
1

PAYMENT ARENA YESTERDAY, TODAY, AND TOMORROW

INTRODUCTION

The payment process in the business world, for both corporates and not-for-profits, is undergoing a quiet evolution. Techniques that were used by only a few organizations considered to be on the bleeding edge just a few short years ago are becoming commonplace. Interestingly, these techniques have not been limited to a few big companies with money to spend on the newest technologies. There has been widespread adoption, across industry and size lines. What's more, looking forward, organizations of all sorts expect to emulate the success of the payment pioneers who blazed the trail.

Part of the reason for the widespread adoption of new technologies is the low cost. In fact, in many instances, adoption of these technologies will result in lower costs, something that no organization can afford to ignore. Additionally, unlike some of the

precursors (think electronic data interchange [EDI]), the new payment methodologies are easy to understand and often have their roots in the consumer world. Thus, when executives are first presented with proposals to take the new route, they understand what is being put before them. Combine the ease of understanding with the cost savings and often improved internal controls, and it is easy to understand why this payment revolution is taking place.

PAYMENT WORLD YESTERDAY

It wasn't too long ago that companies paid all their bills with checks and perhaps a few wire transfers for large-dollar items or funds going overseas. Checks were routinely signed by hand, with two signatures being required for most. The paper-heavy process was cumbersome and laden with problems.

A small number of large companies used financial EDI, the electronic movement of payments and payment-related information through the banking system in a standard format between two parties. EDI, with its rigid standards, worked because the standards were developed and everyone using the same "definition" meant the same thing. Although the EDI process was and is cumbersome, it allowed for some automation of the payment process. It is still around today mainly because of the large investment some companies have made in their systems.

While check forgery has always been a problem, it was not until the 1970s and 1980s that the fraud became a serious issue across the board. Prior to changes in the Uniform Commercial Code (UCC) in the early 1990s, banks routinely absorbed all the losses associated with check fraud. Thus there was little incentive for organizations to take safeguards in order to limit the losses.

With the changes in the UCC and the shared responsibility came new products to minimize check fraud as well as the emerging acceptance of electronic payment methodology. While direct deposit

of payroll and Social Security payments have been around for many years, for the most part, that was the extent of electronic payments in the United States.

The United States might be a world leader in many arenas, but when it came to electronic payments, it was definitely a laggard. Interestingly, despite the efforts of many financial institutions to move their clients to electronic payment methodology, the impetus came from the consumer side. Some of this credit has to go to eBay and PayPal. As consumers became comfortable with online auctions and paying for the goods online, they became less reluctant to pay their own bills electronically.

At the same time, banks everywhere were touting the benefits of their online bill payment services. First with their mortgage and insurance payments, consumers started to make the move. For most, once they tried it, they found they liked it. This consumer acceptance led executives who had tried it at home to be more amenable to electronic payment methodology at work. Thus, these consumer movements have set the stage for the advances we are today experiencing in the payment arena.

PAYMENT WORLD TODAY

Today, organizations have a wide variety of payment methodologies available to them. Checks, while still accounting for the largest number of payments, are no longer King of the Hill. Over 87% of all companies now make some sort of automated clearinghouse (ACH) payments. This is just one of the nuggets of information *Accounts Payable Now & Tomorrow* mined from the study it conducted called, "The Future of Accounts Payable." One of the issues it looked at was how companies are making payments today as well as where they saw their payment structures going five years down the road.

Initiating Check Payments

Accounts payable initiates the lion's share of check payments. The data show that in only a few organizations are checks done outside accounts payable. We suspect that these isolated instances are checkbooks given to remote locations for emergency use. While there may be a business requirement necessitating check issuance outside of accounts payable, such a practice is not recommended as it tends to open the door to fraud and/or duplicate payments. Organizations that feel they must have the ability to issue a check outside accounts payable should insist on tight internal controls.

Outsourcing is still not a huge factor in accounts payable. In just 2% of the cases, check payments are outsourced. To see how your check payment practices stack up, review the payment data from the study shown in Exhibit 1.1.

