Freight Invoice Auditing & Payment: A Primer for Shippers

by Giles Taylor
Founder and President
Trans-Solutions, Inc.

The business of outsourced auditing and payment of freight bills has become very sophisticated over the last 20 years, in step with advances in information technology. Actually, the "auditing" part of this business is relatively new. These companies once focused on freight payment. Most revenue was generated through float on the money that was to be paid to transportation companies. For example, a payment firm would collect interest on the money for 30 to 90 days before paying the bill. When interest rates came down and shippers realized they could get better pricing with better payment terms, payment firms needed to find additional revenue streams. At the same time, post-auditors (companies that audited freight bills after the bill was paid) flourished by finding what the pre-auditor did not. Post-auditors are typically compensated with 50% of what is recovered.

In the last ten years, payment to carriers has improved, and pre-auditing of freight bills has been enhanced. These improvements caused additional work for the auditing firm, but there was new money collected from the carriers, or less money paid to the carriers, due to the errors found in freight bills. Some auditing firms would charge a higher rate for the pre-auditing work. They justified the higher rate because the shipper paid less to the carriers and could give a little more money to the auditing firms.

During the mid-1990's, a few individuals (mostly ex-UPS and ex-FedEx employees) realized there was a market for auditing small parcel invoices and services. What distinguishes this mode of transportation is that these shipments are guaranteed to arrive by a specific time and/or day. If they don't, the shipper is eligible for a refund from the carrier. By the end of the 1990's, dozens of audit companies emerged to take advantage of this policy.

The Freight Audit and Payment Industry Today

Providers of freight bill audit and payment services can be divided into four categories:

1. Large companies with staffs of over 200 employees that process several billions of dollars of freight invoices and employ some level of technology in auditing and paying bills.
2. Medium-size companies that have less than 200 employees and process between several hundred million and billions of dollars of freight invoices. They may use new technologies to efficiently conduct business.
3. Small "mom & pop" firms that represent a majority of the freight audit/pay providers and the majority of freight dollars paid to carriers. Often, smaller firms have one or two large customers and perform the same services for several other smaller shippers. Or, they may use the audit and payment services to supplement other services they may offer. These firms typically have less than 10 associates (often one or two) and may employ some level of technology in auditing freight invoices. Often they provide other services like freight negotiation and logistics consulting. These companies are often third party logistics (3PL) providers.

4. Specialty firms that concentrate on one or two modes of transportation, mostly small parcel or express. These firms capitalize on service guarantee failures or unique tariffs like household goods. There is much competition in this group, but only a few provide extensive invoice audits.

Today, automation is driving change in this industry. But only some providers are leveraging available technology in ways that benefit the shipper. A buyer of freight audit and payment services might be told by a service provider, "We are able to transmit data in XML and flat files and in real time," when in reality most of the transportation industry is still using EDI and is slow to update records in real time. Just because the auditing firm can send XML, a shipper won't get the information any faster from carriers that are still using EDI. Firms that understand this reality might say, "We can transmit data in many formats, and we use the latest version of EDI." Invoice files from carriers need to be translated into data that audit and payment firms can import into their systems. Carriers update or change these files, which requires the auditing firms to modify their programs to translate the file. The reality is that auditing firms do not always change their translation programs to keep up with carrier changes. It costs money and resources. As a result, carriers send many versions of invoice files to auditing firms. New invoice files tend to contain more detail than older files, therefore, auditing firms with older translations provide less detail on shipment transactions.

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For the most part, auditing freight bills is a labor-intensive process. In order to maintain profitability, many auditing firms look for the most probable errors or they target the larger bills of trucking companies with a long history of making errors. For instance, an auditing firm may audit only larger invoices from a carrier with a bad record of accuracy. The bi-product of this practice is less money found for the shipper. Ironically, the smaller mom and pop auditors know a shipper's business intimately and may be more likely to recognize errors. The same individual could be manually auditing a company's bills for years and know they never ship a 10,000 lb. shipment, questioning any invoice for such a shipment. Whereas, an auditor that employs an electronic match program would pay this bill because the size of shipment is included in the tariff or contract used by the shipper. Some of the highly automated providers might indicate they can catch these oddities, but practically speaking the system programming required to do so would be either too specialized or costly to warrant the effort.

Like much of the transportation industry, the freight audit and payment industry has become a niche business. Almost all auditing firms will say they can audit all types of invoices, and most do a credible job with LTL and TL shipments. For other modes of transportation (household moves, ocean freight, rail, intermodal, dedicated fleets), only a few firms excel. To effectively audit these types of invoices, the auditor would have to know these tariffs intimately, like many know a CzarLite tariff. Becoming familiar with these tariffs typically requires additional manpower and expertise that many companies cannot afford.

Small Parcel Auditing

Small parcel auditing stands out in two ways:
1) almost all shipments are guaranteed by the carriers, and 2) the highest shipment level detail is provided in economical and easy-to-import electronic formats by the carriers.

