

Workflow Automation #2: Cash Application

Thomas Gannon, CCE

One of the more time-consuming and time-sensitive processes for an Accounts Receivable/Credit Management organization is cash application. While some Credit Departments are not directly responsible for the function, they are still concerned with its results. Conversely, those remote cash appliers and their supervisors must also be concerned with the timing and accuracy of their actions.

If customers always paid every invoice in full and on time, applying their payments would seem to be an easy task. However, in real life, there are always discrepancies, payments out of sequence and so on. While it would seem that payments could simply be applied oldest-forward, and, in fact, there may be an appropriate agreement with the customer to allow that, there will always be disputes, questions or merely lousy bookkeeping by the customer. All of this may ultimately affect the relationship and potential for reduced purchases, slower payments and even the total loss of the customer altogether.

Information Required for the Process

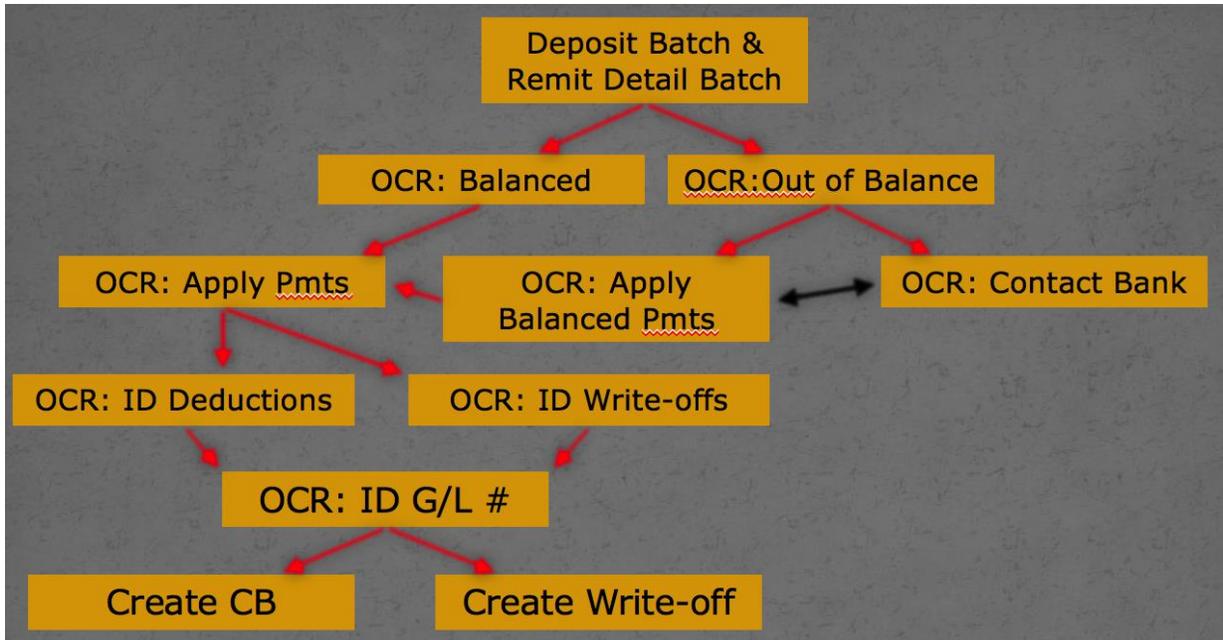
In order to automate this workflow process, there must be data and tasks:

- Databases:
 - Open item list, by customer
 - Invoice detail, including individual items, pricing, etc.
 - Special pricing quotes
 - General Ledger accounts, including sub-ledgers for different locations
 - Sales and Use Tax tables, by jurisdiction and ZIP Code
 - Customer Purchase Order(s) data
 - Contact information for Common Carriers, LTL Carriers, UPS, Fed Ex, etc.
 - Sales Associate and location contact information
- Tasks:
 - Receipt of deposit information and remittance detail
 - Posting payments to open items
 - Identifying discrepancies, deductions, over-payments
 - Posting chargebacks and write-offs to proper customer and G/L accounts
 - Directing follow-up to proper people
 - Making later adjustments, after the appropriate follow-up is complete

This database information is essential to the automation process, so it must be available from the beginning. The step-by-step automation process will include reading the data, analyzing it by what-if scenarios and filters, taking the next step and then taking the next one and so on.

