

Gain 21st Century Efficiencies: Make the Move to E-payments

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Some 30 years ago the pundits began stating that we were moving to a “Checkless Society.” The reasons seemed obvious: Technological advances would make it possible to move money electronically, resulting in lower costs and administrative efficiencies, such as just-in-time disbursement and automated revenue collection. E-payments also give companies the enhanced visibility that’s so important today for managing cash flow, budgets and compliance reporting.

Why then do checks still represent more than half of all payments in our banking system? Let’s take a look at some historical considerations, before moving to a discussion of the e-payment options available to businesses today.

The Metavante Payment Progress Index 2008 sums up the check writing situation this way: “Despite ambitions to make a notable shift to e-payments between 2006 and 2008, corporations made only an incremental shift from 39 percent to 41 percent of total

transactions, which was significantly below the goal of 55 percent set in 2006. The overall conclusion is that corporations are not overly concerned about their payment practices.”

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— Metavante Payment
Progress Index 2008

While the reasons for transitioning to e-payments seem obvious, at Silicon Valley Bank we understand that there are numerous factors to consider and every organization needs to carefully evaluate whether moving to e-payments is right for them.

WHY PAY MORE?

If your company is primarily making disbursements by check, you almost certainly are paying more than an e-payment alternative. There are a number of industry studies that try to capture the costs of issuing payments by check, but a rational number is close to \$1.25 per check. This includes the cost of the stock, printing, mailing and reconciling. Beyond the monetary savings, however, reduced administration, greater transparency and compliance and data aggregation make the benefits of automating payments and the entire procure-to-pay process significant for all organizations involved.

On the collection side, it means you are utilizing at least one lockbox location, if not several, to capture and process these check payments. While improvements in mail times, processing times and clearing have improved the availability of these funds for your organization, the uncertainty of these flows remains a challenge. Additionally, the processing of the remittance information can be costly and time-consuming even with the advantages of lockbox features such as imaging and data capture.

TOP SEVEN REASONS TO CONVERT TO E-PAYMENTS

1. Reduce costs
2. Makes payroll effortless
3. Simplify employee expense reimbursements
4. Automate tax payments at federal, state, and local levels
5. Just-in-time remittances to vendors
6. Create new efficiencies across all payment types using a “payment hub”
7. Aggregate data to enhance administrative control and compliance

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Look for our future article where we address ways in which you can achieve maximum benefits from lockbox services.

AVOID E-PAYMENT INERTIA...

The overriding reason companies continue to use checks is the remittance information. This is certainly a valid issue, but there are ways to address the problem which we'll discuss in more detail in a moment. Another reason often cited is the float value for the checks. This is becoming far less a factor as check clearing is moving rapidly to take advantage of “Check 21” with the vast majority of checks being cleared electronically by image or conversion to ACH. The Federal Reserve predicts that within two years they will have gone from 48 check processing sites around the country to two and virtually all items will be “local.”

A more difficult challenge is a lack of resources to tackle an e-payment project. Most treasury departments and accounts payable are understaffed and projects often do not get priority for additional resources. While a case can certainly be made to justify the move to electronic payments, it is not always a simple ROI model that is needed. The need is far more strategic and the rewards, when combined with additional automation of accounts payable, may be far more compelling.

The case for moving to e-payments should be strategic, and the rewards, when combined with additional automation of accounts payable, may be far more compelling.

...TAKE THE FIRST STEP

Take an inventory of the checks you are writing today. These checks should be placed in key categories:

- Payroll
- Employee expense reimbursements
- Taxes
- Vendor payments **under** \$10,000.00
- Vendor payments **over** \$10,000.00

Each of these categories of payments can be completed electronically using somewhat different approaches.

PAYROLL

For most firms, payroll is the most obvious and simple opportunity for moving to e-payments. Making ACH Direct Deposit of Payroll mandatory for most employees is the simplest way to eliminate the majority of payroll checks. It's also important to keep in mind that payroll processing companies have the tools and materials to make the sign-up process relatively painless.

Payroll processing companies have the tools and materials to make ACH Direct Deposit sign-up a relatively painless process.

Companies that have a large number of temporary workers, significant turnover or employees that are unbanked should consider the use of payroll cards. These cards can be distributed, managed and controlled by payroll administration.