Guaranteed Service Refunds (GSRs) are a particularly sensitive issue with carriers. Both UPS and FedEx guarantee their service, but collecting refunds is not always easy. Federal Express Air is by far the best company to work with to identify and collect on service failures. Smaller, regional carriers are the most difficult. For these regional carriers, we do not know of any automated system to collect on invoice errors or service failures. If any money is collected, it is most likely through a manual process. UPS and FedEx ground create some challenges in collecting GSRs. A few auditors do much better than most to get as much as possible from these carriers. These auditors use a combination of technology and manual labor. Some shippers believe that, if they collect on GSRs, then the carrier will increase rates or offer a lesser discount.

Most carriers are open to auditing and securing credits for billing errors such as duplicate invoices, incorrect rates, packages that were never picked up by the carriers (these are known as NPOS – no proof of service). When it comes to collecting on other errors, like GSRs and no proof of delivery (NPOD) claims, collecting can be difficult. It is much tougher to collect on these types of errors from UPS than FedEx Express. Both UPS and FedEx Ground require a shipper to sign an agreement that stipulates electronic invoice (EDI 210 files) and delivery data (EDI 214) cannot be used to collect on GSRs. A few clever auditing firms have found loopholes around this condition.

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You Get What You Pay For

Over the last five years, the push by payment firms to automate their auditing process has accelerated. Considerable incentives are given to customers who have invoice information sent via an electronic file (EDI, CSV file, FTP). For the bill review to be electronic, the auditing program must be loaded to identify specific variances or errors. In a fully automated audit, the potential errors that are not loaded into the audit program are not audited. The end result is that the auditors become more efficient, but at the expense of the customer.

Today payment firms rely less on the float of money to generate profit, but this practice is far from over. In fact, many auditing firms offer two prices, one that includes float and another that does not. For very large shippers, the float on the freight bills can be substantial and some payment firms may not charge for the "audit" of freight bills.

The level of audit can range from a cursory review of the bill to an extensive combing of all data. Most firms provide a simple match audit. There are two errors caught through this method: 1) duplicate invoice and 2) incorrect rate. We find that the larger auditing firms provide this level of review. When totaling duplicate invoices, this number can be very large, especially when bill payment is slow. A shipper should be cautious that the payment firm does not overstate the recoveries when the amount found through this process is from such basic auditing practices. Smaller firms will look for additional potential errors. An effective auditing firm will look for over a dozen potential errors on every invoice, such as whether the shipment was made, whether the correct classification was coded and whether the right miles were used. Identifying these types of errors is what separates an effective auditing firm from one interested simply in increasing its efficiency.

Do not be fooled by seemingly low audit/pay charges. If only duplicate invoices and correct rates are audited, the opportunity loss to shippers can be substantial. For instance, how much is lost by not auditing an invoice for a 10,000 lb. shipment that is paid when an extra zero is added to a freight bill or when an incorrect mileage is used on a freight invoice?

The Audit Rationale Ratio

To ensure you are getting your money's worth, use an "Audit Rationale Ratio" (ARR). This ratio is calculated by dividing what is found through the audit by what it costs. When the ARR is 1:1 or less, the value for the audit may not be justified. For instance, a weekly find of $4,500 in overpayments and a weekly audit cost of $6,200 results in an ARR of 1:1.4.

It is also important to include in this rationale the value of information, reporting, and timely payment of bills. It may be difficult to quantify this value, but through better information and reporting, a shipper should know a lot more about their freight characteristics, which in turn should identify areas where freight expenses can be reduced. So, quantify this value. As for timely payment of freight invoices, unless the shipper wants to take advantage of float, most carriers (FedEx & UPS are the exceptions) experience payment terms of 30 days. Since the majority of transportation companies operate with an operating ratio (OR) in the high 90s, quick bill payment is extremely important and can improve carrier pricing.

In-house vs. Third Party Auditing and Payment

Since deregulation, traffic departments have been getting smaller. At one time, many companies had large accounting staffs to pay freight invoices. When freight bills were 20% to 50% higher than they are today and errors more common, greater emphasis was placed on freight payment and audit. Corporate downsizing and automation have driven a greater tendency to outsource these services to expert third parties. Many small shippers still audit freight bills, but that equates to a general review to identify duplicate payments and incorrect rates.

It is an individual decision whether to keep freight bill audit and payment services in-house or to outsource it. The following should be considered when making that decision:

- Consider the value of information. Auditors with sophisticated and current technology can provide transportation information that can be used to make educated decisions about your logistics operation, resulting in significant savings. Sometimes the value of such information is not factored into the cost analysis.
- Capture all of the costs associated with internal audit and pay. In an article in Controller Magazine, Leahy and McLemore reported that the average company processes 190,000 vendor invoices per $1 billion of revenue and pays each employee $36,705 per year in salary and benefits. The same article cited a Hackett Group finding that the average company processes 11,100 invoices per person, per year. The math is straightforward: $36,705/11,100 = $3.31. That is, direct labor cost alone for payables processing averages $3.31 per invoice. Cass Information Systems, a large freight payment company, calculates direct labor represents 30% of fully allocated payables costs when indirect labor, equipment, postage, supplies, administration, overhead, and other cost components are considered. This ratio holds for other companies, as well. Applying this 30% factor to the $3.31 direct labor cost yields a fully allocated average payables cost of $11.03 per invoice. This average invoice payables cost is closely validated by IOMA's (Institute of Management and Administration) "Managing Accounts Payable" publication.

