

## Accounts Payable in the 21st Century

Many large organizations have made massive inroads into accounts payable and quite frankly will find this chapter rather basic. To those I say simply move to Chapter 2. However, many finance teams are wedded to Charles Dickens's processes and procedures.

This chapter is an extract from a white paper<sup>1</sup> I deliver around the world that has revolutionized many accounts payable teams.

### Removal of Charles Dickens's Processes

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I believe the accounts payable team is the center of an accounting function, for without its smooth operation:

- Monthly accounts cannot be prepared promptly.
- The company does not, at any point in time, know its total liabilities.
- Budget holders spend too much of their valuable time processing orders and approving invoices for payment.
- There is a low level of accuracy in the monthly accounts due to missed liabilities and posting errors.
- The processing procedures are more akin to the Charles Dickens era than to those of the 21st century. (after all, Charles Dickens had a checkbook and received paper-based invoices.)
- Suppliers are forever on the phone querying payments.
- Expense claims are a nightmare for claimants and the accounts payable team.

Let us look at some areas to attack.

## Move to a Paperless Accounts Payable Function

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As already mentioned, many accounts payable (AP) processing procedures are more akin to those from the Charles Dickens era than to those of the 21st century. Why do we go from an electronic transaction in the supplier's accounting system to a paper-based invoice? Surely we should be able to change this easily with our major suppliers.

Many U.S. multinationals have achieved this already. Doing so requires an investment, skilled AP staff, and retraining of the budget holders. The rewards are immense. To appreciate the benefits, I suggest the AP team regularly visit the website of the Accounts Payable Network ([www.TAPN.com](http://www.TAPN.com)).

The various ways to make this move into the 21st-century AP paperless procedures include:

- Invest in an electronic ordering system (procurement system) so control is at the order stage, receipting is electronic, and supplier invoices can be automatically matched to orders and paid (see the next section).
- Introduce the purchase card to all staff with delegated authority so all small-value items can be purchased through it, thereby saving thousands of hours of processing time by both budget holders and the accounts payable teams (see “Introduce a Purchase Card.”).
- Require all major suppliers to provide electronic feeds of the invoices, which will include the general ledger account codes. This requires liaison between your information technology (IT) team and the supplier's IT team.
- Process electronic expense claims through a web-based system so employees, wherever they are, can process their claims. (Purchase cards have an accompanying online system supplied by the relevant bank provider that can also accommodate cash expense items).
- Eliminate all check payments, framing the last check on the CEO's office wall; see “Mount the Last Signed Check on the CEO's Wall” later in the chapter.
- Introduce scanning technology for all paper-based invoices from your minor suppliers (all major suppliers will become electronic feeds over time). The electronic image can then be sent to the budget holder for approval if there is no purchase invoice.
- Post remittances electronically onto your website in a secure area so that suppliers with passwords can download them. This removes the need to send remittances by email or post.

## Invest in an Electronic Ordering System (Procurement System)

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Most accounting systems come with an integrated purchase order system. Some systems even enable the order to be priced using the supplier's online

price list and then emailed automatically to the preferred supplier, providing the order is within the budget holder's delegated authority.

These systems should be purchased and implemented before the accounting team ever considers upgrading the general ledger (G/L). Increasingly today the G/L is only the holder of actuals, with the targets, reporting, and drill down being provided in auxiliary systems.

This is a major exercise and one that should be researched immediately. There should be an organization near your locality that uses the same accounting system and where the purchase order system is working well. Visit that organization and learn how to implement the system.

## Introduce a Purchase Card

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A purchase card is a free AP system, run by your card provider, financed by your suppliers. It is a no-brainer. Get a purchase card system implemented as soon as possible.

It has been estimated that the average cost of the whole purchase cycle is between \$65 and \$85 per transaction. Pretty horrific when you realize that a high portion of your transactions are for minor amounts. Exhibit 1.1 shows a typical profile of AP invoices. The bulk of invoices may be for low-value amounts, especially if consolidation invoices have not yet been organized. Remember that it costs the same to process a \$10 transaction as it does a \$100,000 transaction. In addition, is it appropriate to request budget holders to raise an order in your purchase order system for a \$20 transaction? Surely the AP system is designed around 100 percent compliance of major invoices (say over \$2,000).

Purchase cards are different from credit cards and are here to stay. There are three liability options: limited to genuine business, company has sole liability, and individual has sole liability. They work particularly well with high-value, low-volume items where you are purchasing through the same suppliers, as they will be able to insert G/L code information on the transaction (e.g., an organization has told its national stationery supplier the G/L code for stationery and has given it the department codes associated with each purchase card).