EMPLOYEE EXPENSE REIMBURSEMENTS

There are a couple of options for employee expense reimbursements:

- One of the simplest to set up is ACH
- The other is Business Credit Cards (BCC)

If you already have employees signing up for ACH Direct Deposit of Payroll, you can add a check box to the form to include reimbursements for expenses. To make these payments, specific information for each employee can be entered into your online banking ACH module, using the payroll application. When the employee's expenses have been approved, payment can be executed directly by selecting their information — adding the approved amount and the date to be paid — and submitting the batch.

ONLINE BANKING ACH MODULE

Employee Name: <input type="text" value="Doe, John"/>	
Employee ID: <input type="text" value="999999999"/>	
Net Pay Amount: <input type="text" value="\$555.00"/>	Employee's Bank Account No.: <input type="text" value="674574"/>
Employee's Bank ID: <input type="text" value="052000113"/>	Checking/Savings: <input checked="" type="radio"/> Checking <input type="radio"/> Savings
Start Date: <input type="text" value="07/05/2004"/>	Create Prenote: <input type="checkbox"/>
Last Pay Date: <input type="text"/>	Prenote Date: <input type="text"/>
Hold Transfer <input type="checkbox"/>	

The use of ACH is a benefit that can be promoted to employees, particularly those that often travel for the company. It means they get paid promptly and have the funds available without having to wait for the mail and then making a trip to the bank.

The other option for employee expenses can be managed through BCC. There are a number of different billing options available to make the use of the BCC consistent with your company's payments policies. These include the ability to invoice the employee or the company responsible for paying the bill on revolving or pay in full options:

- Corporate bill revolving
- Corporate bill charge
- Cardholder bill revolving
- Cardholder bill charge

With BCC you can set controls for each individual cardholder or across all cardholders, limiting spend and defining the appropriate Merchant Category Codes (MCC) to which they have access. Online reporting is available to monitor and manage the usage.

ACH PAYMENTS FOR TAXES

Most revenue collecting agencies at the federal, state and local level now accept and encourage ACH payments for taxes. You can use your online banking ACH module to select the specific tax entity to be paid and fill in the information requested. This will enable you to easily ensure that the proper information is supplied in the format requested by that agency or entity.

VENDOR PAYMENTS UNDER \$10,000.00

These payments could be made with your BCC. One option would be to indicate on your purchase order (PO) your desire to pay by credit card either upon receipt of goods or services or invoice. Alternatively, you may choose to provide your BCC number to the vendor at the time of the PO generation. The BCC number provided may even be for a ghost card, which is a card number assigned specifically for use in these kinds of payments where no plastic is actually issued.

Another alternative is to provide a specific account number to each of your primary vendors. The limit can be set to zero by the card administrator until such time as the PO has been approved for payment. The vendor then submits their charge and the limit is reset for the specific amount then reset to zero.

ACH is another option for these vendor payments. To make ACH a practical solution for vendor payments, your purchasing team needs to work with selected vendors to obtain agreement to pay by ACH, collect the appropriate banking information and determine the minimum remittance information required to be sent with the payment. The remittance information can be in the form of the EPN 820. The EPN 820 is a new format that takes the primary elements from Financial EDI and simplifies the process for organizations that are not EDI capable. The new standard is both simple and universal, applying to all types of industries.

VENDOR PAYMENTS OVER \$10,000.00

For larger payments, your vendors may not be willing to accept payment by credit card due to the expense of the merchant service fees. However, there are a number of options available to make the acceptance of large value payments by credit card more appealing. One opportunity may be to offer to pay earlier, providing improved cash flow to your vendor while not having to actually fund the transaction until the credit card is due.

While ACH is defined as a low-value payment system, many companies use the system to pay vendors larger amounts. If you choose to do so and have agreement from your vendors, you may need to ensure your bank is aware of the potential increase in spend through this channel.

Wire transfer is another option, but little or no remittance information can be transmitted. Fortunately, however, the Association of Financial Professionals (AFP), an

industry group representing treasury professionals, has lobbied for and obtained agreement from the operators of Fedwire and CHIPS to implement major changes to the wire transfer format.

Companies and banks have a role to play in making this new enhancement a reality. Both must make software changes to receive and send remittance information. When remittance information is included with wire transfers in a standard format, companies will be able to apply wires to the correct accounts without time-consuming research and to process payments straight through to accounts receivable systems. To start, here are first steps that companies can take:

- Meet with your wire transfer banks to let them know of your interest in receiving remittance information and explain your willingness to send the required information with your outgoing wires.
- Speak with your organization's IT staff about the software you use to send and receive wire transfer information. How is information provided to the bank now? What software must be changed to receive and send remittance information? What accounting or Enterprise Resource Planning (ERP) systems are involved?

