Strategies in Accounts Receivable:
Driving Department Efficiencies

Introduction

At its core, the accounts receivable (AR) function is a primary method by which a business collects and earns revenue, comprising up to 40 percent of a company's balance sheet[1]. Despite being an essential function in corporate solvency, research shows that many organizations struggle to create efficiencies and scale. This can be a deterrent to growth, and along with outside economic pressures, means many financial executives are squeezed to improve working capital while reducing the costs of managing receivables. In fact, in a 2016 survey by TD Bank and CFO Research, 62 percent of companies reported that their business' capacity to increase capital spending over the next two years depends on significantly improving working capital efficiency,[2] with 60 percent of respondents in this same study citing that getting paid faster (accelerating receivables) is a primary strategy. Many businesses, especially those in growth mode, focus on the end result - revenue collection - without addressing the effectiveness or efficiency with which the accounts receivable department operates. As with sales goals and employee efficiency, implementing best practices with measurable objectives can greatly improve performance (and thereby reduce costs), enhance cash flow and gain productivity.

Challenges in Accounts Receivable

Virtually all AR challenges are rooted in an industry-wide lack of standardization for invoices, payments or cash application in the U.S. Each of these AR components is subject to various geographic, segment, industry and company specific formats, processes and preferences. Although it can be apparent that AR processes need fine-tuning, many organizations remain stalled in the status quo. Together, these challenges can be time consuming at best and costly at worst. Estimates suggest paper invoices cost a business about $1.17 each to produce for a highly efficient operation and as much as $39 for a smaller, less efficient company, while typical processing time can last several days.[3] Add to these expenditures the "cost of business" to run an AR operation, such as equipment/printers/fax machines, postage, envelopes, paper and more, and the true expense of generating paper invoices climbs.

2016 survey by TD Bank & CFO Research

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1 "The A/R Risk Balancing Act," Treasuring & Risk, August 5, 2014.
2 "Funding the Future of Your Company: CFO Strategies for Optimizing Working Capital and Capital Investment," TD Bank-CFO Research, 2016.
3 "Accounts Receivable Performance: Doing OK is No Longer Good Enough," APQC, 2012.

Obstacles also abound once invoices are distributed and customer preferences become apparent. Payments frequently are received in paper form, with 93 percent of businesses noting they still receive checks from customers even though 82 percent of companies have capabilities to send payments through at least one electronic method.[4] Without question, paper checks are costly to process with many organizations staffing multiple employees to open mail, post payments and prepare and make deposits. By enabling paper receivables, organizations fall victim to inertia and nurturing their own inefficiencies. Furthermore, additional processing complications can arise from postal delays, payers electing their own payment timing and volume cyclicality.

Companies that serve both business-to-consumer (B2C) and business-to-business (B2B) customers may find that consumers typically follow payment instructions and rules, for instance, while a business may do what meets its own needs — often without considering the impacts on the receiving organization. This is most apparent with remittance details, the payment-related information used to perform cash application. Regardless of payment type, the task remains for AR to quickly and correctly apply that payment to the company's accounting records and the customer's account. Multiple payment types — cash, check, ACH, wire, card and bill pay — remitted via various channels means associated details have a similar variety and inconsistency. This accounting challenge is in addition to more traditional cash application duties such as manually matching payments to accounts (payment is applied to the incorrect customer), handling exceptions and deciphering partial payments.

In addition, non-standardized credit terms, cash discounts, payment terms and more can make it increasingly difficult for today's AR professionals to manage which customer is offered what and if any formal agreement is in place. With these challenges in mind, improving the receivables process is essential for organizational success.

Efficiency through Automation

In an era when many U.S. workers use a computer or mobile device for primary work tasks, the most logical method to optimize the accounts receivable process is through automation. Companies have been slow to acclimate, however. Just 17 percent of corporate treasurers and financial professionals reported in a TD Bank survey at the 2016 Association for Financial Professionals (AFP) annual conference that their receivables are currently paper-free.[5] Further data from the Federal Reserve Bank estimates that U.S. organizations generate approximately 25 billion invoices annually, but fewer than 25 percent of these are exchanged electronically.[6]

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4   "2013 AFP Electronic Payments Survey," Association for Financial Professionals.

