Accounts Payable
Best Practices

Mary S. Schaeffer

Executive Editor
IOMA’s Report on Managing Accounts Payable

Co-creator
The Accounts Payable Certification Programs

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John Wiley & Sons, Inc.
For my candle in the wind,
my father,
Ron Schacht
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Introduction

Companies should be interested in implementing best practices in their accounts payable (AP) operations for the same reason that Willy Sutton focused on banks—it’s where the money is. The fundamental structure of the AP function is that it is about a company’s financial integrity. Those who disregard their AP operations will adversely affect their bottom line, either directly by

- Paying invoices more than once
- Paying charges that should have been borne by the supplier
- Failing to take advantage of special pricing arrangements
- Not taking earned discounts
- Being fined by states for failing to comply with escheat or sales and tax rules

or indirectly through

- Increased transactional costs
- Increased costs to resolve discrepancies
- Increased costs to fix errors
- Increased costs by failing to take advantage of new processes and technologies
- Failing to earn early payment discounts
OVERVIEW: FACTORS

The AP function has changed radically over the last 10 years, and it appears that the transformation will continue at least for the foreseeable future. The following are some of the factors affecting this transformation:

• Check fraud had reached levels that demanded not only a change in the way companies write checks but also the technology used to limit the scams.
• Companies looking for ways to keep costs under control have cut AP staffs to the bone.
• Technology has made a big dent in the amount of resources companies now need to allocate to transactional work.
• The concentration in a growing number of accounts payable operations is shifting from transactional processing to an analytical focus.
• The overall number of people working in AP is declining. That decrease is almost entirely in the clerical staff. Consequently, the professional level of these departments is rising.
• States, desperate for ways to increase their coffers without alienating the voters, have found companies failing to comply with unclaimed property and sales and use tax rules to be just the answer to their problems. They are aggressively pursuing them and, when they find them in noncompliance, auditing and fining them uncompromisingly. States now use third-party auditors in many cases. They also work together.
• The accounting scandals and the enactment of the Sarbanes-Oxley Act have raised the level of inspection at many companies, both private and public.
• The Internet
BEST PRACTICE PRINCIPLES

With reduced resources and increased scrutiny, implementing best practices in AP is more crucial than ever. Strictly focusing on cost is apt to get a company into trouble. While keeping costs down is a good idea, it is important not to let that be the only consideration. It is important that sufficient thought also be given to adequate controls, fraud prevention, and good vendor relationships.

To that end, in defining best practices, the following overriding principles will govern:

• Up-front controls
• A move toward minimizing paper
• Clear and easily traceable audit trails
• Minimal clerical data entry
• Transactional efficiency

This should translate into lower costs, in most instances.

BEST PRACTICES IN A THEORETICAL BEST PRACTICE COMPANY

If it were possible to select best practices simply on the basis of what’s best and not taking into account corporate culture, existing procedures, financial limitations, and unique corporate procedures, here’s what the list might look like:

• Implement e-invoicing for all invoicing.
• Use positive pay.
• Insist that all purchase orders be completely filled out before they are issued, and that Receiving completely check packing slips.
• Use workflow to route invoices for reviews with an escalating approval structure.
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- Have travel and entertainment (T&E) reports completed electronically; spot check rather than completely review each report; and make all employee reimbursements using direct deposit.
- Comply with all escheat and sales and use tax regulations.
- Make every payment possible electronically.
- Encourage all employees to be paid via direct deposit.
- Take advantage of all early payment discounts, but don’t make any payments before the due date.
- Provide adequate resources for employee continuing education opportunities.

IMPLEMENTING BEST ACCOUNTS PAYABLE PRACTICE POLICIES

While the rest of this book examines AP functions in detail and spells out the best practices for each, this section will look at some overall best practice policies:

- Minimize or eliminate low-dollar invoices. This can be done through a variety of techniques, including:
  - Use of purchase cards (p-cards)
  - Making payments to certain vendors from statements rather than invoices
  - E-invoicing
- Institute strong up-front controls, eliminating the most back-end approval processes:
  - Completely filled-out purchase orders
  - Evaluated receipt settlement
  - Negative assurance
- Get rid of as much paper as possible using:
  - Imaging
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- E-invoicing
- A firm policy regarding where invoices should be sent first
- P-cards
- Consider outsourcing specialty functions, including:
  - Sales and use tax
  - Escheat
  - Duplicate payment audits
  - Value-added tax reclaim
  - Telecom and freight payment and audits
- Make as many payments as possible electronically, using:
  - Direct deposit
  - Automated clearinghouse credits and, where appropriate, debits
- Limit the number of phone calls coming into AP by:
  - Using online dispute resolution
  - Updating payment status on the Internet
  - Updating payment status using interactive voice response (IVR)
  - Publicizing payment timetables
  - Including an explanation slip with all short payments
- Don’t forget the value employees bring to the AP function:
  - Motivate staff
  - Focus on morale
  - Allocate some resources for staff education

A WORD ABOUT BEST PRACTICES

It's fine to talk about best practices in a theoretical sense, but professionals who toil in the field know that sometimes what works in theory will not work in their organization. Some-
times industry peculiarities stand in the way, and other times it might be the corporate culture or practices in another department. If the receiving dock does not do a good job at checking packing slips, it is pointless to implement a process that relies on accurate information from Receiving.