The purchase card is certainly a way for you to take control of processing these minor-value/high-volume transactions, that cannot be organized through an electronic consolidated invoice.

For more information, search the web for "purchase card" + "name of your bank."

*My financial controller lobbied hard for a purchase card for all staff with all expenditure under \$2,000 being processed via the card. The staff entered coding for purchases that were not already recoded by the*

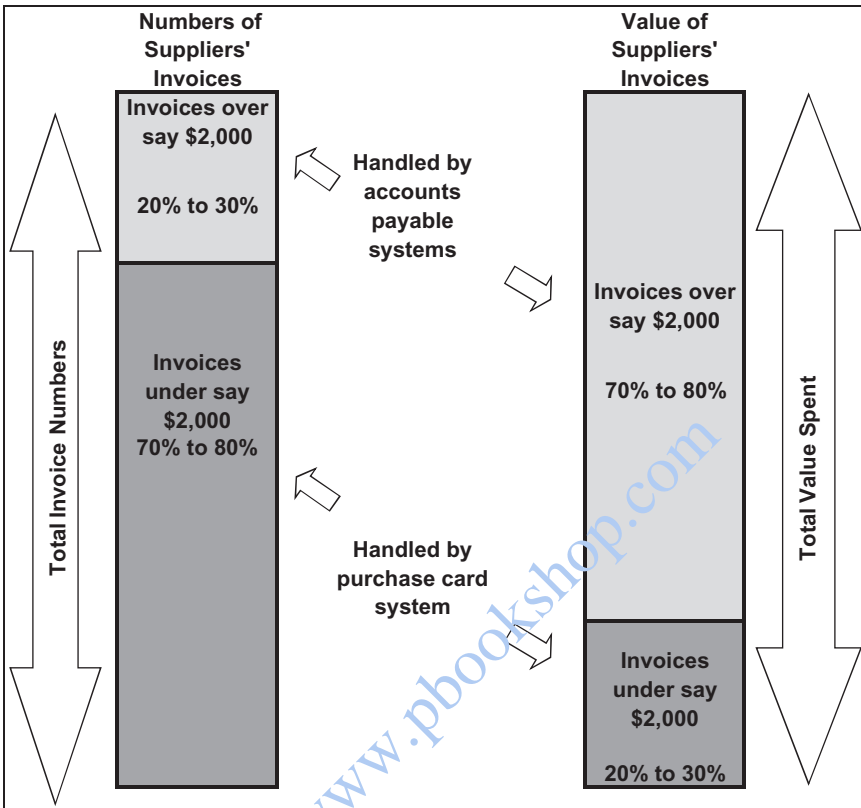


EXHIBIT 1.1 AP Invoices that a Purchase Card Is Targeting

*supplier, and the approval process was online. Thousands of transactions were replaced by one electronic feed and one direct debit.*

*CFO with blue chip international experience*

The purchase card statements are sent electronically with additional vendor spend analysis and can be loaded directly into the G/L.

These systems have been working well in many companies. All you need to do is contact your bank, which will have many better practice examples.

## Cut Off Accounts Payable on the Last Working Day

If AP is held open, you will find it difficult to complete prompt month-end reporting. What benefit does holding open AP for one or two days have?

## EXHIBIT 1.2 Month-End Time Key

Day -2	Day -1	Day +1	Day +2
2nd to last working day	Last working day	First working day	2nd working day of new month

Better practice is to cut off AP at noon on the last working day. In my workshops I come across organizations that cut off AP even earlier, on day -2 and day -3 (see Exhibit 1.2). They manage this by relying more on recurring reversing accruals supplemented by budget holders' accruals for the larger one-off amounts. They place timeliness above preciseness. This requires good communication to budget holders and suppliers with the latter sending their invoices earlier by changing the timing of billing.

*Your month-end result doesn't become more accurate the longer you leave it. It just becomes more expensive to produce.*

*CFO with blue chip international experience*

### Close Accruals a Day before the Accounts Payable Ledger

One smart accountant I have come across worked out that budget holders know little more about month-end purchase invoices at day +2 than at day -2. So, the accountant introduced accrual cutoff on day -2, the day before month-end. Budget holders were required to send their last invoices for processing to meet the month-end AP cutoff by noon on day -2, which gave AP 24 hours to process them before the day -1 AP cutoff. He also told them to prepare their accruals in the afternoon of day -2, directly into the G/L. Cutting off accruals early recognizes that month-end invoices will not arrive miraculously by day +1 or day +2, so staff will need to phone some key suppliers to get accrual information regardless of when the cutoff is. Another point to note is that the accrual cutoff does not need to be after the AP cutoff!. All that is required is a guarantee that all invoices approved for payment by budget holders within the deadline will in fact be processed prior to the AP cutoff or accrued directly by the AP team.