5   TD Bank survey at the Association for Financial Professionals Conference, October 2016.

6   "U.S. Adoption of Electronic Invoicing: Challenges and Opportunities", Federal Reserve Bank of Minnesota, June 30, 2016.

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A global examination shows that this is largely an American problem. North America lags behind other continents in electronic invoicing (e-invoicing) adoption, largely due to tax regulations in other regions such as Value-Added Tax (VAT) and government mandates to move invoicing and payments to electronic methods. In 2014, North America and Europe sent 24 percent of invoices electronically, with an expected increase to 38 percent in North America by 2024 versus a 96 percent adoption rate in Europe in that same time period.[7] The lack of regulatory incentive to automate, coupled with the additional complication of nearly 10,000 tax jurisdictions in the U.S., means there are universal obstacles to swift change.

Although U.S. adoption of electronic accounts receivable methods has been slow, it could bring invaluable savings. Monetary savings for converting paper invoices to electronic methods are estimated at $4 to $8 per invoice, a material benefit for any company that adopts e-invoicing.[8] Reliance on manual procedures also allows for more errors that translate into additional time and money spent to reconcile disputed invoices — as much as $53.50 per invoice to resolve mistakes, according to a 2010 survey by Sterling Commerce.[9] Taken together, this means a mid-sized business could spend nearly $100 per invoice before they even receive and apply the payment, a red flag for efficiency in any company.

Along with the tangible cost savings for paper, printing and postage, electronic conversion will reduce labor costs. The TD Bank survey at the AFP annual conference showed that nearly 60 percent of financial professionals anticipate automating accounts receivable processes will result in a time savings of 6–10 percent of work hours within their finance department.[10] Despite this positive impact to the bottom line, 30 percent of executives polled report that electronic change is not imminent, mostly due to technology and infrastructure challenges that need to be resolved first.

Key Takeaways

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7   "2014 Global eInvoicing Report", Paystream Advisors.
8   "2014 Global eInvoicing Report", Paystream Advisors.
9   "The Business Value of e-Invoicing," Sterling Commerce, 2010.
10   TD Bank survey at the Association for Financial Professionals Conference, October 2016.

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Creating a Better Accounts Receivable Department

Crafting functional and strategic changes will ensure an AR department is running at maximum efficiency and generating profit for an organization. The following steps will help to ensure optimal performance in accounts receivable:

Enhance invoicing.

Streamlining the invoice-to-cash (I2C) process starts with addressing the invoice itself. Is it well-designed and does it provide clear instructions for payment remittance and terms? Is it prepared in a timely fashion, and is it distributed electronically or mailed? While the average company is not able to communicate using EDI 810 invoices, numerous solutions are available to help businesses of all sizes move away from paper-based processes and provide invoices to their customers electronically. Addressing basic concerns such as invoice format and more complex ones like electronic invoicing lays a solid foundation to make a significant impact in AR.

Optimize electronic payments.

A fundamental step to maximizing electronic receivables is to develop a concise payment strategy that encompasses roles and responsibilities, customer segmentation, payment analysis, delivery channels and related risks. While there is no one-size-fits-all approach, developing a plan will help you identify customer characteristics, the advantages and disadvantages of various payment types, optimal payment mix and how specific payment vehicles best align with segments of your customer base. For example, consumers might prefer the convenience of a credit card, while a wholesaler prefers the control of ACH. Consider also the type of information associated with each payment method any how that can assist with performing accounting functions and customer service. Further evaluate how you might influence customer behavior, which may be as simple as creating awareness of accepted payment types and your organization's preferences. Finally, research peers for comparison to help you set target goals. Ultimately, conducting this exercise will establish benchmarks for future success and create an evolving tool to help measure results.

Streamline and automate cash application.

The fundamental question of cash application is: Did we get paid what we should have, on time, and did we properly account for the payment? Cash application and many other

accounting functions are largely manual, time-consuming processes for many organizations, and this data entry lacks controls, eroding the positive impact of the dollars collected. Some measure of automation such as electronic posting files for cash application is the logical first step and will provide better control as a business begins to streamline the process. Receiving a separate file for each payment received can become cumbersome, however, so companies should strive to combine these details into a single channel. Integrated receivables will consolidate payment details from multiple payment types — lockbox, ACH, cards, etc. — streamlining remittance information into a single file for automated posting. By addressing the unique formatting requirements of each payment type, integrated receivables helps to create consistency and operational standardization.