The new message format will contain 9,000 characters that can report remittance detail for 25-30 invoices with a single payment, and data can be translated into a variety of formats, including EDI STP 820, XML ISO 20022 and certain proprietary or human readable formats. Keep in mind, however, because wire transfer payments are same-day and final, with tight security, the implementation and testing process will be extensive. The enhanced message format is scheduled to be live by fourth quarter 2010.

PAYMENT HUBS: THE FUTURE OF E-PAYMENTS

There are a number of initiatives underway that will ultimately help companies move more readily to e-payments. All of these can be characterized as a "payment hub," which offers the promise of a true consolidated payments process. The idea is to allow companies to generate a file from the payables system in a single format with payments destined to flow through a number of payment systems for settlement. Today, that could include payments to be cleared as wire transfers, ACH or printed out as checks. In the future, the payment hub may include credit card and any number of international systems, both high value and low value, in multiple currencies.

With a fully operational payment hub, the bank would not only reformat each payment instruction to the appropriate standard, but also decide which clearing and settlement system is the most advantageous based on criteria such as the date the payment is due, the amount and the payee/beneficiary. The challenges to this ideal include:

- The need for the banking information for the payee/beneficiary.
 - To offset this challenge the company should work closely with their vendors to obtain the banking information necessary to pay them electronically and keep this information up to date in the vendor master file.
- The need to develop and test a file from the payables system with the bank to ensure it can be mapped appropriately and contains the required information in the appropriate fields.
- The method of delivery must be ascertained, implemented and tested. This may be secure FTP, HTTPS or other secure transport protocol.

NEXT STEPS

While the case for converting to e-payments is one that makes sense to most CFOs and CEOs, there is considerable inertia to overcome in order to get a commitment to implement. It may require a coordinated campaign on the part of your treasury department to bring your payments process into the 21st century. In our experience, there are three key elements to a successful campaign.

- 1. Cost/benefit analysis.** The cost of traditional paper payments is significant, approximately \$1.25 per check. Management may counter that the float offsets this cost, but new regulations will likely put an end to this source of income. Be thorough and objective in your analysis. And remember, ROI isn't the whole story; it's all the strategic benefits, which you'll need to describe in a separate strategic benefits report.
- 2. Strategic benefits report.** Up-front monetary savings are just the beginning for companies transitioning to e-payments. Once implemented, companies reliably experience reduced administration, greater transparency of cash flows, an improved ability to document compliance and the many proven business benefits that come with data aggregation. Be sure to

discuss all of these topics as they apply specifically to your organization.

- 3. Best practices and vendor selection.** Obviously, there are issues of security, reliability and efficiency in implementing an e-payment system. As a result, we've provided a link to an overview of [Best Practices for Payments from the AFP Payments Advisory Group](#) at the end of this document. You can use them as a guideline in preparing your criteria for selecting an e-payments vendor to help you with the transition.

By taking these steps, you will have performed the necessary due diligence to build a compelling case for e-payments and to help pave the way for a successful transition.

If you require guidance in preparing your case, or creating a plan for implementing e-payments in your organization, our treasury management professionals have extensive experience. For more information about our e-payment solutions or any of our treasury management services, please call us at 408.654.7400 or visit www.svb.com.

GREATER TRANSPARENCY WITH A PAYMENT HUB

Aside from the ability to use a payment hub to enable a consolidated payments file, there is also the potential to provide greater transparency to the flow of funds. Reports can be generated that show all of the payments for a company over a period of time, by type or amount or destination. These reports can aid in cash flow forecasting and in determining which payments, still being made by check should be converted to e-payments.

The payment hub can also improve transparency by providing better alerts on the status of a given payment or batch of payments as they flow through the system. This includes alerts that a particular payment may be delayed or rejected due to incorrect or insufficient information. The sooner the company is aware of the issues the sooner the payment instruction can be corrected and the payment continues to its destination.

BEST PRACTICES FOR PAYMENTS

From the AFP Payments Advisory Group

PAYMENTS POLICIES AND PROCEDURES

- Educate payment processing areas about NACHA rules and ACH requirements, including timing of ACH file submissions, return and notification timing, contractual arrangements, liability and banking services offered.
- Ensure that appropriate controls are in place to guard against fraud risk, operating risk, settlement risk and regulatory risk.
- Maintain a paper or electronic copy of the procedures manual, key bank and financial service providers, and internal contacts at an offsite location for contingency and recovery purposes.