### Limit the Accruals

It is important to set materiality levels for the accruals based on what is material for the whole organization. You may say to all budget holders that

a department can raise accruals only if the total comes to over \$5,000, \$10,000, and so forth, and each individual debit is greater than \$1,000 or \$2,000.

For many smaller departments, their accruals will never reach these levels. They can be told, “You are too small to do accruals.”

## Mount the Last Signed Check on the CEO’s Wall

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For some time, many companies have tried to change their suppliers’ preferences for checks. The benefits from using electronic funds transfers as a payment method include lower costs, predictable cash flows, and fewer supplier phone calls over late payment. The question is, how do you get the reluctant suppliers to give you their bank details?

Some progressive companies have given up mailing request letters to suppliers and have hired temporary staff to call suppliers. One company with 99 percent of accounts paying by direct debit (and they are still not happy) calls suppliers and says, “We would like to pay you but we cannot . . . pause . . . we are a modern company and pay all our accounts electronically. We have thrown away the checkbook and are at a loss as to how we can pay you as you have ignored our requests for your bank account details!” One company cancelled its check payment run and was able to obtain 120 suppliers’ bank details within four hours of phoning them to say “We cannot pay you!”

I recommend that the last check be written payable to “A.N. Other” for 99 cents. This check is then ceremoniously mounted in a golden frame with a plaque saying “This is the last check and is a symbol of our drive to end all Charles Dickens processes.” The framed check is then mounted in the CEO’s office. The CEO will get much pleasure in answering visitors when they ask, “What is a check doing in a frame?”

## Perform Frequent Direct Credit Payment Runs

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It is a better practice to perform frequent direct credit payment runs, in fact treating this as a normal day-to-day activity. In organizations doing frequent runs, an invoice is received directly by AP from the supplier, and the details are matched to the order and the electronic receiving flag that says “goods/services have been received in full.” Once order, invoice, and receiving match one another, a payment is processed on the agreed future payment date.

## **Improve Budget Holders' Cooperation**

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There are many ways to improve budget holders' cooperation, including:

- Increasing budget holder turnaround on purchase invoice approval by linking performance to their bonus element.
- Establishing account management within the finance team (e.g., Sarah looks after budget holders A, B, and C; Ted looks after budget holders D, E, and F).
- Sending a “welcome letter” to new budget holders to train them from the beginning and eliminate potential bad habits before they have a chance to set in.
- Holding workshops outlining how budget holders, and their relevant staff, should work with the finance systems (AP, reporting system, G/L, completion of expense claims, use of purchase card, etc.).
- Rewarding and recognizing good budget holder behavior.
- Making budget holders aware of all their errors.

## **Speed Up Budget Holders' Correction of Omissions**

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One company reports that it now has a 24-hour turnaround for all branches to approve all invoices that cannot be matched to orders and have not been electronically receipted. If a branch manager does not achieve this on one single day in the month, he or she loses one month's performance bonus. The CEO was approached and got behind this initiative. This takes clever marketing, and is well worth the effort.

This change, along with streamlining of supplier invoice timings, will have a profound impact on processing volumes, helping to smooth out the workload, as shown in Exhibit 1.3.

## **A Welcome Letter to All New Budget Holders**

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Imagine the goodwill created when a new employee receives a welcome letter from the AP department asking for a slot to deliver a 20-minute training session for the individual within the next few weeks.

Why wait till new employees are educated by the uneducated (budget holders who do not know or do not comply with the AP procedures)? Get in there first. Deliver a brief training presentation, including:

- The procedures
- The forms

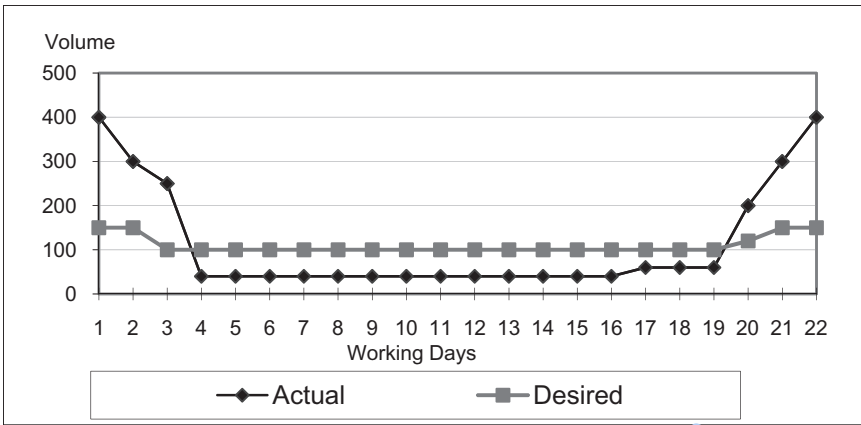


EXHIBIT 1.3 AP Invoice Processing Volumes during Month

- The problems we have and why they create a lot of wasted time
- How budget holders and the AP team can work most effectively together
- The presence of “shame and name” lists, which you point out, “but this of course will not affect you.”

