

Accounts Payable Transformation: Lessons in High Performance from the Private Sector



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Executive summary

For many public sector organizations, the ability to pay suppliers within terms can be a challenge. Physical paper flows, manual processes, internal policies and supplier disputes all contribute to inefficiencies in the purchase-to-payment process. While enterprise resource planning systems, electronic initiatives and shared service models can increase efficiencies, public sector organizations stand to reap significant gains in value by taking a fresh look at the accounts payable process.

Two key opportunities for improved performance are:

Achieving operational efficiencies by removing paper-based and manual processes from the invoice-to-pay cycle. This reduces transaction costs, the likelihood of manual errors

and the cost of employing large numbers of back-office staff whose primary role is to manage transactional paper flows.

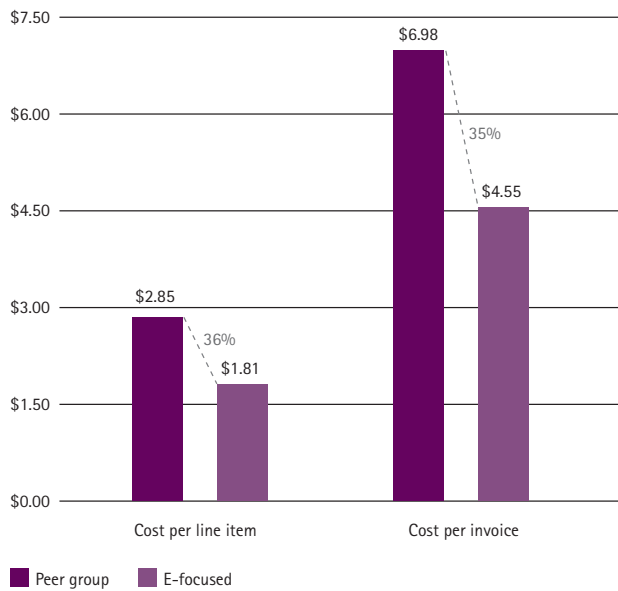
Realizing hard dollar savings by identifying and meeting prompt-payment terms offered by suppliers. This has the potential to both lower expenditures and optimize working capital.

These opportunities are intrinsically linked. In the vast majority of cases, failure to take advantage of discounts is a direct consequence of inefficiencies in the processing and payment of invoices. Even though there has been an increase in control and transparency over the accounts payable process following investment in

enterprise resource planning systems, Accenture's research confirms that the majority of implementations in the public sector have not fully achieved the associated benefits that accrue from underlying process transformation.

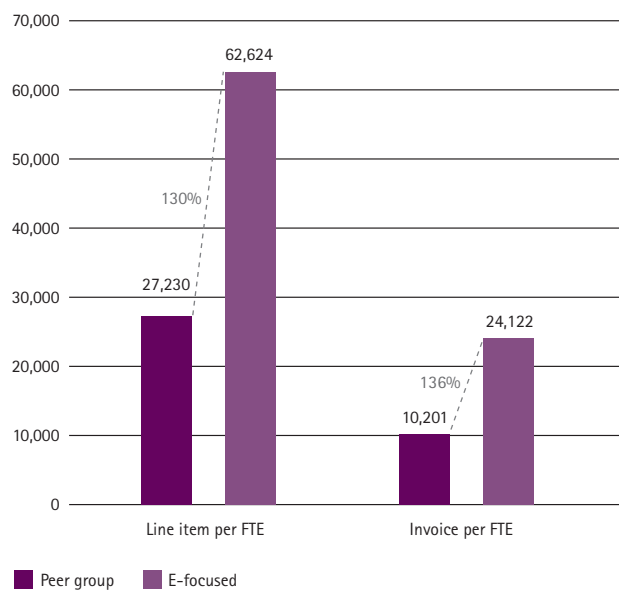
Many private sector companies have already embarked on successful attempts to drive paper and manual processes out of the accounts payable process using electronic invoice presentation and payment technology. While there are obvious efficiencies in time and materials, substantial savings also arise from the realization of prompt-payment discounts. For a large organization, the possibility of negotiating half-a-percent discounts on a total spend of \$1 billion to \$2 billion can yield savings of \$20 million or more per year.