Take a holistic view of Order-to-Cash (O2C).

In order to evaluate and enhance the AR function (which traditionally encompasses I2C), begin by inspecting the broader O2C process. Prerequisite steps such as customer orders, credit evaluation, fulfillment and delivery have downstream impacts on invoicing, payments and cash application. Understanding the comprehensive relationship between O2C components will help you not only improve AR, but cultivate efficiencies within every aspect of the work stream. Results could be as basic as eliminating duplicate efforts or as transformational as outsourcing certain repetitive operations in order to assign employees to value-added tasks. While every company's culture and process is different, inviting all stakeholders to the discussion table and drafting an O2C workflow diagram to foster collaboration is a good starting point.

Create measurable KPIs.

Key performance indicators (KPIs) give insight into the AR department's efficiency, but which are the right measures to track? An obvious KPI is Days Sales Outstanding (DSO), but going further and leveraging the Collections Effectiveness Index (CEI) — which compares the funds received over a certain time period to the amount in receivables open for collection during that same period — gives a better measure of effectiveness. The CEI will help compare your organization with peers, and the Credit Research Foundation has industry benchmarks available to ensure your company is on track. Other more traditional KPIs to consider are past due invoices, write-off expenses, AR aging balance, Average Days Delinquent (ADD), credit overrides and payment channel usage. After determining which KPIs are right for your organization, don't just report them for the sake of reporting. Instead, use KPIs to set targets, measure annual performance and make more informed decisions.

Mitigate risks through strong policies and procedures.

As previously stated, customers often will do what works best for them when remitting payments, so operating with sound and enforceable guidelines is critical. If an organization is too flexible in terms — or frequently revises those terms to avoid discord in a business relationship — it is creating needless risks. Key to mitigating this is to effectively manage credit extended to customers and collect revenue in a timely manner, as well as regularly review, update and communicate rules regarding credit, payment terms and any late-payment penalties. Policy violations create risk in AR and across a business, as inconsistencies in cash flow can impact a business' ability to disburse payroll, pay suppliers, take advantage of early-pay discounts and disrupt general business operations. Any customer worth keeping will respect a company's need to adhere to policies, and regularly maintaining them will require less creative management.

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Customer Case Study – DC Water

DC Water (District of Columbia Water and Sewer Authority) provides water in Washington, D.C., and wastewater services to several surrounding counties in Maryland and Virginia to a total of more than 2 million area residents. The Authority operates the Blue Plains Advanced Wastewater Treatment Plant, the largest facility of its kind in the world. With such a sizable operation and customer base, payment collection is a critical financial operation. Over time, inefficiencies had evolved within these accounts receivable (AR) processes and DC Water decided to make improvements.

Several years ago, TD Bank was selected to help assess and implement AR-related process improvements. As part of this new relationship, TD would provide lockbox services to process incoming payments, an online lockbox application to improve visibility and a customized integrated receivables solution to help automate cash application. The integrated receivables solution provided DC Water with a single daily file of remittance details consolidated from multiple payment channels such as lockbox, online and bill payments. Equally as important as the technology, the respective teams worked together to recommend changes to processing guidelines and reporting formats.

Through the combination of consultation and solutions, DC Water achieved its stated goals. Incoming payment processing accuracy improved and lockbox exception items were reduced by more than 25 percent. This meaningful reduction in exceptions, which required manual handling by DC Water, helped the Authority save 1-1.5 labor hours each day. In addition, the integrated receivables file eliminated the need for handling of multiple files in varying formats, reducing IT overhead and associated processing challenges. Used not only to populate their Lawson ERP system, this information enabled DC Water to provide more timely account information and improved service to its customers.

"This partnership has allowed us to create a more efficient receivables process," said Bob Hunt, Director of Finance, DC Water. "The seamless integration of lockbox data to our internal systems allows my team to accurately post payments and feed our customer service database so our support specialists have the information they need to serve our customers."

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Conclusion

While incorporating electronic processes into Accounts Receivable and creating a truly integrated experience is the "gold standard" for today's CFO, many organizations are hindered by costs or struggle with inertia. Even if going paperless remains a long-term goal, companies can incorporate several best practices today to streamline and develop efficiencies that will reap time and money savings, and ensure future performance with measurable, industry-led KPIs.

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