Thus, in this book, you will see discussions of best practices as well as what we refer to as “almost best practices.” These take into account that not all practices will work at all companies and offer an alternative to those who cannot implement the absolutely best practices.

We also include a discussion of those practices that definitely should not be used but, as many reading this know from painful experience, are in use in parts of Corporate America. Hopefully, by seeing these practices identified in print, some will decide to replace them in their own organizations.

WHAT’S INSIDE
The book starts at the beginning, reviewing the way invoices are processed. It identifies a number of potential problem areas and then offers best practice solutions. Some of the items may seem mundane to those not intimately familiar with AP. However, if they are ignored, expect duplicate payments and perhaps even fraud to increase.

At least for the present, as most AP departments have not made the leap to 100 percent electronic payments, checks dominate the payment landscape. If all aspects of this function are not handled properly, check fraud, duplicate payments, and processing costs will all increase. Also, the company may put itself in the position of being completely liable for any check fraud that does occur.

The mundane operational aspects of AP are reviewed in a way that focuses attention on issues that are sometimes ignored. A complete chapter follows this on one of the most im-
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important, yet overlooked aspects of the purchase-to-pay cycle—the master vendor file. You would be surprised how often the master vendor file is not even an issue on the table—with disastrous consequences. With the renewed interest in internal audit and controls, thanks to the Sarbanes-Oxley Act, companies disregard their master vendor file at their own peril.

P-cards are one of the easiest innovations to understand, and companies everywhere are adopting them. The potential for growth in this area is staggering. Thus, it is imperative that those who use them do so correctly. The cost and time savings will be maximized if best practices are implemented from the beginning.

T&E is an area that has changed dramatically in the last decade. Online filing, the increased use of T&E cards, and other electronic initiatives have changed the way most of corporate America handles their T&E function. The chapter on T&E reveals some of the techniques used at innovative companies.

While few people think of AP and regulatory issues in the same breath, there are a few issues that, if not handled correctly, can bring trouble to a company. Specifically, in this chapter we take a look at 1099 reporting, sales and use tax handling and reporting, and unclaimed property, also called escheat. It is the last two areas, sometimes ignored by companies, that are drawing increased attention from the states.

As the AP function becomes more analytical, it is inevitable that companies begin to expect that the professionals who run AP take a cash management approach to the function. In some ways, paying too early is just as bad as paying too late. This chapter takes a look at some of the cash management initiatives that are increasingly falling on the shoulders of the AP department.

Although in many cases, AP was one of the last groups within some companies to get computers, they are making up for it in a big way today. Technology is making inroads into
the department in an extraordinary manner. This chapter shares some of those innovations. We expect this area to continue to expand, especially as AP takes the lead in pushing for electronic invoicing and a move to electronic payments—away from the check standard.

Finally, successful AP departments are starting to realize that they have customers—both internal and external. By finding ways to deal with both, they are also improving vendor relationships. Those that do not make this leap can hurt the vendor relationship and increase costs as poor communications with other departments run up the dispute resolution bill.

Upon looking back at the items covered, it is truly amazing how much AP has changed in the last 5 to 10 years. This book attempts to identify the best practices that will make your AP department first rate.
Invoices can present a real challenge to the payment function. If any of the aspects are not handled correctly, the payment process bogs down. In this chapter, we’ll look at

- Invoice handling: approvals
- Forwarding invoices
- Verifying invoice data
- Invoice-coding standards
- Short-paying invoices
- Paying small-dollar invoices
- Handling unidentified invoices
- Handling invoices without invoice numbers

INVOICE HANDLING: APPROVALS

Background

As most reading this are well aware, Accounts Payable (AP) does a three-way match before paying an invoice. This entails matching the
In theory, if all POs are filled out completely and correctly, if receiving thoroughly checks all packing slips, and vendors create accurate invoices, the AP department should be able to pay the invoice without input from any other party. However, few companies are at this point. Even at those companies in which the documentation is good, management often demands that the original purchaser get involved and approve the invoice for payment. Part of the reasoning for this is that often POs are not completely filled out and special pricing or payment deals are not reflected on the PO. Unfortunately, the purchaser who neglects to include special terms on the PO is just as likely to forget about them when the invoice shows up.

With no formal policy governing where invoices are sent, first invoices sometimes float around the corporation, laying the groundwork for all sorts of poor practices. For starters, the invoice often fails to arrive in any location that could process it before the end of the early discount period. Additionally, it provides cover for those approvers who tend to let the invoice lie on their desk for weeks without taking action. Then, when the supplier is threatening to put the company on credit hold, these individuals deceitfully claim that they “sent that invoice down to Accounts Payable for processing weeks ago.”

Recent innovations in the area of electronic invoicing are rapidly changing the way we think about invoices. This is reflected in some of the following recommendations.

