



Treasury Operations Best Practices in Receivables & Disbursement Functions

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Introduction

Given the current uncertain economic environment, companies are holding more cash today than in previous years to brace for the prolonged credit crisis at hand. Currently, all companies in the S&P 500 stock index have increased their cash across the board by 1.5% year on year. In the risk-driven world of hedge funds, managers are moving into the safe haven of cash, effectively foregoing potential returns for the assurance of liquidity and the ability to pounce on opportunities to buy beaten-down assets. All this has translated to more cash to be handled by treasurers. Treasurers are constantly under pressure to maintain liquidity vis-a-vis the investment opportunities, optimize the cash resources of the company, finance the capital needs of the company effectively and manage risks. Although there are various treasury management tools and techniques which can aid the treasurer to take strategic decisions, it is up to the treasurers to make use of these techniques effectively and in a way that the business objective of the organization is met. As part of this article, we will focus on some of best practices of treasury management receivables and disbursement functions which can help a treasurer handle the challenges posed by economy.

Best Practices in Receivable Management

Receivables management is a key function of treasury management and has direct bearing on the corporate financial position if it is not managed properly. Any delay in the collection of receivables has a direct impact on the working capital needs of a company and also will increase the Day Sales Outstanding (DSO). Managing receivables will enable companies to accurately forecast their cash flow, which in turn makes effective liquidity management possible.

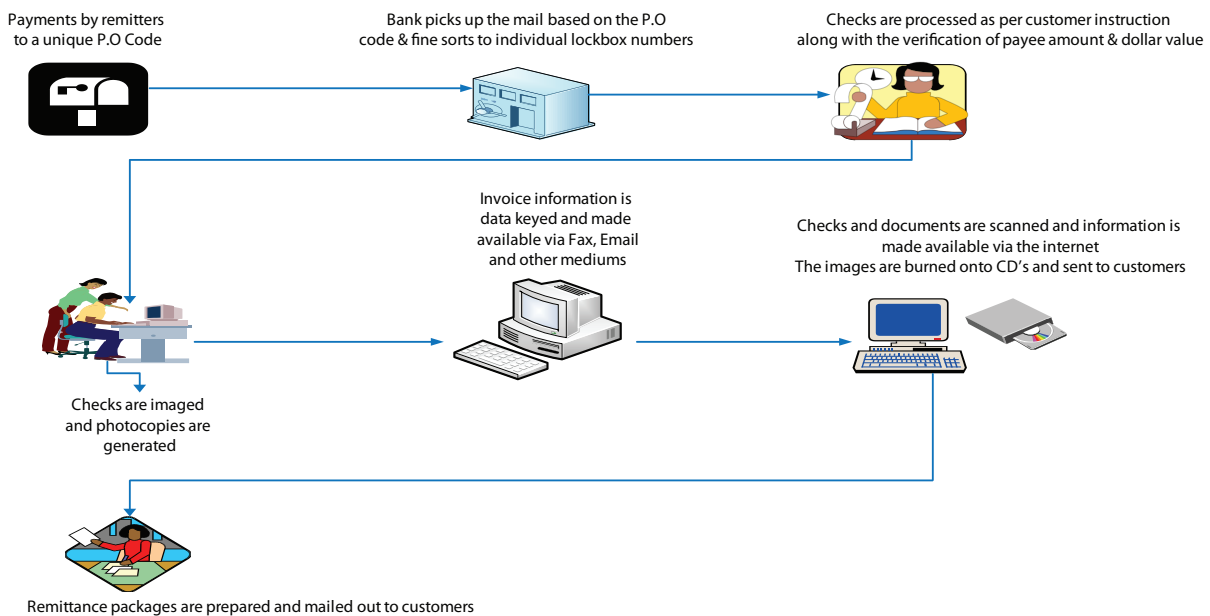
Following are some of the popular best practices used for receivables management -

Lock Box Processing

Lock box is one of the techniques available to fasten the processing of payments received and thereby to enable a company in effective cash forecasting and cash management. Lock box is a service offered by commercial banks that simplifies collection and processing of account receivables by having payments mailed directly to a location accessible by the bank.