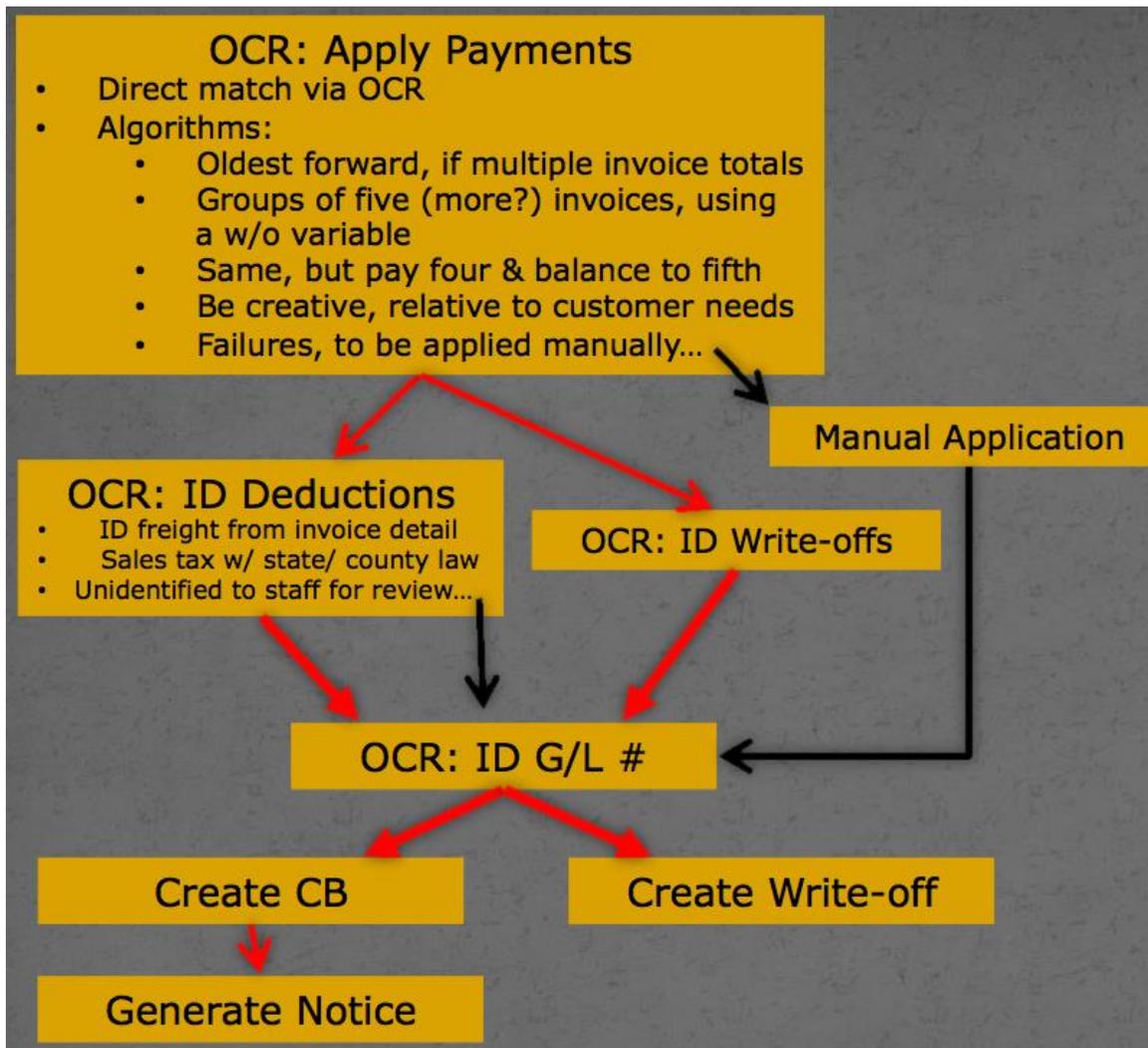
Step #1: Receipt the Deposit Information & Posting the Remittance Detail