SECURITY

- Establish minimum acceptable security procedures and required approvals by type of payment, amount and method of payment instruction.
- Establish a security policy that covers:
 - Physical security, e.g., controlled access to the payment processing area, check storage
 - Technical security, e.g., encryption, authentication, passwords, tokens
 - Procedural security, e.g., separation of duties, dual approvals
- Centralize the administration of treasury system security within treasury. The security administrator controls access to payment systems through the issuance of User IDs, passwords, secure ID

tokens, and other tools provided by your financial institution.

- If staffing levels permit, security administration should be located in an area of treasury that does not execute payments, to ensure separation of duties.
- Designate at least three security administrators, and utilize dual control administration. This will mitigate two key risks:
 - Issuance of unauthorized IDs and passwords by a single person
 - Inability to issue IDs and passwords because a single individual is unavailable.
- Audit the security administration function on a routine basis.
- Assign every user a unique log-in and password. User ID sharing within departments should not be allowed, even for view-only access

RECONCILIATION

- Understand the types of reconciliation and their purpose.
 - Matching of paid items compares data from the bank's information reporting system and data from the company's books. Its purpose is to ensure that all transactions posted to the company's bank accounts are valid and correct.

BEST PRACTICES FOR PAYMENTS

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- Account reconciliation should be a three-way process comparing:
 - Data on the company's bank account statement
 - Data posted in the general ledger
 - The source document
- Require daily matching of paid items.
- Perform account reconciliation daily as a best practice. It can be done weekly. It must be done at least monthly.
- Reconcile electronic payment accounts on a daily basis.
- The frequency of reconciliation will depend on the business purpose of the account and the volume of activity.
- Reconcile all accounts, including corporate card accounts: travel and entertainment, purchasing, fleet, etc.
- Exercise "reasonable promptness" in examining your bank statement and promptly notify the bank of fraud or errors. Failure to do so may result in liability being transferred to the company.
- Be informed and educate your staff about the length of time your bank service agreement permits you to report fraudulent checks after you have received your bank statement. The bank agreement will usually specify a shorter time period (some as short as 30 days) for reporting fraud than the one-year maximum allowed by the Uniform Commercial Code.

ELECTRONIC PAYMENTS: ACH

- Encourage your trading partners to accept electronic payments and to pay your organization electronically, preferably by ACH credit.
- When setting up electronic payment arrangements with your trading partners:
 - Ensure that the account number that you provide to your trading partners is accurate.
 - Require payors to include invoice or account numbers with their payments in a format that you can accept, along with additional remittance information, if necessary.
 - Ensure that your ACH payment authorization form follows NACHA guidelines, that the authorization allows you to reverse any erroneous entries, and that it spells out how disputes will be settled.
 - Establish each outgoing ACH credit as a repetitive transaction, when possible, set up under dual control.
 - Require source documentation from trading partners to set up bank instructions for repetitive ACH payments.
 - If you use a third-party vendor to originate ACH debits via your Web site, do not assume that the vendor's wording on the debit authorization form to be signed by the payor is acceptable.
- Use the correct NACHA Standard Entry Class code for each type of transaction (CTX, CCD, PPD, etc.).

BEST PRACTICES FOR PAYMENTS

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- Employ ACH blocks (prohibits all ACH debits) and/or ACH debit filters (authorizes specific ACH debits) to limit your exposure to fraudulent ACH debit attempts. Businesses have only 24 hours (one business day) to report an unauthorized ACH debit to their financial institution.
- Use your bank's same-day ACH reports to monitor and reconcile all ACH activity.
- Consider pre-noting your ACH transactions to ensure the accuracy of the bank account information. Many banks ignore zero dollar transactions; for pre-notes, you may use a one cent transaction, which must be posted by the bank.
- Establish deadlines for wire transfer requests to be presented to treasury, to facilitate entry of information and funding of the payment.
- Use only secured e-mail systems to communicate wire transfer instructions to treasury for execution.
- For each wire request, a form should be completed and signed by an authorized individual with appropriate authority, and submitted to treasury with all back-up documentation such as purchase orders, vouchers, invoices, etc. for approval by a second individual.