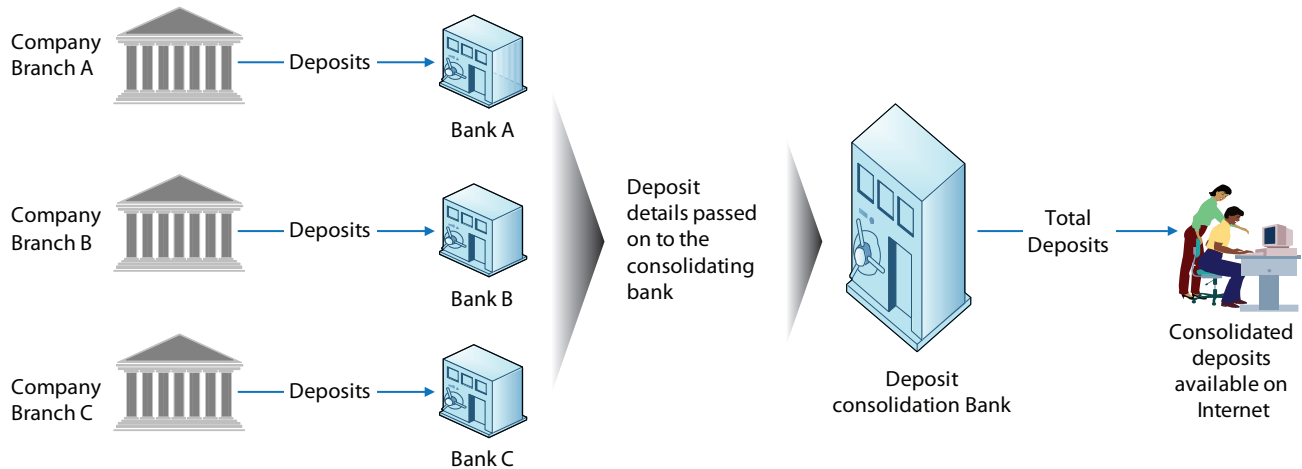
The company receives payments by mail to a post office box and the bank picks up the payments multiple times a day, deposits them into the company's account and notifies the company of the deposit. Some of the benefits for companies using Lock Box Processing are -

- Reduced errors due to reduced manual payment processing
- Faster payment processing which in turn allows a company to maximize returns



