BEST PRACTICE

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The accounts payable function is on the frontline of any business. They are the port of call for incoming queries from suppliers when there are invoices that haven't been paid, or similarly queries about when invoices are going to be paid.

An **ineffective** accounts payable process can impact an organisation in several ways:

1. Delays in processing invoices to enable them to get paid, whilst adhering to supplier's payment terms

2. Paying invoices in line with negotiated contractual terms to take advantage of early payment discounts

3. Contributing to a poor relationship with your supplier's accounts receivable teams, which can negatively impact future negotiations around payment terms

For more than 15 years, Westgate Moore have worked alongside many accounts payable functions, locating and recovering all aspects of payment errors that have been made to suppliers, and in the process, recovering millions of pounds of lost revenue from suppliers that Accounts Payable functions didn't know had been lost due to payment errors.

In this paper, we will outline some top tips about how to make an effective accounts payable function. We will discuss erroneous payments in detail and talk and offer some best practice insights. We will also share our thoughts on keeping a clean vendor master file and how this can help alleviate a large proportion of inefficiencies. We will highlight how improving communication between the AP & AR functions is the main method to create a much more efficient department.

WHAT IS BEST PRACTICE?

The term best practice came about in the 1970s, particularly in the manufacturing sector, who were captivated by benchmarking and then grew in popularity during the 1980s when companies became obsessed with finding out how they rated alongside their competitors. Law (2009) states that benchmarking is defined as “the process of identifying the best practice in relation to products and processes, both within an industry and outside it, with the object of using this as a guide and reference point for improving the practice of one’s own organisation”. Respectively, best practice is defined as “a practice that has been shown to produce superior performance”, and by adopting best practice within a particular business function can improve its performance (Scwejczewski, 2011)

If we apply this definition to the accounts payable arena, and specifically the individual roles within the AP function, there are 4 practices or spokes to the AP wheel, that if adhered to, then the AP function should produce a ‘superior performance’. These practices are:

1. **An up to date and ‘clean’ vendor master file**
2. **Company policies on processing invoices**
3. **Periodic reviews of transactional data, in the form of a recovery audit**
4. **Regular communications with suppliers**

A CLEAN AND UP TO DATE VENDOR MASTER FILE

Like the old saying goes 'shit in shit out' - this has to be followed when dealing with your supplier master file.

1. The supplier master file should be reviewed, updated, and purged of inactive suppliers annually.

2. Suppliers should be added to the supplier master file only upon completion of supplier selection process and financial validation, specifically using a supplier onboarding or management tool.

3. The ability to enter new suppliers into the supplier master file should be limited to designated personnel whose duties do not include entering receiving, purchase order, or invoice information for those suppliers. Additions to the supplier master file should also be reported to management for review and approval.

4. Every supplier with more than one supplier record and who has been inactive during the last 18 months should be considered for purging or archiving. Duplicate payment system controls are circumvented when a payment references a different supplier record. Maintaining unnecessary records can also result in slower system response time, and unnecessary and expensive disk space utilisation.

5. Supplier records without addresses created for “one-off payments” should also be considered for purging or archiving.

6. All unnecessary records should be reviewed twice a year and eliminated, to improve the accuracy of supplier payments and to reduce the possibility of duplicate payments.

7. Under some circumstances, multiple supplier records may have the same payment addresses. If possible, these records should be “linked” on the system to allow duplicate payment detection across related supplier records. Legitimate multiple supplier records present an opportunity to consolidate payments to one payment address. This may also introduce the possibility of dealing with the supplier on a companywide, rather than division level, basis.

Indeed, many well respected gurus within the AP arena agree, that a clean and up to date supplier master file is a necessity for an efficient AP function; the likes of Mary Schaeffer and Debra Richardson et al. In Mary’s book, Accounts Payable Best Practices (2004 p.77), she notes, “The master vendor file is one of the most overlooked aspects of the Accounting and Accounts Payable (AP) functions. Ignoring it can lead to trouble in the form of duplicate payments and increased risk for fraud.”

COMPANY POLICIES ON PROCESSING INVOICES WHICH ARE KNOWN COPIES OF ORIGINAL DOCUMENTS

All companies have rules to limit the number of copy invoices that are paid, but the nature of business means that some instances are unavoidable. Such instances will probably involve some urgency, so it is important to ensure that there is a firm set of procedures in place to reduce the chance of these payments resulting in duplication In any case paying from a copy invoice requires extra work and extra strain is placed on the system, so controls must be robust.

1. Limit the Circumstances where Copies are Paid.

- Pay from a copy only when an invoice is a given period overdue – e.g. 60 days.
- Set invoice materiality values according to individual suppliers.
- Never pay from a statement.

2. Identify the Cause of a Copy

- Require an explanation for the lack of original. In many cases it is problems concerning authorisation procedures rather than processing weaknesses in AP that are the root cause.
- Document why the original invoice is not being used.

3. Procedural Controls

(i) System Checks

- Run a system check daily by invoice number, date and value to identify duplicates before payment.