Figure 1: Cost comparison between e-focused and peer companies



¹2004 The Hackett Group

Figure 2: Productivity comparison between e-focused and peer companies



¹2004 The Hackett Group

According to The Hackett Group,¹ “e-focused companies”—those that take advantage of Web-enabled accounts payable processes—have significantly lowered transactional processing costs and are more productive than their peers.

The results show how an e-focus can help drive high performance:

- Processing costs for line items and invoices were lower among the e-focused organizations by 36 percent and 35 percent, respectively (Figure 1).
- E-focused companies were also 130 percent more productive in line items processed and 136 percent in number of invoices processed (Figure 2).

Previously, innovations that have helped automate the payment process—such as electronic data interchange—have been viable only for larger suppliers, who could afford the necessary investment. It is only in recent years that mature, Internet-based solutions have become available that can handle electronic invoice presentation, automated payments, remittance advice, three-way matching, dispute management and automated routing, while still being affordable for all sizes of organizations.

On the supplier side, the Internet has also emerged as a way to eliminate paper and manual intervention. On average, every 10 percent increase in electronic invoices corresponds to a three-day reduction in days sales outstanding, thereby improving cash

flow. To government suppliers, this translates to an annual savings of \$821,900 per billion dollars. Other benefits include reductions in float, non-payment, processing errors, postage and paper. Vendors are often willing to pass along these savings in the form of discounts for invoices paid quickly.

The public sector is now in a perfect position to take advantage of the technology that has enabled these results. By leveraging the experience and successes of accounts payable automation programs that have been widely adopted by private sector companies, public sector organizations can achieve lower transactional processing costs and lucrative prompt-payment discounts.

¹Hackett Research conducted for Accenture (August 2005)

Private sector trends in accounts payable

As with the public sector, the invoice-to-payment process for a majority of the private sector still remains a paper-based and manually intensive one, despite the automation of some processes through enterprise resource planning accounts payable functionality. Most invoices are still printed and mailed, check payments are still processed by hand, and payment reconciliations are still performed by large internal teams dealing with large stacks of paper. This significantly impairs any attempt to realize the benefits offered by prompt-payment discounts because each step of the process is prone to delays (Figure 3).

Order delivery. Many organizations have made investments in technologies that target the efficiency of internal purchase-to-payment processes. However, the practice of extending

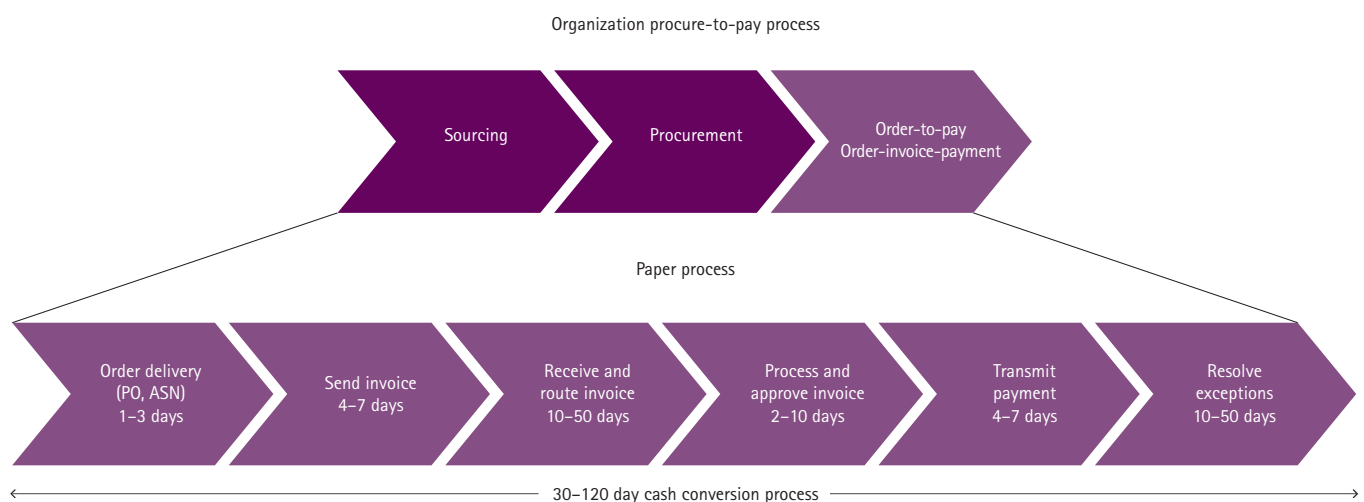
this philosophy outside the organization has been limited. Capabilities now exist to electronically deliver purchase order and acknowledgments to supplier systems. In doing so, they integrate to the supplier's order-to-cash process, and support the concept of "lights out processing," whereby the majority of processing is automated. Accenture's experience is that order acknowledgments can have a significant impact on subsequent invoice resolution.