**Best Practices**

At most companies, only certain people can approve invoices for payment. Most companies limit this ability by rank, job re-
Invoices

responsibility, type of purchase, and sometimes even the dollar amount. In the best of circumstances, the board of directors should have given these approvers authority, and AP should have copies of these board authorizations.

Copies of the list, if it exists in paper format, should be given only to those who need it, and in all cases should be filed away carefully. The list should not be hung on the wall for easy reference or left lying on a desk where anyone walking by could see it and easily make a copy. When the list is updated, as it periodically will be, old copies of the list should be destroyed.

If you want to be super careful, new copies of the list should only be exchanged for the old ones, and all the old ones can be destroyed together.

The fact that an invoice arrives in Accounts Payable with a senior executive’s signature on it does not mean that the senior executive actually approved the invoice. To protect the AP staff, the department should have signature cards containing the actual signature of anyone authorized to approve invoices. It should be the executive’s real signature, the one he or she uses every day, and not the Sunday-school signature. More than one executive has taken the time to sign a signature card carefully, when in actuality everything else has an illegible scrawl on it. In these cases, the signature card should have the illegible scrawl as well, or the AP associate might suspect fraud when the signature cards are checked.

We are not suggesting that these cards be checked for every invoice that shows up. However, spot checking once in a while is not a bad idea. And, obviously, if a suspicious-looking signature arrives on an invoice, the signature cards should be checked immediately.

Ideally, invoices will arrive electronically. Admittedly, today, only a small portion of invoices is received electronically, but that number is growing by leaps and bounds. When an invoice is received electronically, it should be forwarded to AP
for processing. Using workflow, the AP department can forward the invoice for approval to the appropriate approver. This is based on information provided on the invoice integrated with the approver list discussed earlier.

Companies should include in their workflow programming an escalating approval feature. What this means is that if the first approver does not respond within a given time frame, say five days, the invoice is automatically routed to the next higher approver in that chain of command. This not only takes care of tardy approvers, but also vacations and unexpected absences. It simultaneously creates an audit trail for everyone to see. No longer can Purchasing claim it sent an invoice back to AP when it is still in the department. Finally, the audit trail feature combined with escalating approvals make it far less likely that managers will relegate invoice approval to the bottom of their workload—especially when not approving invoices may actually create more work for their immediate supervisors.

When companies receive paper invoices, as virtually every company does, the invoices should be directed to AP rather than the individual purchasers. This allows AP to log the invoice in and forward it to the appropriate approver. It helps get a handle on the voluminous paper that can spread throughout a company without any boundaries. Ideally, when all invoices are directed to AP, they can then be scanned and forwarded, as described above, for approvals. Even if the intricate workflow programming is not feasible, there is still some audit trail and the number of lost invoices is greatly reduced. The invoice never leaves AP, and thus the “opportunity” to get lost on someone’s desk or in the mail is diminished. In order to make such a process work efficiently, vendors should be directed to include the name of the purchaser on all invoices. Companies that make this process work the best are those that send invoices without the purchaser’s name back to the vendor.

Having all invoices come first to AP also introduces another control against employee fraud. Invoices cannot be al-
Invoices

tered, nor can they show up out of the blue with what looks like an executive’s signature on them. By scanning the invoices and forwarding them for approval, it makes it all the harder for a scheming employee to forge a boss’s signature.

Almost Best Practices

In the absence of board authorizations, AP should have a list of who can approve what purchases. A high-level executive at the company should sign off on this list. Otherwise, it is exceedingly easy to have fraud, and AP could end up taking on a responsibility it should not.

If it is not possible to get imaging—even an inexpensive model—in AP, a policy still should be set up for receiving invoices. If all the invoices come to AP first, it will be necessary to set up a log to track which invoices were received, their due dates, and whom they were sent to for approvals. This can be a tedious and time-consuming, paper-intensive process—as copies should be made of the invoices before they are sent out for approval.

Having the invoices come first to AP helps with the possible employee fraud issue discussed earlier.

Reality Check for Accounts Payable

While sending invoices lacking the purchaser’s name back to suppliers may lead to a smoother AP operation, not all management teams are going to think this is a great idea—especially if key suppliers balk or complain. Thus, it might be a good idea to get management on board before instituting this policy.

Worst Practices

Worst practices include

- Having no policy regarding where invoices should be sent for payment
FORWARDING INVOICES

Background

On the face of it, it would seem that where invoices were mailed should have little impact on the payment function. Unfortunately, this is not the case. In a typical company with no invoice forwarding policy, invoices that are addressed to the company but not a particular individual can float for weeks from desk to desk before eventually ending up in AP or on the desk of the purchaser. When invoices are not properly routed,

- Any chance of earning an early payment discount is lost.
- Duplicate payments can occur when a second invoice is sent.
- Late fees can occur.
- Vendor relations are weakened.

Best Practices

Companies need to have a firm policy regarding where invoices should be sent. This can be one of two places:

1. The AP department
2. The original purchaser

Either way works just as long as there is consistency in the approach. There is a slight advantage of directing all invoices to AP. When the invoices are sent directly to AP, a best practice is to insist that the purchaser’s name be included on the invoice so the AP staff knows where to forward the invoice for approval. Some companies adhere to this approach, strictly re-