(ii) Manual Checks

- Have all copies marked as duplicates.
- Require a manual search to ensure that the original was not paid, especially for older invoices. System checks will be inadequate where multiple live accounts are maintained for the same suppliers; they will not satisfactorily search across accounts. Require extra research according to invoice value.
- Require proof of delivery where appropriate when sent the copy, if original receipt documentation is not available.
- Complete a 3 way match to confirm whether or not the purchase order has been filled. Check for unmatched goods receipts on the purchase order.

4. Assumptions

The following assumptions should be made prior to the payment of copies of original:

- The invoice has been paid previously and therefore has been posted to a purchase order or supplier account.
- The invoice has been received but not processed and is held in an open file.
- The invoice has been misplaced or is being held by an end user for authorisation.

PRIOR TO PAYMENT THE FOLLOWING TESTS SHOULD BE COMPLETED:

_____ Invoice not posted to hard copy or electronic copy of purchase order.
_____ Invoice not listed on remittance advice in paid file.
_____ Invoice not listed on remittance advice of items yet to be filed.
_____ Invoice not located in an open file of unprocessed invoices.
_____ Invoice not found in vouchered invoices not yet batched.
_____ Other:

Tests performed by: ______________________
Date: ______________________
Payment authorised by: ______________________
Date: ______________________

PERIODIC REVIEWS OF TRANSACTIONAL DATA, IN THE FORM OF A RECOVERY AUDIT

Under most circumstances your ERP's duplicate payment controls would prevent the processing of a secondary, non-original invoices. But sometimes a breakdown of control can occur which will bypass the duplicate payment control. Organisation's employees cannot always be 100% accurate, it is only by human nature that this cannot be the case. For example processing an invoice using an incorrect or altered invoice number or date.

Every year millions of pounds are either lost or overspent through payment errors as a result of human error by accounts payable staff. These mistakes are not a result of deliberate acts of malice, nor are they a result of ineptness of employees. In a department which is so transaction intensive and perhaps more than 1,000 invoices are processed each week, it is inevitable that mistakes occur as a result of human error. Even with the internal checks that accounts payable departments have in place when it comes to duplicate payments, more often than not, suppliers will add or delete extension codes or numbers off invoice numbers and send in duplicate invoices. Systems cannot detect this and this will lead to a supplier being paid multiple times.

Remember a recovery audit finds the payment errors you do not know you have made.

Most AP functions process invoices **99.98%** accurately

So just **0.02%** of payments are made incorrectly

PAYMENT ERRORS CAN BE:

- Paid to the wrong supplier
- Paid to the same supplier more than once
- Credit notes are paid as invoices
- Paid with wrong VAT amount

EXAMPLE OF MEDIUM SIZED ORGANISATION

Annual supplier spend of **£800,000,000**

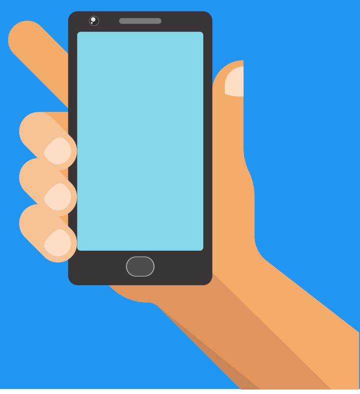
0.02% inaccuracy rate of processing invoices means: **£160,000** per year is being paid incorrectly

All of a sudden **0.02%** starts to look like quite a serious sum of lost cash

Multiplied over a number of years, results in a considerable sum of cash vis-a-vis **'profits'** which are being lost, without realising

Due to lack of internal controls or limited human resources, this financial leakage often remains lost.

You receive a call from the supplier…
“Have you got my invoice?”
“When are you going to pay my invoice?”



First and foremost, ensure your **Master Supplier Database** has the correct contact details for the people you may need to speak to. Credit Control / Sales Ledger. How you onboard a supplier and how you store their information will set the precedent for a positive relationship with your suppliers.

Equally it is vital you **outline how you wish to be contacted** by your suppliers; one of the biggest bugbears of accounts receivable is the inability to speak with the same person each time. A contact card is an excellent way of sharing AP contacts: emails and telephone numbers. Larger AP teams tend to manage suppliers in an alphabetised method – so you should be able to detail contact’s names.

It is also vital to communicate to suppliers company details for invoicing – **where invoices AND credit notes should be sent**; this is discussed further down.

The final piece to the communication jigsaw is remittance advice. This is the key document which communicates what and how much has been paid to the suppliers on a particular payment run. This is vital to **ensure that payments are matched against supplier records** – not sending remittances could result in payments not being allocated, thus increasing the likelihood of further untold volume of inbound phone calls from suppliers.

To complete the circle, **reconciling supplier statements is required** to ensure that the records your suppliers have in terms of paid/unpaid and missing items is communicated to the accounts payable team. Adhering to this best practice improves relationships and increasing transparency between 'us and them', further reducing the need for constant communication

Adopting and adhering to these open lines of communication is essential in ensuring an efficient and well managed AP function.

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