collective wisdom®
SZABO ASSOCIATES, INC. VOLUME 34, ISSUE 3, SEPTEMBER 30, 2019

MORE is better than less.

Dear Friends:

It's a great feeling when you know you've broken through an impasse with a delinquent customer. The dispute has been solved, you've reached an agreement about a payment timetable, and the money actually arrives. Unfortunately, none of this ultimately matters until the cash is applied. The accuracy and timeliness of cash application have a significant impact on the financial health of your organization. In this issue's feature article, we talk about the challenges to the process and the opportunities to improve this critical function.

Our fall calendar of events includes Breakfast with MFM/BCCA, October 16 in Atlanta, Georgia and the 2019 BCCA Media Credit Workshop, October 23-24 in Washington DC.

Best wishes for a fine fall season,

Robin Szabo, President
Szabo Associates, Inc.

Collecting is Not the Endgame . . .
Accurate Timely Cash Application Is!

The customer has paid. You have the money. Time to breathe a sigh of relief, right? Not so fast! When a payment is received from a customer, businesses often consider the transaction to be complete, overlooking the final step of the sales cycle—cash application.

As important as accurate and timely cash application is, the process is difficult for many companies. Technological advances have made it possible to place orders and receive payments in dozens of ways. Unfortunately, having all of these options creates numerous ways for payments to get applied late or applied wrong.

Prior to the digital age, cash application was relatively straightforward. Orders would come in and be recorded, followed by a check for the invoiced amount. The accountant matched the customer's name and amount on the order with the check, then cashed the check to make the funds available to the business bank accounts.

Today, we have electronic invoicing, digital payment portals, proprietary B2B apps. Payments may come in via traditional lockbox services, paper checks, wire transfers, ACH, and private cards, all of which must be compared to orders from various sources. Often, a single invoice is sent for several orders. Many times the payment will not match the invoice or full amount owed on the account. Given all of these obstacles, it is no wonder that an A/R team is unable to close out daily reconciliations and must rely on a great amount of tedious manual work.

Why it Matters.
Efficient accounts receivable and cash application functions are critical to the financial health of companies, having the potential to significantly influence overall financial performance.

You cannot spend what you do not have. An order or payment waiting to be reconciled and applied is like a ticket you are holding to see a movie. It is only a piece of paper until you trade it in for a seat in the theater. Until the cash is applied, it has no effect. A high A/R reconciliation rate has a positive impact on DSO, frees up credit lines for more sales, and releases cash into your organization.

Additionally, your customer is not helped by a delay in applying the payment. Enterprise Resource Planning (ERP) solutions are a critical part of business structure, and best practices dictate that accountants close their books daily based on the structure established by the ERP software. An unprocessed payment creates a mismatch between the balance shown and the cash that is cleared to use. Timely cash application, therefore, is a courtesy to your customers.

Likewise, your collections staff is spared the embarrassment of asking a customer for money that your organization has already received. Having real-time visibility of payments received facilitates systematic and strategic dunning and customer contact.

Challenges.
A/R faces a number of challenges

—continued on page 2

Collecting —

—continued from page 1

that need to be addressed in order to increase efficiency and to achieve the highest possible reconciliation rate.

Check float. There is most certainly none among us who has not heard the typical procrastinator's response, "The check is in the mail." Even as more customers embrace electronic payments, many continue to prefer checks because of the time lag between the time the check is written and the time it takes for the money to transfer from their bank account to the recipient's bank account, known affectionately as "check float." Check float also includes "mail float," the time required for a check payment to travel from the customer to the recipient through the postal service. Media are understandably reluctant to ask, much less demand, that these customers up their payment game by paying electronically. Requiring this switch from the status quo would require customers to invest in internal upgrades, which media are loath to require given the competitive nature of advertising sales.

Lockboxes. Offered by commercial banks and designed to ease the flow of business transactions, lockbox services have significant pros and cons.

There are some clear advantages of using a lockbox service. By having your customers send or drop off payment directly to a convenient location easily accessible to the bank, the problem of check float can be significantly reduced. The bank checks the lockbox at least once a day, and bank staff directly deposit payments into the bank account, ensuring payments are deposited on the same day they are received.

A lockbox service can give your organization significant savings in resources. Having one or more members of your staff prepare deposits, deliver them to the bank, and prepare reports is expensive, especially when they could be performing more profitable and interesting tasks. Additionally, the influx of payments is not consistent, further reducing the efficiency of handling them in-house.