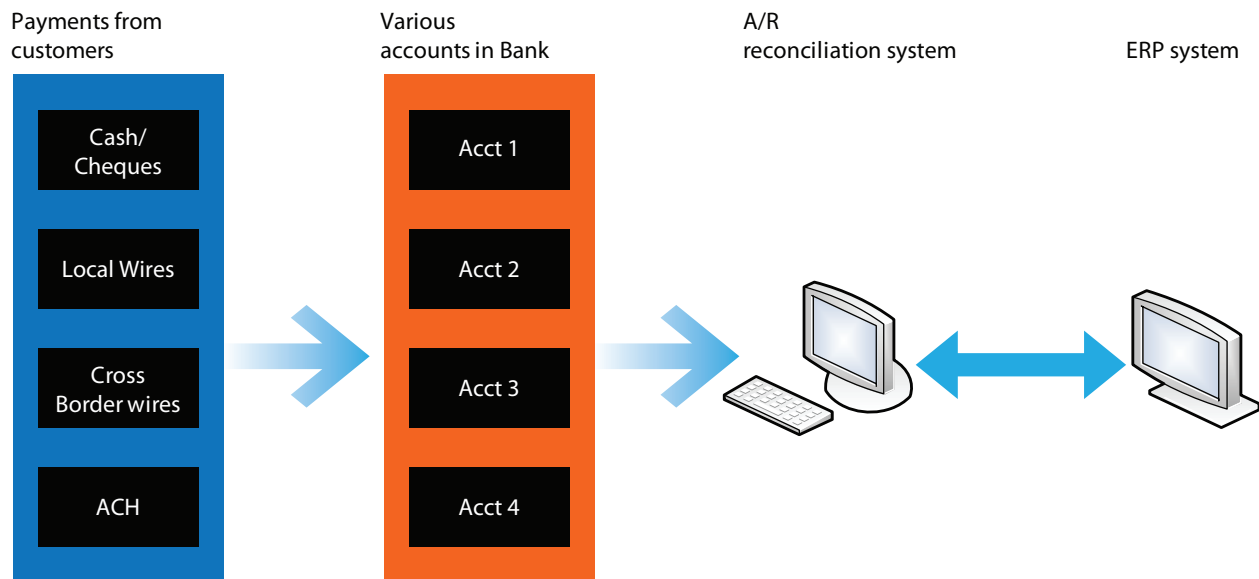
Deposit Consolidations

Deposit consolidation is a process of consolidating the deposits held in various banks at different locations onto a single bank account every day; which can be viewed online and enables treasury managers to effectively analyze the current cash position of the company and plan for its effective usage. Deposit consolidation is useful if a company has its operations in multiple geographies, and has a tie up with the bank in that particular geography to service its business needs. Since managers have up-to-date information with respect to the available cash in terms of the deposits made at various locations, they are in a position to plan investment strategies more effectively.



Comprehensive receivables

Comprehensive receivables are receivables service that allows customers to access a single file from the bank to consolidate all receivable types. A well-designed reconciliation system integrated with the enterprise resource planning system would enable people to view the reconciled data in real-time and hence will result in better cash management. This will also reduce the manual work of the treasury personnel and also will enable them to focus on other strategic areas.



Recommendation will be to use the above mentioned practices after assessing the business needs. For a geographically located companies deposit consolidation will be more beneficial. Whereas for a company, which receives payments through different mechanism comprehensive receivables can be used. Lock Box Processing is used by companies which process payments manually, have an in house system or those who outsource. Bank, Credit Unions, government municipalities, insurance companies, telephone companies, cable companies, universities and charitable organizations are some examples of companies using Lockbox Processing.

Best Practices in Disbursement Management

Disbursing funds at the right time is as important, as collecting payments. Companies have to plan disbursement of funds in a systematic manner, thus reducing the costs involved in penalty. There are several techniques for managing disbursements efficiently.

Following are some of the popular best practices used for disbursement management -

Controlled disbursement

This is a very effective technique used by many organizations today, which allows fund managers to put all of the excess available cash to productive use. In this technique, all the checks presented to the banks will be notified to the relevant customer and thus the customer can keep only the funds required to clear the checks that would be presented for the day in the account and the rest can be efficiently invested. This reduces the borrowing expenses and also avoids embarrassment due to check return on an account of non-availability of funds in the account. After funding the account with the exact amount needed, one can automatically pool the remaining funds for investment or debt reduction and eliminate idle balances and overdraft charges. Funds that have been invested earn interest up to the time they are again needed to fund some disbursements.

In cases where controlled disbursement accounts are held with a bank, the banks hold checks received after a particular time in the day (this is after notification to the customer about the required balance for check clearance,) or will make arrangements for clearing adjustments the next day thus eliminating the requirement of getting the funds transferred to honor the checks presented.

Positive pay

Usually, all high-value transaction payments are done through checks and hence they are prone to several frauds. Positive pay is a service provided by banks and has to be included by all companies to prevent frauds and ultimately save money.

The positive pay technique aims at identifying the mismatches in check numbers and amount between what was sent across by the bank in terms of details of checks that have been issued by them and the actual checks presented. In case of any suspicion, the company is immediately notified and they are given sometime to validate the same. Wherever the bank comes back within the stipulated time that the transaction should be rejected, all such transactions are stopped.

Reverse Pay

Reverse positive pay is similar to positive pay, but the process is reversed. Here, the onus lies with the company which has the checks issued. Banks provide details of the checks presented in terms of serial number, account, amount etc., and the company compares the information with its internal records. The company lets the bank know which checks match its internal information, and the bank pays those checks. The bank then verifies the checks that do not match, with the company records and corrects any misreads or encoding errors that might have happened and determines if the cause is fraudulent or an error. The bank pays only some exceptions, that is, those that can be reconciled with the company's internal records.