Send invoice. A large number of invoices are still paper based and received by mail. Many supplier organizations have invested in electronic billing solutions only to generate paper-based invoices that have to be manually processed. For suppliers who generate invoices manually, the lack of insight into the buyer's internal organizational process hampers their ability to collect.

Receive and route invoice. The time between the issue of the supplier invoice and the receipt of the invoice in the buyer's accounts payable process can vary substantially, with invoices being lost, sent to the wrong address or misrouted along the way. The result is that the baseline from which the invoice due date is determined may vary and impact the ability to pay within terms.

Once an invoice has arrived in an organization, several factors can contribute to delays and errors including manual data entry of invoices into the accounts payable system, ineffective document scanning or optical character recognition and inefficient dispute management processes.

Figure 3: Order-to-pay cycle



- Average days payable outstanding/days sales outstanding (DPO/DSO): > 42 days
- Over 50 percent invoices past due when they arrive at accounts payable
- Available discount (2 percent net 10) out of reach for many payers
- 10 percent–20 percent of invoices involve an exception process
- Cost to process/pay an invoice estimated over \$10 (cost triples to \$30 per exception item)

Innovation through electronic invoice presentment and payment

Process and approve invoice. Key inefficiencies relating to the approval of invoices and the handling of any relevant disputes include:

- Coding transactions so that they can be recorded according to accounting distributions and policies
- Waiting for manual approvals
- Ineffective, decentralized processes and responsibilities surrounding matching
- Poorly implemented enterprise resource planning workflow
- Data discrepancies between the purchase order and the invoice that require manual resolution
- The dispute management process

Transmit payment. Many organizations have increased the use of electronic payments, but paper checks are still prevalent and lead to increased administrative workload across the payment process.

Resolve exceptions. Dispute resolution—for example, a mismatch between what was ordered or received and what was invoiced—should be the domain of the buyer and the supplier, but too often becomes the responsibility of accounts payable. Individuals who don't have insight into the transaction process waste time ineffectively responding to supplier queries.

Significant recent advances in electronic invoice presentment and payment solutions have opened up the opportunity to substantially compress cycle times. The options for electronic invoice presentment and payment solutions vary (for example, buyer-centric, supplier-centric or consolidator), but early adopters in the private sector have been able to generate value by saving on administrative costs, increasing their cash discounts and reducing charges for late payments.

A recent survey² conducted by MasterCard® and Ariba found that two thirds of US companies with annual revenues exceeding \$500 million use some form of electronic invoice presentment and payment. Furthermore, eight out of 10 respondents from companies that do not currently use the technology plan to implement it within the next two years.

The capabilities of electronic invoice presentment and payment solutions in the marketplace also vary, from solutions that digitize and present physical invoices to those that have comprehensive capabilities that support and/or replicate enterprise resource planning system capabilities. However, the core function of all these solutions is invoice translation and validation. Invoices can be automatically verified according to required data (for example, purchase order numbers and agreed payment terms), and both buyers and sellers are able to settle disputes online rather than entering into off-line discussions that can be frustrated by asymmetric information. Further efficiencies are driven by the

automatic reconciliation of invoices to purchase orders and “goods received” notes. The adoption of this advanced functionality minimizes the number of handoffs in the accounts payable process, and in doing so reduces manual effort and overall costs.