Traditional lockbox services also have some noteworthy disadvantages. Even though you may enjoy some efficiency savings with their use, lockboxes can be costly. Banks typically earn a fixed setup and continuous monthly fee for each lockbox, along with a service/transaction fee for each payment processed. A high volume of checks equates to high lockbox service fees.

There are security concerns associated with lockboxes. The bank may use an offshore business process outsourcing (BPO) service to manually process each payment, or it may use new, inexperienced personnel to perform the tedious task of keying in data. Either can be vulnerable to criminal intrusion, and the lockbox payment provides plenty of information for those intent on committing fraud with counterfeit checks. Additionally, manual processes are always subject to human error.

By today's standards, traditional lockboxes are slow, although probably faster than you could process them manually yourself, but slow nonetheless given the electronic possibilities. Real-time availability of funds is not possible with traditional lockboxes.

Your back office team will still probably need to match the customer information associated with the deposit to the information stored in your system. Also, traditional lockbox services do not directly integrate with other, newer methods of payment. As your organization moves away from physical checks to other faster, more efficient methods of payment, traditional lockbox services continue to decline in value.

Electronic lockbox services replace the physical address of the traditional lockbox with a digital web address and replace paper checks with electronic payments. Designed to make it easy and quick for customers to make electronic payments, e-lockbox services allow you to offer customers a number of payment options, including ACH, eCheck and credit card. Advantages are many: elimination of check float, reduction in manual labor, elimination of fraud, easy payment tracking, and easy integration with your system.

While e-lockboxes may be comparable or even lower in cost to a bank's traditional service, they are not inexpensive. While companies offering this Software-as-a-Service (SaaS) may try to reduce your transaction costs to make it a worthwhile investment, it still comes with a considerable price tag. Additionally, this is not a service that you will want to budget-buy; quality is essential to reduce risk and serve you—and your customers—well. Serving customers satisfactorily is critical, since you must ask them to abandon their paper checks in exchange for a billing portal.

Remittance formats. While multiple payment forms continue to plague A/R, so do multiple remittance formats. When customers pay electronically, remittance data is usually decoupled from the payment. The remittance can come in one of several formats (.txt, .csv, BAI2, .pdf) and through one of several channels (email, web portals, fax).

Formats such as EDI (Electronic Data Interchange) and BAI2 (Bank Administration Institute 2) offer some much-needed standardization. Ideally, a company receives remittance information coupled with a payment in a standardized template. Next best is a remittance that is decoupled from the payment, but submitted in a standardized format to a recipient with the technology to process it. The worst is remittance data that an analyst must download from email, web portal, or EDI and then manually key in. Even so, getting banks, businesses, third-party agencies, and payment platforms to recognize and embrace the benefits of standardized remittance is a tall order.

Matching. One way or another, the payment and remittance data are now linked. Next comes the task of matching the payment with open invoices. Hopefully, the remittance information includes the invoice number, and the payment amount matches the open invoice amount. By reviewing at a line-item level, you should be able to identify deductions, discounts, and any inconsistencies for individual line-items.

Unfortunately, this is not the way matching is always done. Some analysts match the payment with the open invoice without paying attention to references in the remittance. Or, some may simply compare the open amount and the received amount at the customer/account level. This method fails to identify any discrepancies that would be caught at the line-item level.

Perhaps the customer made a short payment, either because of a dispute or a discount. This situation can lead to time-consuming interdepartmental efforts to resolve the matter, leading some companies to simply write off the discount, eligible or not.

Posting. The cash application process is complete only when the payments are posted to your ERP system. In a manual process, batch files are created and pushed into the system, then the status of the application appears in the ERP. If the status is "unprocessed," the file must be examined, fixed, and reposted.

House Repairs.

Perhaps you are thinking, "If only I could find the right technology solution, then our cash application process would be perfect." Unfortunately, even the "right" technology solution will go only so far if your current process is flawed.

Bill Gates once said, "The first rule of any technology used in a business is that automation applied to an efficient operation will magnify the efficiency. The second is that automation applied to an inefficient operation will magnify the inefficiency."

The first step in improving your cash application process is to take it apart, examine each task, and identify problems. Identify each task in your cash application process. What are the obstacles and/or time involved with regard to performing the task?

For example, perhaps your organization receives payments and remittance data through a bank lockbox. How many hours does it take your staff to prepare the file for the lockbox program? To resolve errors after the initial processing? To read paper remittance images from the file? To check remittance data to identify the right invoice? To post the payment?

Once you have these numbers, look at the final result. What is your cash application resolution rate? Do you have an excess of unapplied cash? Too many write-offs for deductions?

