



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Scott P. Johnson

SUBJECT: SEE BELOW

DATE: September 9, 2009

Approved

Date

9/11/09

SUBJECT: REPORT ON RFP FOR RECOVERY AUDIT SERVICES

RECOMMENDATION

1. Adopt a resolution authorizing the Director of Finance to:
 - a. Negotiate and execute an agreement with Lavante, Inc. to provide audit and recovery services relating to the City's accounts payable vendor disbursements and invoices ("Recovery Audit Services") for a twelve-month initial term, with compensation to be paid on a fee recovery basis equal to 18% of actual claims recovered, subject to a \$100,000 maximum for any one claim realized.
 - b. Exercise three, one-year options to renew the Agreement, subject to the appropriation of funds.

OUTCOME

The outcome of this Agreement will ensure vendors' compliance with the payment terms of their agreements, and to improve efficiencies in our vendor payment processing. Successful performance under the Agreement will reduce City costs across various funds.

BACKGROUND

One of the key objectives of the Finance Department is to identify ways to reduce cost and enhance revenues for the City of San Jose. Consistent with this objective, Finance assumed responsibility for the audit program that was initiated in 2006 by the City Auditor's Office.

Currently, City Departments are responsible for managing their purchase orders (PO's) and contracts, which includes approving the payment of invoices prior to being processed for

payment by the Finance Department. For the 2008 calendar year, the City expended approximately \$570 million for goods and services procured through PO's and contracts. This dollar amount for PO's and contracts excludes payments related to capital projects. Based on historical trends in the private sector, the estimated recovery is one-tenth of one percent (.10%). Therefore, the projected annual recovery of expenses could be as high as \$570,000 (\$570 million x .10 %). However, since we have not initiated such a program in the past, staff has used a more conservative recovery rate assumption as compared to the private sector's experience (one third of the private sector experience resulting in an estimated savings of approximately \$200,000).

The Request for Proposal (RFP) process to select a vendor was initiated in 2006. However, the selection process was temporarily suspended due to staffing constraints, transition of program from The City Auditor's Office to Finance, and other projects of higher priority such as the Revenue Compliance Strategic Plan and the Telecommunications Users Tax/Emergency Communications System Support Fee ballot measures implementation.

ANALYSIS

On August 4, 2006, the City issued an RFP for recovery audit services to select a service provider to identify inefficiencies in the City's vendor payment process and assist departments with managing their vendor invoice and contract management related responsibilities. Scope of Services includes:

- Identifying overpayments made by the City when paying vendors' invoices for inventory, supplies, services, and other expenses.
- Identifying payment errors such as duplicate payments, pricing errors, unrecorded purchase returns, unapplied cash, misapplied payments and rebate returns due to the City.

Two proposals were received: 1) Audit Solutions (San Jose, CA) and 2) Horn & Associates, Inc. (Salt Lake City, UT). Audit Solutions underwent a name change to Lavante on April 1, 2009, without any changes to the ownership or organizational structure of the firm.

An evaluation team with representatives from the Finance Department and City Auditor's Office was formed to evaluate the proposals under the following criteria: proposal responsiveness, audit approach, firm experience, team experience, fee structure, local business enterprise and small business enterprise. The evaluation process consisted of a review of the written proposals, as well as oral presentations. The evaluation team concluded that Lavante's proposal demonstrated superior experience and expertise and provided the best overall value for the City.

Lavante is a San Jose based business that was established in 2001, and they have successfully performed recovery audits for many companies across a wide variety of industries. Their public sector experience includes the State of Delaware and the Tennessee Valley Authority.

Although the RFP was initially issued and reviewed in 2006, staff believes that it is reasonable to award the contract based on the 2006 RFP based on Lavante agreeing to continue with their original proposal and the firm's demonstration of a key understanding of the City's requirements.

Summary of Agreement Terms

The City will pay Lavante 18% of realized recoveries (claims received), subject to a cap of \$100,000 for any one claim. The 18% fee structure is fixed for the initial one year term of the Agreement, as well as the three one-year options. Initially, Lavante will be provided with a current master vendor file containing basic vendor information. As part of the scope of services, Lavante will also be responsible for updating the City's master vendor file with current vendor contact information.

Lavante will perform an audit of the City's accounts payable data of the City's vendors to detect and identify open credits that fall within the appropriate past years age scope that have been verified by vendors. For example, the "appropriate age scope" for the period from the effective date of agreement through June 30, 2010, is limited to FY 2006-07, 2007-08 and 2008-09.

The data in the master vendor file will be used by Lavante to create an audit database. Lavante will create for each vendor a digital file to store all related correspondence, account details and supporting documents. Lavante will document all correspondence with vendors, in order to perform recoveries and provide relevant reports. The City will have unlimited access to the audit database to review claims. Once the City has approved and received the credit or reimbursement of overpayment from the vendors, the City will then compensate Lavante upon receipt of a monthly invoice, due and payable within 30 days.

A claim will be realized by the City due to the efforts of Lavante when the City verifies a recovery, either through a monetary reimbursement or a vendor credit memo. This may be accomplished when, due to the efforts of Lavante in identifying a potential claim, the City completes one of the following:

1. Deducts or confirms that a one-time deduction or on-going deductions was/were made to payments to the specified vendor.
2. Verifies that a vendor has appropriately adjusted the City's account.
3. Verifies that the City has received a check or cash payment from a vendor for a claim owed to the City. (A check or cash payment by a vendor to the City to satisfy a claim may occur when a vendor does not have an invoice against which the claim may be deducted or the claim amount exceeds the amount owed by the City to the vendor.)

As part of the review process, the Finance Department will ensure the appropriate funds and accounts are credited for any reimbursements.

EVALUATION AND FOLLOW-UP

Staff does not anticipate any follow-up at this time.

POLICY ALTERNATIVES

Not applicable.

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, and staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item meets none of the criteria set forth above. This Council report will be posted to the City's website for the September 29, 2009 City Council Agenda.

COORDINATION

This report has been coordinated with the Office of the City Auditor, City Attorney's Office, and the City Manager's Budget Office.

FISCAL/POLICY ALIGNMENT

This recovery audit pilot program is consistent with the budget balancing strategy to focus on improving business practices, and simplifying City operations, focus on improving employee productivity and continuously improving business practices so that services can be delivered at a higher quality level at a lower cost.

September 9, 2009

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Page 5

COST SUMMARY/IMPLICATIONS

In the 2009-2010 Adopted Operating Budget, it is assumed that \$200,000 in General Fund revenues will be generated from these efforts. A portion of the Revenue Enhancement Consulting Services appropriation is allocated to cover the costs associated with this vendor. This should provide sufficient funding to pay the vendor for these efforts. Once the City has actual experience, budget actions will be brought forward to recognize any additional revenue generated from the vendor audits.

BUDGET REFERENCE

Fund	Appn.	Appn. Name	Total Appn.	2009-10 Proposed Budget Page*	Last Budget Action (Date, Ord. No.)
001	2060	Revenue Enhancement Consulting Services	\$525,000	IX-25	6/23/09, Ord. No. 28593

* 2009-2010 Operating Budget was adopted by the City Council on June 23rd, 2009.

CEQA

Not a project.


SCOTT P. JOHNSON
Director, Finance

For questions, please contact David McPherson, Division Manager-Finance Department at (408) 535-7091.