This scenario assumes that both the standard deposit batch detail and the remittance detail are digitized, from the bank. If the remittance information is presented in paper form, it is still possible to follow this, after scanning the documents. (Remember that the red arrows represent automated flow, while the black represent human intervention.)



Of course, this is a general overview, with a visual emphasis on OCR (Optical Character Recognition). The diagram lays out the basic process, with a little more detail to follow. From the top:

- Whether via their lockbox operation, electronic deposit or a regular in-person deposit, banks can provide the complete detail, as provided by your customer, electronically, even if it is hand-keyed.
 - Occasionally, the cash total and the remittance detail totals do not balance. If this happens:
 - The process will identify payments and remits that do balance, so the system can apply them.
 - Contact the bank for correction. This may involve human intervention.
 - Once the corrections are done, the payment can be applied, possibly with human intervention, or not.
- In the meantime, all of the balanced batches are applied.



The most difficult part of this is designing the application algorithms. Much depends on the industry, the number of open items on a given account, along with what your customer requires in the way of support and the complexity of the billing.

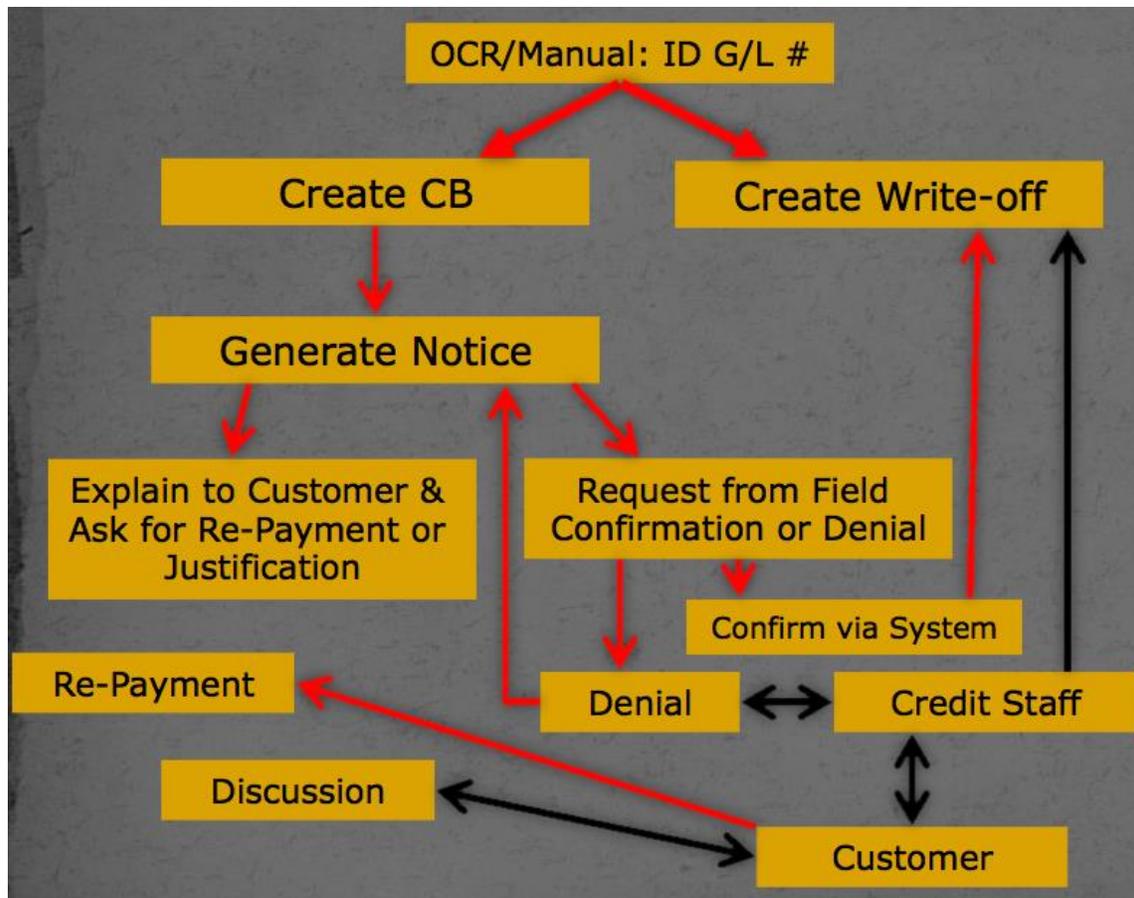
- Most customers will want their payments applied exactly as they indicate, even if they fail to properly “indicate”. Hopefully, their remittance detail allows for accurate interpretation. If your company’s policy demands that the oldest items be paid first, it is suggested that you include a clause in your Credit Application and Sales Agreement to that effect. Otherwise, arbitrarily applying to the oldest, even if the customer fails to provide adequate detail, will generate a multitude of problems.
- Another option, with a greater chance of success and fewer customer problems, is to consider using groups of invoices within a given timeframe, to equal the amount of the payment. With an understanding of the potential issues, as above, there could also be an adjustment variable included,
- In the scenario above, rather than make an adjustment, you could also clear a set of appropriate invoices and then apply the remainder to another invoice, leaving a net balance.

