From Profit Recovery to Profit Retention:

How Best-In-Class Firms Increase Control, Strengthen Accounts Payable Through Intelligent Invoice Reconciliation

Many companies today rely on "post-transaction recovery" to audit, reconcile and recover mistaken vendor payments. However, this blunt-force, after-the-fact approach to invoice reconciliation is extraordinarily costly and wasteful.

Due to process inadequacies in their accounts payable (AP) departments, they are cutting checks that are not owed, paying phantom bills and contributing to various forms of "profit leakage."

Indeed, they are missing prompt payment discounts, encouraging maverick spending and leaving themselves vulnerable to fraud. In some cases, they are creating an embarrassing image problem with their suppliers by handling their AP processes in an unprofessional manner. Most significantly, they are absorbing the opportunity costs of recovering their escaped capital.

Best-in-class companies, however, have discovered that these operational mistakes are preventable. Leveraging Intelligent Invoice Reconciliation (IIR) solutions, they are engaging in the "pre-transaction retention" of mishandled payables—taking action before dollars erroneously fly out the door.

They are, quite simply, getting it right the first time. By analyzing their transaction data in real-time and reconciling invoices with payables, they are pre-empting AP leakage, enhancing operational processes and protecting their profits. In this position paper, you'll find out how these advanced companies are rethinking their approaches to invoice reconciliation and establishing a stronger foundation for accounts payable. You'll learn how they are contributing to their firms' bottom lines by ensuring that earned profits are retained in the first place.

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Market Drivers: Why are Companies Rethinking Payables?

In recent years, there has been a steady shift in the management of supplier interactions and transactions. As new digital technology proliferates and new services emerge, companies are beginning to gain a stronger handle on their invoice and purchasing data.

No longer must they re-key data and run down endless paper trails. Foundational technologies such as digital archiving, imaging, optical character recognition and a host of other document management tools have contributed to this movement. And new and incremental advancements emerge every day. Data that once was widely dispersed is now easier to access and manage. Such trends are changing the way many companies think about accounts payable in general and invoice reconciliation in particular.

Consider some of the trends that are now encouraging companies to rethink their management of vendors and handling of payables:

+ **Transition to e-billing and supply chain integration**—We are increasingly witnessing the move toward electronic invoice presentment and bill paying. As a result, invoice data, purchase order data and proof of delivery data is becoming available in electronic form. This makes this information easier to access, manipulate and analyze. At the same time, many companies are deepening their relationships with suppliers,

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standardizing on data sharing methodologies and approaches. Wal-Mart, Home Depot and other large retailers have played a leading role in this movement in order to streamline supply chains and facilitate just-in-time manufacturing and fulfillment. And, again, this contributes to the digitization of AP data and sets the stage for greater process automation. Having data in an electronic format makes it possible to run reconciliations earlier, faster and more effectively than companies ever have in the past.

+ **Growing investment in reconciliation systems**—Due to the growing volume of exceptions and expanding efforts to keep them under control, companies increasingly are investing in new reconciliation systems and other exception-generating applications. According to the Aite Group, companies are now spending more than $25 billion per year on reconciliation systems.[1] "Transaction volumes which were unimaginable then are now commonplace, and processing times which would have sounded impossible are now de facto standards," says Phillip Silitschanu, senior analyst with Aite Group and author of this report. "Add to these new demands being placed on older systems—notably reconciliation systems—and the remarkably inexpensive cost of hardware, and it becomes clear why spending on reconciliation systems is on the rise."

+ **Emergence of outsourcing providers**—Organizations are beginning to embrace outsourcing as a cost effective path to AP automation. Due to the challenges associated with accounts payable (such as ensuring all relevant data is available in a common form), companies increasingly are delegating to outsourcers AP activities that they consider overly taxing and non-strategic. Outsourcers generally are able to leverage both professional specialization and economies of scale to offer a lower cost of ownership for such business processes. While a significant portion of companies that outsource do so for AP audit and recovery purposes, still others outsource invoice receipt and processing as well as payment and disbursement.

+ **Recognition of AP underperformance**—Having witnessed the successful redesign of processes such as procurement and supply chain management, companies are recognizing AP as an area that also is ripe for process improvement. They intend to increase the productivity of AP by automating manual activities, reducing transaction costs and reducing departmental headcount. And in the post-Sarbanes-Oxley era, companies expect increasing visibility into their operational processes, particularly those that pertain to the finance of the enterprise.

