a practical cost savings that would benefit his company for years to come. This deregulated option ceased to be beneficial to new clients only 18 months after this client had signed on. And although others could not locate significant savings, this discerning client continued to have great savings for the term of its contract.

Case Study Wrap-Up

These case studies show how additional utility savings and even refunds may be available to companies. While this may be the case, they are often difficult to defend and retrieve. Many vendors may expect a great detail of evidence and effort to activate savings and reclaim any lost dollars. That is why third-party consultants like Utility Reduction Analysts are often retained to support a company in these savings and recovery initiatives.

Why Use a Third-Party Utility Auditing Firm?

Using a third-party firm may increase your savings and refund opportunities substantially and cost you very little, as many are paid on a shared savings plan. This allows the company and the consulting firm to work collaboratively and to share in any found money. The consulting firm actually creates its own budget when it works on a shared savings plan because it is receiving only what it locates, funds that were being lost.

The third-party audit firm has the following advantages:

- Past successes to draw from when devising plans to recover funds
- Knowledge of what many companies are paying (vendor and market intelligence)
- Experience in negotiating utility expenses and refunds (yielding greater results)
- Network of connections with key people at many utility companies
- Unique third-party advantage (perspective)
- Ability to support company staff and collaborate on savings opportunities

Recoveries to Find

There may be opportunities to reduce costs and recover refunds through the review of these areas:

- *Better rates at the current vendor*. Meet and speak with the utility vendor and see whether there are options to the rate plan. Are there better rates available to take advantage of if there is less usage? Run the numbers and see what decreased usage would save the company.
- *Deregulated options* (gas and electric). Depending on the market, there may be deregulated options available to the company for gas and electric. The local utility Web sites typically explain the program, history of the program, relevant legislation behind it, and include contact numbers for approved suppliers. Deregulation can be advantageous for companies if they are able to assess alternative supplier costs in direct comparison to what they are paying their regulated utility provider. There are differing components between quotes from suppliers and companies may misunderstand the value of the alternative option or contract term they are signing on to. Use caution—make sure you are comparing apples to apples when you review comparative rates and programs. Review contracts, terms, conditions, and length of the agreement. Weigh the ups and downs of this commitment.
- *Request for proposal (RFP)*. An RFP can help a company confirm that it has the best pricing available in the market. An RFP allows a company to assess what additional market opportunities are available through a vendor and other potential providers as it has vendors compete for their business. Vendors are given the same specs for the RFP so apple-to-apple pricing is received.

- *Billings to contract differences by your utility vendor (or landlord)?* If the company operates on a contracted rate, check the original agreement and confirm whether the company is being billed correctly. If not, meet with the provider and present supporting data. Prepare a narrative to detail the overbilling and proposed corrections. If possible, ask for a refund for all overbilling and interest.
- *Estimated bills.* Bills should be checked to determine if each billing period's read is actual or estimated. Estimated readings should be checked to see whether usage is in line with previous usage. If bills have been estimated, request correction from the utility billing department and refunds or credits, as appropriate.
- *Penalties on the bill (example: power factor/electric).* Penalties on the bill for usage in off times or for exceeding a certain level can be reduced or eliminated if better negotiated with the utility vendor.
- *Master list of meters.* Companies should have a master list of all their meters and their utility account numbers so they can confirm that they are being billed on only their meters and so they know where all meters are located.

Questions to Ask When Assessing the Opportunity

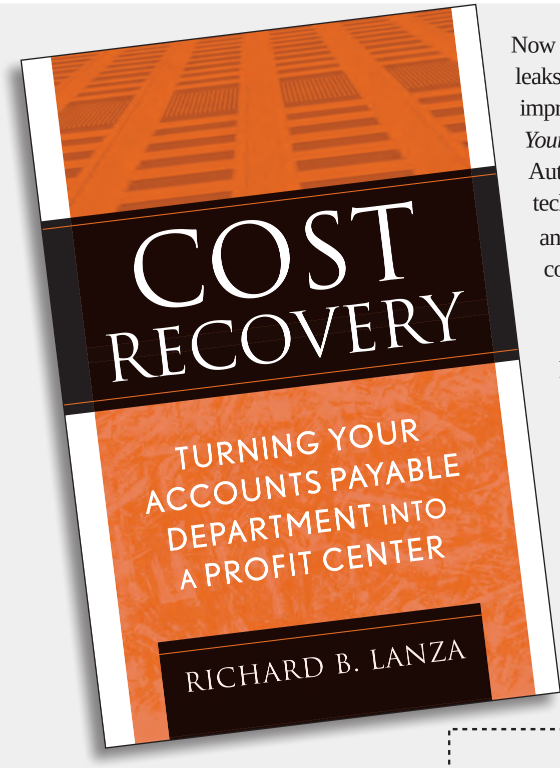
- *What is the volume of utility spending?* Would a return of 2 to 5 percent in utilities (general estimation) be enough to interest the company to spend the time needed to compile the bills and contracts needed to perform an audit? If a company spends $5,000,000 on utilities, that represents a possible savings of $100,000 (2 percent of total volume). Make sure all parties agree on a measurement of success before initiating a review.
- *Are copies of utility and telecom contracts available for review?* Copies of agreements from utility providers assist utility audit firms in accurately auditing the client's bills and pricing components. Contracts can be coordinated through the vendor but they typically would rather not have to provide a duplicate copy of the agreement to the client, especially if a third-party firm is involved.
- *Is the company decisive?* It is crucial to the savings initiative for the key decision maker to be decisive and motivated to make improvements and implement cost savings. If a third party audits the company's utility expenses for weeks or even months (depending on the complexity of the review) and the decision maker is hesitant to move on savings plans, the opportunities can evaporate (based on changes in the market). Third-party vendors paid on shared savings will not want to assess savings and refund opportunities for a company that does not intend to move ahead on recommendations.

- *Has a savings analysis been performed in the past three to five years?* If so, what were the results? Who was involved? Can anything be learned from the project? These items may be helpful in assessing whether another review would be prudent.
- *Does the company have multiple utility providers in contiguous areas?* If so, streamlining of vendors may be a good idea. Are there vendors that could serve other locations currently served by another provider? Combining spending levels may encourage a vendor to be more competitive with its pricing. If cost reductions and improved customer service can be achieved from aggregating locations with a single vendor, it is wise to review.
- *Is your company operating your facility in a different manner from before?* If you are using more utilities or operating with different hours, these changes may cause a company to pay higher rates if you have not made the appropriate rate changes with your utility provider. Companies often change how they use their utilities, yet do not make revisions to their rate plans with their utility vendors that would benefit their company.

Conclusion

Utilities are a substantial expense for most companies, especially for those in the manufacturing industry. If your company spends a considerable amount on utilities, one should perform a utility audit. Generally, there are savings opportunities that can be realized by a company once a thorough review and market assessment is done. Gas, electric, water, and waste removal should be reviewed for a minimum of the past 12 months. Whether performing a utility audit internally or with assistance of an experienced third-party consulting firm, a company can most likely yield savings and refunds that will improve its bottom line.

All the tools you need to generate cash recoveries, stop profit leaks, and work towards process improvements.



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Audit technology expert Richard Lanza clearly explains how to utilize free services offered by cost recovery consultants as well as how to assess risk based on the company's control issues to identify the top areas of likelihood for recovery and process improvements. This important book looks at cost recovery from every angle, with in-depth coverage of areas including telecommunications, utilities, healthcare, advertising, media, freight, tax reduction, project fraud, and more.

978-0-470-32238-3 • Hardcover • 343 pp.
August 2009 • US $75.00

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