- The key to all or any of this type of calculation being successful is being considerate of the needs and expectations of the customer. The goal is to have the application process completed using OCR, so any customer who regularly fails to provide adequate remittance detail should be contacted and convinced to do so. Otherwise, the answer may be an agreement to apply oldest forward, without dispute.

Obviously, any item that fails the algorithms must be applied manually.

In the meantime, there are other steps in the application process that can be automated.

Step #2: Deductions



Deductions are a significant issue, even at a low volume of business. During the application process, they must, first, be identified as to the reason. Then, perhaps some of them can be confirmed as being legitimate, so an adjustment is required. A few may fall within a category of meaningless, with another adjustment needed. However, the bulk of them will require action of some sort, before a proper resolution is determined.

Identification:

- Manual observation is easy, but costly, in terms of time and labor.
- Knowing that OCR is available, there is another way:
 - Establish a series databases that the automated process can read:

- Sales and Use Tax rates are available by jurisdiction, down the ZIP+4 level.
- The invoice will, or should, have Bill-to and Ship-to information, with a default to the Bill-to if the other is missing.
- Invoices usually, or should, include the shipping/ delivery method, as in CPU (Customer Pickup), OT (Our Truck) or any other specific carrier.
 - If delivery is via CPU or OT, there should be a signed invoice or delivery ticket.
 - If delivery was via an outside carrier, they should have access to the POD (Proof of Delivery).
 - If possible, include the Bill of Lading number or any other identification number.
- Hopefully, there is a code for special quotes and contracts, along with the details of same, per customer and quote number, for multiples.
- If you are involved in the construction industry, ensure that the job name, hopefully the official version, is captured on the invoice or delivery ticket.
- It will take a series of questions, filters and prompts to take the deduction and compare it to the data above:
 - At a pace faster than the speed of light, the automation process can take an amount, a reference/ invoice number and a timeframe and search through these databases for a match(s).
 - Example A: Take the deduction amount. Compare it to the amount of sales tax on the referenced invoice number. Match the billed tax rate to the proper rate for the Ship-to ZIP+4, then the same for the Bill-to, the Ship-via code and so on. If the proper rate differs from the billed rate, does it match the deduction? If yes, make the adjustment. If not, move on to the next database.
 - Example B: If the deduction amount matches the freight amount billed, scan the ticket for any special quote, and then generate an automatic notice to the sales representative or billing location, asking them to confirm if freight was billed incorrectly. This may involve human intervention, with the field person contacting Credit. There may also be a means for the field to respond electronically. Depending on the circumstances, an adjustment may be in order, or an AR chargeback can be created to rebill the customer. The CB (Chargeback) should include standardized wording and contact information for an appeal.
- Of course, any of these processes may fail to adequately, within a set of variables perhaps, identify a deduction:
 - Automatically create a CB and generate an unidentified deduction notice, asking the customer to provide a detailed reason for the deduction.
 - Forward the deduction to a staff person for manual contact with the customer.