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Given these trends, enablers and drivers, companies now face an environment in which AP data is more readily accessible and affordably analyzed. That increases the potential for enhancing invoice reconciliations and avoiding the mismanagement of payables. But expectations have changed, too. Now, such behavior is becoming ever more unacceptable—even intolerable.

While best-in-class companies now lead the way in terms of AP performance, companies that lag behind will soon have their poor performance exposed and challenged. Board members and executive leaders will be shining a light on the issue of invoice reconciliation if they haven't already. They will be asking why so much money is lost to recovery audits and activities. What problems might they expect to find in organizations that are still considered AP laggards?

[1] Aite Group, Impact Report, April 23, 2008.

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From Profit Retention to Profit Recovery

Business Challenges: Profit Leakage and the Unending Recovery

AP departments are now challenged to rethink their approaches to invoice reconciliation. Due to process inadequacies, they are paying bills they do not owe and cutting into the profitability of their companies. They are relying on "post transaction" audits and recovery processes to get their money back. But this is costly and slow. This is the first element of the problem:

+ **High expenses associated with post-audit recovery.** Companies can end up paying millions or even tens of millions of dollars to recover money that has erroneously been paid to their vendors. Conventional solutions, which often rely on consultants to audit payables and service providers to recover them, are generally designed to treat symptoms as opposed to root causes. Indeed, recovery audit specialists, who often work on a contingency fee basis, arguably have no incentive in seeing the reconciliation problem solved. The more dysfunctional the AP organization, the more money they make.

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Under this approach, the problem never gets solved. So-called "solution providers" perpetually drain profit from the host in a truly parasitic fashion. But consider the larger scope of this problem. The hidden factors of "AP leakage" wreak further havoc on the companies that struggle with invoice reconciliation issues. Among them:

+ **Missed payment discounts.** Many vendors provide an incentive—or discount—to encourage early payment on bills. However, companies will simply miss these opportunities if they are slow to handle their payables. While companies that take extra time to reconcile their payables may avoid overpayments or duplicate payments, they will nevertheless miss the discounts that are offered to them. These are costs that must be deducted from the bottom line.

+ **Unchecked maverick spending.** In the absence of rigorous management over payables, companies are also unlikely to prevent maverick—or undisciplined—procurement activities. Aberdeen Research, for instance, found that e-procurement users reduced off-contract/maverick spenders by 64%, saving 7.3% for each dollar brought back on contract.[2] This suggests companies that fail to get a grip on their payables will bear the significant added costs associated with off-contract spending activity.

+ **Vulnerability to fraud.** Notoriously damaging acts of organizational fraud are perpetually making the news. The city of Washington, D.C., for instance, recently experienced a case of fraud in which governmental employees set up shell companies that some reports claim granted nearly $50 million worth of property tax rebates.[3] The absence of proper oversight set the stage for such an action. Similar corporate scams are not uncommon. However, companies leave themselves vulnerable to such embarrassing—and potentially devastating—acts of fraudulence if they lack proper AP oversight.

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+ **Diminished credibility.** In an era of dynamic collaboration, it is essential that companies establish credibility and build tight relationships with their partners. Competition no longer merely revolves around companies, but rather, value chains. But companies that fail to pay their partners and suppliers accurately set themselves up for damaging image problems. Companies look unprofessional when they put

[2] Aberdeen Research, The Strategic Response of Payables and Post Audit Recovery to Corporate Challenges, March 2005.

[3] Carol Leonnig, Washington Post, "Tab in Scam at Tax Office in DC Nears $50 Million," Feb. 20, 2008.

themselves in the position of "clawing back" monies they have already paid out to vendors. They undermine the confidence of other companies in their supplier ecosystem.

+ Opportunity costs. Finance executives, who are the stewards of corporate capital, should be especially concerned about a situation in which corporate profits are unwittingly eroded. But that's the reality with poorly managed payables. Corporate capital, which would otherwise be invested in profit-generating activities, slips away into the hands of outside parties. Whether or not the capital is eventually recovered, its absence alone is costly. Considering the time value of money, the time spent engaged in its recovery is time lost—not to mention the costs of recovery and collection.

The efficiency gained through faster and less expensive AP processing can increase your company's overall competitiveness, which benefits all staff.