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Database/ Accounting Management

Good auditors can provide a wealth of shipment and freight invoice data, which a shipper can use to identify additional opportunities for freight savings. Electronic data files are the best way to receive this information. It is efficient and full of shipment information. EDI requires expensive VAN services. However, many transportation companies can translate EDI data to flat files and send them via e-mail or FTP. In fact, this data can be so robust it can occupy valuable storage space on your server. A shipper can have the auditing firm hold the data until requested. For periodic status of shipment activity, most auditing firms can provide high-level reports or smaller data files on a weekly or monthly basis. It is important to remember, auditing firms will experience the same data storage issues.

To conserve data storage space, auditing firms and carriers truncate a shipper’s data or delete it. Therefore, shippers should make clear to the auditing firm the level of data they want stored and for how long. To relieve storage space constraints, this can be managed by putting the data on CDs or tapes.

New Trends in Freight Auditing and Payment

On-line Access to Data

Most mid-sized and large companies offer web-enabled solutions to download shipment and payment data. A variety of software and formats are utilized, including Crystal Reports, Business Intelligence, CSV files, EDI and many more. If a shipper's information is not available on-line, most auditing firms can send a shipper a flat file, excel spreadsheet or ACCESS database.

Self-Invoicing & Software

Another technology that appears to be more theory than reality is self-invoicing. Some transportation management software provides the functionality to bill oneself. Before the shipment is tendered to the carrier, its cost can be calculated. Shippers that utilize this technology believe if a bill and the payment accurately reflect the service rendered that it puts the onus on the transportation company to audit the shipper. This sounds good in theory, but there are several variables, like accessorial charges, that may not be calculated by the software. These are charges that occur at or after delivery. Small parcel and air cargo carriers are notorious for adding these charges to the shipment. Before using this solution, ensure you have thoroughly mapped out the process and potential pitfalls.

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A few software programs generate reports that capture shipments failing the service guarantee. This also is great in theory, but presents problems, the biggest of which is that exceptions are not collected and the number of packages failing GSR tends to be significantly overstated. These systems do not take into account exceptions made by the carrier, like weather delays, delivery refusals, late pick ups, and many more. Complicating this problem further is that the shipper has to collect the failures from the carrier. Often, carriers deny a large number of these claims. Also, it might be prudent to separate auditing from your relationship with the transportation company. There is a distinct difference in having a third party file claims versus filing yourself. Ask yourself, who can better contribute the labor to do this work?

Data Management

The freight auditing and payment industry is saturated with providers, especially in the small parcel, truckload, and less-than-truckload modes of transportation. As a result, the price for auditing a freight bill has been driven down considerably. To compete and stay profitable, auditing firms are marketing the value of information. This capability should not be understated or overlooked. However, a shipper should understand the value of this information and quantify it. For example, will this information be used only once to find opportunities to reduce shipping costs? Or, will it be used weekly to determine expense allocation and track performance in the transportation area? In the first case, many effective auditing firms capture this data and can provide it when you need it. In the second case, a sophisticated expense allocation program can be developed for the shipper to ensure the right shipments are charged to the correct cost centers. Online access to shipment and invoice data can be very valuable to some shippers. This can save considerable time and money by avoiding the need to manually research shipment history.

The Right Solution Depends on Your Objective

Be careful not to “over-buy” a freight audit/pay solution. Understand your freight. If it is simple (e.g., mostly truckload), you won’t need a sophisticated solution. If you are looking to retrieve money from the audit, your pool of providers is limited. These are niche players that typically work in specific modes of transportation. You may be able to use an auditing specialist that is able to retrieve money from carriers and integrate that data with that of a multi-modal, information-rich auditor that can provide an abundance of data that is easily retrieved. If information is your driving need, ensure you align with an auditing and payment firm that stays current with the latest carrier file formats and customer needs. There is a cost for the auditor to keep current with technology, so most don't do it annually.

Whether you decide to in-source or outsource freight auditing and payment, you should understand the complexity of auditing certain modes of transportation and the importance of this function in any logistics operation. Auditing truckload invoices is fairly straight-forward, but LTL and ocean tariffs are not so simple.

Good and accurate traffic data can be very helpful at the negotiation table. You will be able to see growth trends with carriers, revenue differentials, freight profile changes, and in some cases service performance. Knowing that your expense with a carrier grew by 10% and the weight-per-shipment by 15%, while performance dipped by .5% percent, can provide good negotiating leverage.

For the most part, logistics data is at a premium in most operations and payment of invoices is some other department's responsibility. But, the transportation cost hits your budget. If you don't have control over these expenses and activities, you at least need visibility. Unless your company is ready and willing to invest in the manpower, technology, and knowledge base for auditing and paying freight bills, outsourcing could enhance your operation.

About the author: Giles Taylor is founder and president of Trans-Solutions, Inc, – http://www.trans-solutions.com – a transportation consulting company that helps small and mid-sized businesses make critical freight management decisions that result in savings of 5% - 25%.