Next is an exploration of solutions. Are you analyzing payments on a line-item basis to identify discrepancies? Are payments applied on-account or on-invoice? Standardized internal codes for the various types of deductions can help avoid confusion, as will clear communication with customers about the discounts for which they are eligible. Have you established these codes and communications?

Technology Solutions.

Perhaps your organization has already realized significant benefits through automation. On the other hand, you may determine that your cash application process might benefit from a new technology investment. There are many considerations and questions to ask yourself, the first and foremost being, What are we hoping to achieve? What benefit in time and money would automating this task bring to us?

The next question might be, What is the investment? Do we want an on-premise solution or Software-as-a-Service (SaaS)? What are the initial costs incurred by each? What are the recurring annual expenditures, such as software maintenance and depreciation, or subscription charges (for SaaS)? Personnel investment is another cost. What resources will we need to allocate short-term and long-term? Will there be ongoing management associated with the solution that are not necessary now?

The end question is, of course, How will automation affect our net profit? What is the net of costs and savings over five years? It may be that the solution you thought would be ideal is simply too expensive. You may conclude that investment in hardware and software for an on-premise solution is too costly both initially and over time, and that a Software-as-a-Service solution is more palatable. Perhaps your bank, along with its FinTech (financial technology) partners, offers a solution that is adequate for your needs at an acceptable price.

Some banks and FinTech companies are now offering integrated receivables solutions that allow organizations to automatically deal with a variety of paper and electronic payment types, assist with

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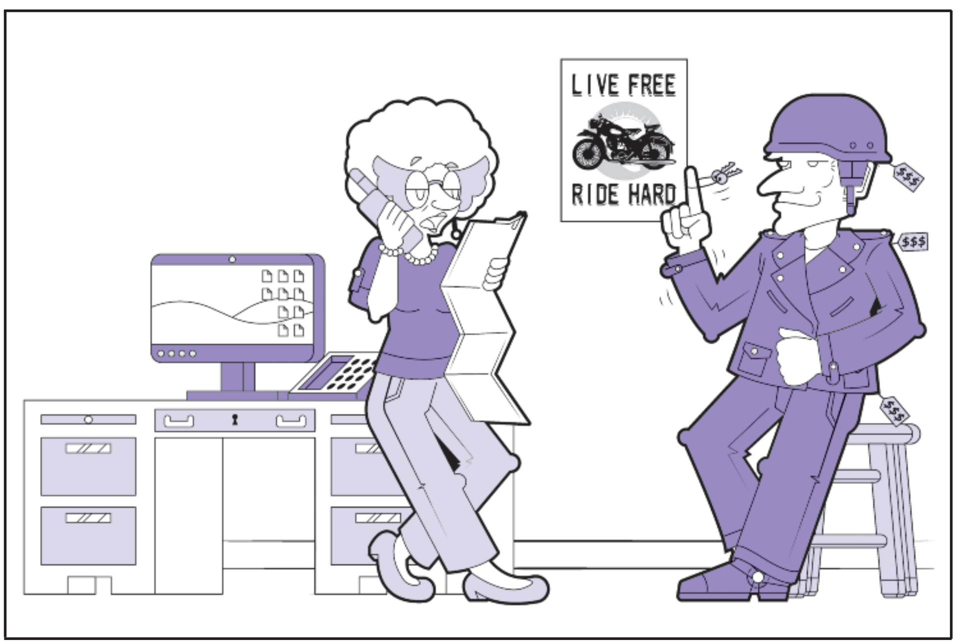

Looks like Sales needs a refresher on the importance of speedy cash application, Boss. He "applied" his new customer's commission to a new Harley and we haven't even invoiced the account yet.

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Collecting —

—continued from page 3

cash application, manage some payment exceptions, and issue reports. While some level of manual intervention is still involved in matching payments to remittance data, these solutions could result in significant savings in time and labor.

Technology solutions continue to evolve, with FinTech companies now employing machine learning and artificial intelligence (AI) to enhance productivity gains. Because finding patterns and anomalies in large data sets is what machine learning and AI do best, these solutions can combine data aggregation, data correction, and A/R matching processes to improve straight-through reconciliation of incoming payments. AI-supported receivables platforms will enable A/R staff to focus on reviewing exceptions, monitoring customer adherence to payment terms, and studying data analytics for better management.

Regardless of the outcome, periodic review of your cash application process is a worthwhile endeavor. Doing so will, at the least, allow your organization to identify problems before they become more difficult to rectify and, at best, to make whatever changes are necessary to increase the net profits of your organization. ♦