Post-transaction recovery is expensive, time-consuming and there's no guarantee one will get their money back. Moreover, there's a whole array of AP leakage issues that undermine the performance of companies.

Finance executives should be asking themselves what alternatives exist to address this painful status quo. Clearly, there's a whole industry of post-transaction auditors and recovery houses that stand to benefit from the continued dysfunction of AP departments.

But is this state of affairs inevitable? Not according to the best-in-class companies that have sought an alternative. These companies have gone beyond treating the symptoms. They have addressed the root causes of the invoice reconciliation problem—moving from profit recovery to profit retention.

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The Solution: Intelligent Invoice Reconciliation

In order to ensure that mistaken vendor payments don't drain profitability and introduce an array of other liabilities, best-in-class companies are embracing a new approach: Intelligent Invoice Reconciliation. Unlike the common practice of post-transaction audit and recovery, these smart companies are committed to pre-transaction audit and reconciliation. They are leveraging today's real-time, analytical technologies to get a lock on payables and ensure profits are retained.

Whereas invoice reconciliation has traditionally been a manual, after-the-fact process in most corporations, best-in-class firms now leverage analytical technologies to rapidly identify and evaluate exceptions and other high priority payables. Today's most advanced solutions are non-intrusive and executed outside the context of existing financial systems—avoiding the necessity for complex integration projects.

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One hotel chain that already has adopted this approach is a recognized leader in the hospitality services industry. The company was facing a situation in which one business unit had turned unprofitable and had vendors that were threatening to deprive them of necessary services. The company faced high transaction volumes and complexity as well as brief timetables for paying vendors. It decided to sell off several of its properties to franchisees to address the profitability problems that had emerged.

However, a pre-transaction profit retention audit demonstrated that the properties were not inherently unprofitable. They merely needed

[4] Caecaerf ernaturis volest ad vitatius et arum.

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greater budget discipline and spending control. The approach enabled the hotel chain to retain profits from mishandled payables that otherwise would have to be recovered by third-party specialists.

Having brought discipline back to the invoice reconciliation process for this particular business unit, this particular company realized it was in a strong position to reacquire the properties that had been sold off to franchisees. The initiative saved the company more than $250,000 a year in post-transaction lost profits alone. These are dollars that went straight to the bottom line.

Such approaches result in a host of compelling benefits. You can:

+ **Increase intelligence and transparency.** By drawing on technologies that provide deeper insight and visibility into the AP process, companies gain a stronger grip on payables. They know exactly what monies are flowing out to vendors and can accurately and rapidly match those payments to invoices.

+ **Preempt AP leakage.** Leveraging today's technology, companies now have the ability to meet payment discount deadlines, gain control over maverick spending and reduce the risk of fraud. Indirect benefits of this kind ensure that AP departments are performing at a high level and protecting the reputation of the enterprise.

+ **Cut transaction costs.** When organizations no longer have to slow down operations and throw human resources at AP reconciliation, they can smartly and effectively execute transactions at a lower cost. Much of the cost of AP transactions now—often reaching as much as $30 per invoice among "laggards"—is related to process inefficiencies that can be addressed by applying today's best practices.[4]

+ **Enhance profitability.** Companies now have the ability to go from profit recovery to profit retention. By ensuring that corporate capital is not erroneously paid out in the first place in the form of mistaken payables, companies avoid the considerable costs associated with recovery and ensure their profits are protected.

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As such benefits suggest, Intelligent Invoice Reconciliation can be expected to overturn the status quo in accounts payable in the coming years. Enterprises will no longer be given the leeway to clean up the mess associated with sloppy payables on a post-transaction basis. They will be expected to handle invoice reconciliation in a real-time fashion—taking accounts payable to a new level of proficiency, discipline and effectiveness.

About Paypool

Built on the premise that all payments are critical, Paypool was created in 2001 to transition any AP transaction to an automated solution. We combine our proprietary technology with unmatched customer service to deliver a complete Software-as-a-Service solution. Clients retain efficient workflows while gaining greater visibility and control, better cash flow management, streamlined approval processes, 24/7 accessibility, and increased auditor confidence. Paypool works with clients ranging from non-profit associations to some of the largest multinationals. We are headquartered in Washington, DC, and are SSAE 16 SOC compliant.

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