Positive pay	Reverse positive pay
Company transfers check issuance data to banks	Banks provide details of checks presented to controlled disbursement accounts
Banks review all presented checks against this issuance record before payment.	Companies compare the list of presentments against its check issuance data.
Any suspect items are referred to the company for a pay/return decision	"Stop payments" can be placed on suspect items

Pooling

Pooling is a treasury technique which is used to offset the cash deficit in one business unit with cash surplus in other and in turn reduces the short term borrowing cost and increases the short term returns from investments. The main objective of pooling is to make the best use of company's net cash position at the end of the day. Pooling can be accomplished using physical/zero balancing or notional pooling approach.

Physical pooling/zero balancing is a technique to transfer funds at the end of the day to the pooling account from company's individual operating accounts. Balances are brought to zero in all the operating accounts irrespective of whether it is a positive balance or negative balance.

Physical pooling has various advantages –

- The entire pool can be invested overnight, resulting in higher returns;
- Operating accounts having overdraft are automatically adjusted at the end of the day.

Notional pooling is a technique that results in same net cash position as zero balancing but there is an agreement between bank its corporate clients that bank will treat subsidiary accounts as one for interest calculation. Funds are not actually transferred and the bank makes the pooling calculation in its books of records.

Notional Pooling vs. Physical Pooling

Notional pooling	Physical pooling
Currency by currency or on a multiple currency basis	Currency by currency only
Cross border transaction are not necessary as pool is accounted for in banks records	Cross border transactions are expensive
Notional pooling is difficult to implement when the cash positions have mismatch	Physical pooling has more cleaner transaction and can be implemented even if the cash positions have mismatch
Burden of documentation is with Banks	Burden of documentation is with participating companies

Over a period of a year, there is a dramatic shift from notional pooling to physical pooling due to advancement in cash visibility, improved corporate and bank systems. However, appeal of notional pooling cannot be underestimated to a large extent due to its ease and simplicity of implementation and tax saving on cross border cash payments.

Bank Reconciliation

From time to time reconciliation is imperative to ensure that the numbers as per the company records and the bank account statement are in sync. If these numbers don't match, a figure needs to be adequately diagnosed to find the reason for the difference and appropriate corrections that needs to be made wherever necessary. Reconciliation is needed both for compliance/audit requirements and for identifying any fraud. A treasurer can opt for full reconciliation or partial reconciliation (for a specific period) as the situation demands.

Conclusion

With the economy facing several ups and downs in a short span of time, and liquidity in the market compressing, the role of treasury management is becoming even more challenging. Above all, best practices are hampered by legacy issues, budgets constraints, or underlying business models. Thus, the need for effective treasury operations cannot be understated and treasury managers should test drive a chosen solution to ensure that the costs involved in a particular solution are worth the efforts; and in sync with the future plans of the organization.

Some of the recommendations for effective treasury operation –

Use of technology and centralized treasury management systems are widely proposed for meeting the growing challenges of market dynamics. While technology cannot help stop a downfall, it can help foresee a downfall when the symptoms have just crept into the system, allowing treasury managers to take precautionary actions.

A centralized system on the other hand can help achieve quicker access to global cash positions; better connectivity across branches, businesses and partners regardless of the global dispersion in operations. Thus, investment in the right technology, coupled with a dedicated and centralized treasury management unit will help you improve liquidity, cash visibility and ultimately reduce the operational, counterparty and liquidity risks.

Finally, strategies like maintaining accurate forecasting systems, balancing funds system for correlating working capital needs with investment decisions, implementing SWIFT, re-engineering of the treasury operations for global integration can be considered if cost incurred outweighs the benefits in long run. Last but not the least, the main objective for treasury managers should be to move towards a future-proof treasury model which is cushioned for any financial or non financial risks.

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