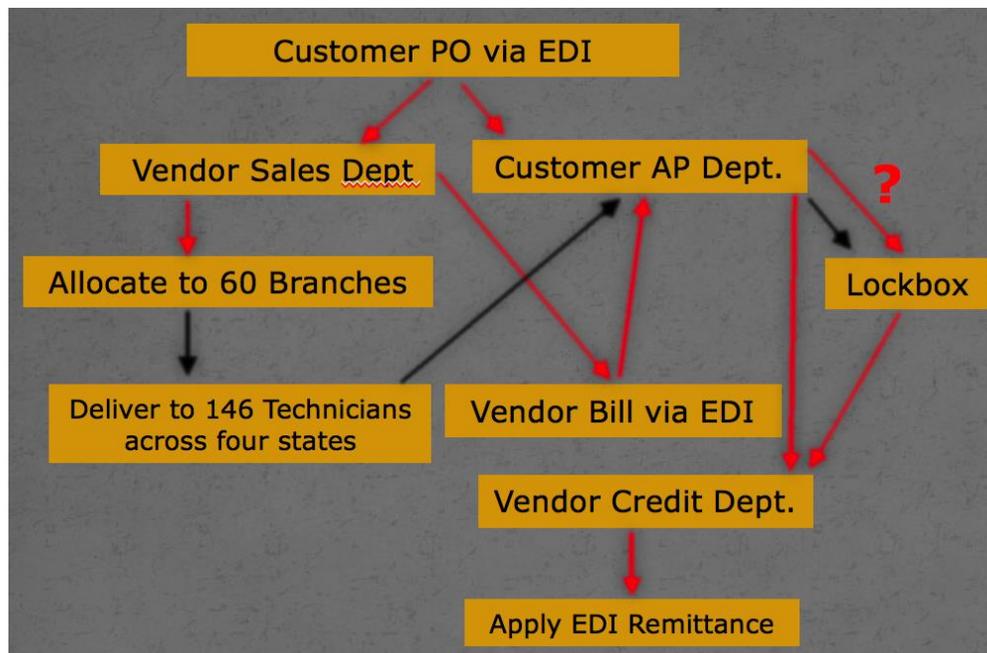
- For all of the adjustments and chargebacks, there must be a set of codes, matched to the various GL (General Ledger) accounts, so that your company's financial statements are balanced and properly coded:
 - Example A: Sales and Use Tax must be collected and paid to the appropriate jurisdiction:
 - If the tax crosses a jurisdictional line, the potential for an audit, by the legal recipient when an amount is billed and then deducted, is real. Your company will have paid the tax it billed to the customer, beforehand.
 - If a tax amount should be billed, but either it is not, or, worse yet, the customer makes a later deduction, with a claim of exemption, it is your responsibility to produce a proper exemption certificate
 - When such a deduction takes place, the automation system should be able to read through a series of digitized certificates, to confirm legitimacy, or not. If it is legitimate, the system, through a macro coding, can then make the adjustment. In the event of an audit, you will have proof to support the lack of original payment or the later adjustment.
 - When the system cannot do so, or the result is a lack of a certificate, human intervention is required to obtain and confirm or deny it. If denied, a CB must be generated.
 - Example B: Assume that your terms are Net-30, and customer claims a discount, by either having a column for it on a standard remittance form or using the word when citing a deduction:
 - The system's OCR ability will read the reason for the deduction.
 - A pre-set macro will generate a CB for disallowed discount, recreating an open AR item, using the proper GL number for receivables, in general and the sub-ledger for the customer's account. The invoice itself will be cleared.
 - Another macro will generate a notice to the customer, using pre-determined language for the disallowed discount code.
 - There can also be a pre-set message to the sales associate for the account, letting him or her know that they can expect questions or, perhaps, some attitude, from the customer.