ELECTRONIC PAYMENTS: WIRE TRANSFERS

- Use repetitive/ template wire transfers whenever possible.
 - Confirm the accuracy of repetitive code information to minimize misdirected funds, repair fees and surcharges.
 - Require dual control to set up or change repetitive wires.
 - Restrict the ability to change reference fields. Changes to reference fields may alter the ultimate beneficiary, enabling internal wire fraud.
 - Require dual control to input and release all non-repetitive wires.
 - Review the bank's wire transfer report at the end of the day to account for all transactions and to ensure that your wires were executed successfully.
- ### INTERNATIONAL CONSIDERATIONS
- Use the International Bank Account Number (IBAN) and the Bank Identification Code (BIC) for European payments; this is a requirement of the Single Euro Payments Area (SEPA) for payments in euros.
 - Incoming payment amounts that differ from expected amounts are not uncommon because of "lifting fees." International banks deduct a "lifting fee" from the principal amount of a funds transfer (primarily wire transfers) for their part in processing the wire. However, within SEPA, no deductions will be permitted from principal amount to cover fees at any stage in the process.
 - Be aware that critical information in reference fields of electronic payments may be truncated. This significantly reduces the success of straight through processing for posting payments.

BEST PRACTICES FOR PAYMENTS

From the AFP Payments Advisory Group

- Because information contained in reference fields of electronic payments is often truncated by banks involved in international payments, limit the amount of information needed to match receivables data.

BUSINESS CREDIT CARDS

- Designate at least two program administrators using dual control to mitigate fraud or other misuse.
- Do not permit program administrators to arrange for payment of credit card balances on behalf of the company without an independent third-person review of the payments, at minimum.
- Establish policies and procedures for proper credit card usage and identify a review process for charges before they are submitted into ERP systems or T&E systems.
- Establish reasonable per transaction or monthly spend limits and identify specific Merchant Category Codes (MCC) for purchasing.
 - Establish spend and MCC limits by employee group, according to spend or supplier need, to mitigate the risk of misuse.
- Block all MCCs for cash and cash advances unless there are clearly defined policies for such use and the items can be tracked.
- Have employees sign an agreement for the use of the card.
 - Work with human resources to ensure that the rules in the agreement are enforced by disciplinary action or termination.
- Issue cards in employee names, not department names, so that charge-back rights can be retained.
- Establish procedures for employees to dispute unauthorized or fraudulent charges and ensure that treasury can track the dispute.
- Establish procedures for treasury to be informed of terminations and leaves of absence so that cards can be cancelled or inactivated.
- Consider setting per transaction value limits and per day value limits for individual suppliers as a fraud control measure.
- Cancel cards immediately in case of suspected fraudulent card usage.
- Establish audit procedures to ensure that expenses are incurred for appropriate business purposes.
 - Ensure the audit is conducted by a person independent of the cardholder or the employee's manager.
- Accounting should reconcile all card statements.
- Use reasonable promptness to reconcile card statements and to notify the card issuing bank of any unidentified activity on cards.
- For large purchases, utilize the discretionary funds feature of cards to ensure that the proper purchasing or other approval process has been followed before the purchase is made.

BEST PRACTICES FOR PAYMENTS

From the AFP Payments Advisory Group

- Ensure actual receipts are properly retained for all purchases of \$75 or more (and any hotel bill, regardless of amount) for IRS compliance.
- When utilizing cards for accounts payable, set up a separate card for each vendor and have the card limit set at \$0 until a payment is authorized.
 - When a payment is authorized, set the limit at the amount you wish to pay the vendor/merchant with an expiration date of five business days. This will keep the vendor from charging any items that may be in dispute or an invoice that you do not yet wish to pay.
- Partner with your IT department to help mitigate fraud by developing procedures to stop obviously fraudulent activity, such as an order by a fictional character.

About Silicon Valley Bank

Silicon Valley Bank is the premier commercial bank for emerging, growth and mature companies in the technology, life science, private equity and premium wine industries. SVB provides a comprehensive suite of financing solutions, treasury management, corporate investment and international banking services to its clients worldwide. Through its focus on specialized markets and extensive knowledge of the people and business issues driving them, Silicon Valley Bank provides a level of service and partnership that measurably impacts its clients' success. Founded in 1983 and headquartered in Santa Clara, Calif., the company serves clients around the world through 27 U.S. offices and five international operations. Silicon Valley Bank is a member of global financial services firm SVB Financial Group, with SVB Analytics, SVB Capital, SVB Global and SVB Private Client Services. More information on the company can be found at www.svb.com.

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