ACH: Electronic Payments for Everyone

In the past, the only way to make an electronic payment was via wire transfers, which tend to be costly. Now, thanks to the ACH, the cost factor has disappeared. In fact, most studies show that paying with an ACH is significantly cheaper than paying with a paper check. There has been a lot of talk and haranguing about ACH. The data from the survey discussed earlier was an eye opener. Just under 90% of the respondents report making ACH payments. This is heartening because once an organization pays one or two vendors via the ACH (also called direct payment), it is likely to increase that activity.

While over half the ACH payments are initiated in accounts payable, a good portion are not. This can lead to duplicate payment trouble if appropriate controls are not put in place. Vendors should be designated as being paid either with a check, ACH, or purchase card (p-card). Only one payment vehicle should be used for each vendor. This is a relatively new concern but one all organizations need to address.

Making Check Payments

Accounts payable department:	92.39%
Partially in AP, partially elsewhere:	2.17%
Other department:	3.26%
Outsourced:	2.17%
Don't know, N/A at our company:	0 0.00%

Making ACH Payments

Accounts payable department:	51.61%
Partially in AP, partially elsewhere:	23.66%
Other department:	11.83%
Outsourced:	0 0.00%
Don't know, N/A at our company:	12.90%

Wire Transfers

Accounts payable department:	29.67%
Partially in AP, partially elsewhere:	30.77%
Other department:	34.07%
Outsourced:	0.00%
Don't know, N/A at our company:	5.49%

EXHIBIT 1.1 WHO MAKES PAYMENTS FOR CORPORATE AMERICA

Source: *Accounts Payable Now & Tomorrow*, "Future of AP Survey 2007."

U.S. consumers use the ACH network primarily to pay bills automatically and electronically, and to receive income and benefit payments via direct deposit. National Automated Clearing House Association (NACHA) estimates that 6.5 to 7.0 billion consumer bills were collected via the ACH network in 2005, including preauthorized debits, Internet and telephone payments, and checks converted into ACH payments.

In the past, whenever the topic of financial EDI was raised, many executives' eyes would start to glaze over. It wasn't an interesting subject, and in many ways it was alien to everything they understood. Its proponents didn't help themselves by talking about things like ANSI X12 standards and 810 and 820 transaction sets. ACH methodology isn't hampered by such an albatross. Because

of their consumer experiences, as discussed, most managers are comfortable with the idea of electronic payments.

Wire Transfer Payments

While accounts payable initiates most check payments, responsibility for other types of payments are shared or handled in other areas, primarily treasury. This is especially true when it comes to wire transfers. As you can see from Exhibit 1.1, accounts payable is not necessarily in control when it comes to wire transfer payments. This can lead to trouble if records are not updated accurately and quickly.

What does this mean? Consider this not-uncommon scenario. For whatever reason, payment to a key supplier was not made. The supplier is refusing to take any additional orders until it receives payment. The supplier may be unreasonable, or it may know it has your company between a rock and a hard place so it insists on a wire transfer. Because your company needs the supplier, it acquiesces. Wires of this sort are often handled in the treasury department. Once the payment is made, everyone breathes a sigh of relief because your organization will get whatever it needed so desperately from this supplier.

What often gets forgotten in this process, however, is updating the accounting records (i.e., make sure the purchase order [PO] is closed and the receiving records adjusted accordingly). If this is not done, when that missing invoice eventually surfaces—and they always do—it will be processed through normal channels. Now the only thing preventing a duplicate payment is someone's memory, and that is not a good control. In fact, depending on someone's memory is almost a guarantee of a duplicate payment.

Therefore, special controls should be put in place when payments are made by wire. Part of that process should be a requirement to update records when a rush wire is made. Since these are often

made outside of accounts payable, we sometimes forget that rush wires can be just as disruptive as rush checks. Making the matter even worse, rush wires tend to be for higher-dollar amounts. And almost all organizations make some wire transfers. The data in the *Accounts Payable Now & Tomorrow* survey shows that only 5.49% of responding organizations don't do wire transfers.

P-Cards

P-cards, also referred to as purchasing cards, corporate procurement cards, and purchase cards, have become the payment vehicle of choice for many when it comes to small-dollar items. The definition of what's small varies from organization to organization. For some it's under \$100, and others it's under \$5,000. A few organizations put no dollar limit on the purchases that can be put on their p-card.