<u>General Ledger Coding</u>

The coding for this process will be in two forms, adjustments (write-offs) and chargebacks, and they will serve an additional purpose, beyond the financial statements. They will also be the source for the wording on the notices, emails, etc.:

- Each code will be set up with a pre-determined series of macros, filters and text for notices.
- Generally, straight write-offs are just that, since they do not immediately affect someone else:
 - An exception is Bad Debt. Since this adjustment often has a negative effect on a sales associate's commissions, when the code is used, it will make all of the necessary account updates, plus it can generate a notice to the associate
 - In all other cases, it is simply the adjustments to reduce AR and increase some other specific GL account.
- Chargebacks, on the other hand, often require notices to someone:
 - As mentioned, something like disallowed discount requires a notice to the customer, and, perhaps an assigned sales rep. Two separate bodies of text will be attached that particular code, with a "switch" to include the sales person, if one is assigned to the account.
 - A CB for an unidentified deduction will send the required notice to the customer, asking for more information and providing the necessary contacts.
 - Pricing codes can be set up to generate two notices: 1. Assigned sales associate 2. Billing location or department.

EDI



There is another option to consider, with a willing customer. There is a function known as EDI (Electronic Data Interchange), which does require specific software on both ends. That software consists of a series of electronic templates. Without going into all of the template details, the example shown above is a real-life scenario from my personal experience. The company names will be kept

secret, to protect both the innocent and the guilty (humor). All that needs to be understood is that the customer's daily transaction volume was huge, which ultimately resulted in a very tedious and time-consuming payment application process. Payments were six figures and the remittance detail consisted of many hundreds of items. The process:

- Each day, the customer would send a PO, with hundreds of line items, intended for multiple field technicians, across four states.
- Their end of the system automatically updated their AP system
- On our end, our system automatically allocated the order(s) to as many as 60 locations.
- Those locations would deliver the material to as many as 146 technicians, either by OT, CPU or another carrier.
- A daily consolidated billing, with an invoice for each separate delivery, went to the customer electronically
- Within their own process, the technicians sent delivery receipts to their AP Dept.
- Once reconciled, they cut a check, which, for their own reasons (float), they mailed to our lockbox. At the same time, they electronically sent the remittance to us.
- Once the check hit the bank, we triggered a program that automatically applied the payment to the individual invoices.

The advantage that any exceptions, which were provided electronically to my cash application section, took, perhaps, 10-15 minutes of human intervention time, for a six figure payment, and hundreds of invoices each time. The same process would work, with a payment sent electronically.

<u>Summary</u>

The purpose of the various charts is to illustrate the degree to which the cash application process can be automated, by visually comparing the number of red arrows vs. black arrows. The difference is significant, especially if you put the number of transactions into the mix. In a manual environment, every paid item requires at least two keystrokes, the down arrow and the "check mark" or whatever your system has. Imagine what that means in an environment with over 400,000 open items on 40,000 open accounts and 20,000 checks to process each month. It takes just as much effort to clear a dollar invoice as it does a \$10,000 one.

Of course, human-to-human contact is necessary for sound customer relations, collections and other important aspects of the Order-to-Cash process. Also, some transactions between one company and another simply cannot be totally and blindly automated. However, and that is a big "however", it could mean a more efficient allocation of staff resources, so that you can maximize the value of the customer relationship. Timeliness is extremely important to that relationship as well, not to mention protecting your company's most liquid asset, Accounts Receivable, and the job of increasing sales through sound business credit decisions. As your company grows, you may have more luck transferring responsibilities to freed-up staff than getting approval to hire more staff. Think about how much more effective your key people, actually all of your people, could be, if they are not always tied up with the mundane stuff.