This presentation is best delivered in a casual format, on a laptop supplied by the IT department, sitting on the new budget holder’s desk. See Appendix J for a draft welcome letter.

## Introduce “Shame and Name” Lists

If you want to change human behavior, you need to work on it for a duration of 12 weeks, and during this time the penny will drop. If you create a number of shame and name lists and publish these on the intranet and in hardcopy for the senior management team (SMT), you will, over 12 weeks, create change. I would recommend preparing a laminated card with all the league tables (i.e., lists of the culprits with the highest number of errors, exceptions, etc.), cut to fit the inside pocket of SMT members’ jackets. All the SMT need to do is discuss the matter with the budget holders when they bump into them, or, when they have time, make a few career-limiting phone calls to these noncompliant staff.

The suggested lists are:

- Budget holders with the most purchase invoices without a corresponding order.

- Employees with late expense claims.
- Budget holders with purchase invoices awaiting approval that are already outside the set approval turnaround time.
- Budget holders who have missed deadlines.

Remember, you will never want to invite all the budget holders to your Sunday afternoon barbeque, so do not worry about being unpopular with a noncompliant budget holder. You need to make one thing clear: Not complying with the accounting system requirements is going to be career limiting. In other words, there are three options open to these nonconforming budget holders: You leave the organization, they leave the organization, or they change. You might, as one attendee pointed out, want to call these lists “budget holders requiring further training.”

## **Reward Good Budget Holder Behavior**

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One accounting team gives a bottle of wine a month to the budget holder who provides the first complete month-end submission. This simple acknowledgment has provided the appropriate environment for timely submissions from budget holders. It is also important to record the “winner” on your intranet page so the relevant budget holder gets the recognition, which is the main reward.

## **Have a Closer Relationship with Your Main Suppliers**

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There are a number of ways a closer relationship with suppliers can improve processing. The more your key suppliers’ systems are linked to yours, the better. It is simply an issue of getting the two IT departments together around the same table.

Better practices include:

- Having all major suppliers link their systems with yours and having the supplier provide electronic invoices that are already G/L coded. Set a target of getting your top five suppliers all electronic within the next three months. You will need to get on the phone today to talk to your counterpart in the supplier organization (the CFO or management accountant). Do not leave this to the IT department to organize, as they find this type of exercise personally challenging. Where have you seen an IT department full of extroverts and great communicators?

- Introducing consignment stock where the supplier is responsible for constant replenishment (e.g., core stock items [which requires online access to relevant stock records], stationery, etc.).
- Asking for consolidated invoices from suppliers, especially utilities, and stationery.
- Changing invoicing cycles on all monthly accounts such as utilities, credit cards, and so on (e.g., invoice cycle including transactions from May 28 to June 27 and being received by June 28). The accruals for these suppliers can then be a standard one, two, or three business days, depending how the working days fall.
- Asking major suppliers to request an order from your budget holders; support this by not paying supplier invoices unless there is a purchase order. Simply return the invoices to suppliers and ask them to attach the purchase order (they will not want to repeat this activity more than once!).
- Ask large-volume, small-dollar suppliers to accept your purchase card.

## Use Self-Generated Invoices (Buyer-Created Invoices)

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Where a supplier invoice will be received too late, where some product may be missing (raw material blown out of the truck), or where your systems are so sophisticated that you have no need for a supplier's paperwork, a "buyer-created invoice" will aid efficiency.

The supplier's shipping document is used to determine the quantity of goods supplied or, in the case of a weigh-bridge process, the actual weight, measured by the weigh bridge. The agreed weight is then multiplied by the agreed purchase contract price to calculate the amount owed. The customer then direct credits the supplier, who also is sent an electronic invoice. The invoice contains all required details, such as quantity, date of service, taxes, value, total payable, and a unique invoice number using, say, the first three letters of your company, two letters of theirs, and four numbers (e.g., invoice #dsbbd1234).

## Note

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1. David Parmenter, "50+ Ways to Improve Your Accounts Payable Function," [www.davidparmenter.com](http://www.davidparmenter.com), 2010.