Initially, some organizations were concerned that their employees would take the cards and make all sorts of unauthorized purchases on them. Has that happened? Yes, but only in limited circumstances. Most card programs require that employees sign a document stating that they understand that they can be fired immediately if the card is used inappropriately. And in a few instances, companies had to let employees go because the cards were used in ways that did not benefit the company. However, these instances have been few and far between.

Very gradually, companies that feared these programs are starting to accept them, and managers who were reluctant to give their employees the cards are getting over those fears.

Routinely, even after they've been in corporate use for well over a decade, some vendors will send an invoice even though the item was paid for with a corporate p-card. This has created new challenges for those trying to avoid duplicate payments. And it probably foreshadows a similar problem with payments made through the ACH. This doesn't mean that the payment methodology should not

be used; it simply shows the necessity for developing monitoring and control routines to ensure the duplicate payment does not occur because of the different payment methodologies.

Concluding Thoughts on Payment Methodology

The payment world is changing. There is widespread acceptance of the ACH as a payment vehicle. The survey also revealed that while checks are almost always initiated in accounts payable, other payment vehicles are not. This means that the corporate world will need to change the processes and controls that surround payments to ensure that the appropriate records are updated in a very timely manner. Otherwise it will quickly find itself plagued with fraud and duplicate payments. This is an opportunity for accounts payable to take the lead and force the discussion on these issues and insist that strong internal controls be instituted to protect the organization—which will show that accounts payable is about more than just paying bills!

PAYMENT WORLD TOMORROW

It doesn't take a genius to predict that for most organizations, the way they pay their bills will change in the next five years. We fully expect the number of paper checks to decrease and the number of electronic payments to increase. Paper checks will take a further hit at those organizations using p-cards. Two recent studies back these assertions.

As part of the *Accounts Payable Now & Tomorrow* survey, respondents indicated that although only 34% were making payments using ACH five years ago, five years from now, 91% expect to be doing so. Clearly not only will the use of ACH expand to a greater number of organizations, but those using it will find ways to expand existing usage.

The 2005 Palmer and Gupta Purchasing Card Benchmark Survey revealed that the p-card approach is moving to smaller organizations

as the concept becomes more widely accepted. Additionally, most organizations using p-cards are increasing their spend on their cards. The study forecast per annum growth over the next few years in the average of 10 to 15%. Thus, we can expect p-cards to remain a viable part of the payment structure for many years to come.

While we do not expect to see the complete demise of the paper check anytime soon, we do expect to see their use continue to diminish in the corporate world. Their place will be taken by electronic payments and use of p-cards. Additionally, and this will be discussed in more detail in Chapter 8 on e-payments, very gradually organizations will allow certain select parties to debit their accounts for monies owed. While this is commonly done in other countries, the United States will continue to be a laggard in this payment methodology. Some companies now use this approach to pay sales tax and in situations where they are captive to a certain vendor. An example of this might be a service station that pays for deliveries of gas and other supplies.

The changing payment paradigm may result in closer integration between the accounts payable function and the treasury function, if treasury is taking the lead with electronic payments. How the staffing function plays out remains to be seen, although initial indications are that it will not be as it was in the past.

AN EMERGING ISSUE: PAYMENT CONTROL

As part of the above mentioned survey, readers were asked who made the various types of payments within their organization. The results are shown in Exhibit 1.1. While typically checks are drawn in accounts payable, when it comes to initiating other types of payments, the responsibility is not located in one department. Accounts payable retains control of the payment process only slightly more than half the time when ACH payments are used and even less when wire transfers are the mode of payment.

The increased number of hands in the payment pie means that a duplicate payment is more likely to occur. As we saw with the introduction of p-cards into the corporate payment arena, vendors are not always able to adjust their processes to accommodate the needs of their customers using the new technology. Hence it is imperative that the organizations using differing payment approaches take care to ensure that controls are in place that will not permit duplicate payments. This issue will be discussed in greater detail in Chapter 14 on integrating your program.

<http://www.pbookshop.com>