Accenture has researched many of the providers in the electronic invoice presentment and payment domain. There is a wide range in provider capability, and the functionality of an electronic invoice presentment and payment solution in itself is not enough to generate success. The propensity for suppliers to adopt these types of solutions is also important, with leading providers focusing on this aspect not just in terms of providing the technical solution, but of providing the process capabilities and strategies that target supplier participation. For example, many electronic invoice presentment and payment providers support purchase order delivery, acknowledgment and invoice presentation, but few have capabilities that enable supplier on-boarding or cash collection capabilities.

As the electronic invoice presentment and payment marketplace matures, providers continue to evolve their solutions to support physical and electronic invoices (for example, scanning physical invoices and interfacing with the electronic invoice presentment and payment application, or even providing a data input service).

²The B2B Spend Management Survey

Public sector opportunities

In a 2002 survey of 22 representatives from the National Association of State Auditors, Comptrollers and Treasurers, Accenture found that government organizations spend more time avoiding late-payment penalties than realizing prompt-payment discount opportunities.

Interviews facilitated by Accenture in 2005 with state comptrollers and a review of publicly available literature outlined several common themes in existing accounts payable processes:

- The majority of inefficiencies surround people and process. The decentralized nature of receiving invoices and the time taken to gain internal approval for payment were cited as the two key contributing factors to payment delays.
- Comptrollers recognize that process re-engineering will need to be enabled by technology changes. Any attempt to compress the payment cycle will have to take account of the need to apply the requisite audit controls surrounding matching and approval, which cannot be achieved by manual process improvements alone.
- State auditors have started to report agencies for not taking full advantage of payment discount offers from suppliers. Furthermore, most comptrollers believe this to be an area where substantial savings could be achieved.

In addition, an analytical case study conducted by Accenture for a US state's accounts payable process revealed the following findings:

- Due to the predominance of paper invoices, 45 percent of transactions took longer than 10 days to be received in the organization and a staggering 25 percent took longer than 30 days.
- Although 80 percent of invoices were processed within two days of receipt, 20 percent of invoices were subject to delay due to internal routing inefficiencies.
- While 60 percent of invoices were immediately approved for payment once they had been entered into the accounts payable system, it took between 10 and 30 days to approve 15 percent of transactions.
- Up to 40 percent of transactions lay idle in the accounts payable system awaiting payment, potentially missing out on early-payment discounts.

Significant cost and efficiency savings are available to public sector organizations looking to streamline and automate their accounts payable processes. These can be defined in terms of soft benefits and hard benefits.

Soft dollar savings

- Centralized processing locations help lower costs for managing accounts payable and disbursements.
- Automated processing is responsible for significant savings in managing accounts payable and disbursements.

- Many government business processes can be streamlined, in a manner consistent with leading practices, to reduce or eliminate the number of processing steps. Accenture analysis suggests that automating and streamlining the accounts payable process can save labor and overhead costs \$10–\$15 per transaction.
- Automation of the invoice entry, matching and approval process can result in significant process efficiencies. The average cost of processing a paper-based invoice in public sector organizations is \$43. We estimate that process automation can cut this to \$4 or by a factor of 10.³

Hard dollar savings

The generally accepted business practice for vendor payables is a 2 percent discount if paid in 10 days and full amount (no discount) if paid in 30 days. Most governments strive to make payments in 30 days. While this practice avoids late-payment penalties, it does not harvest prompt-pay discounts. Paying a vendor 98 percent the face amount of an invoice, representing full satisfaction of the amount owed, generates a savings to the government (slightly less than 2 percent due to interest income forgone) and is attractive to vendors, who already pay the equivalent of 2 percent—or more—to accept government purchasing cards.

³Based on IOMA Accounts Payable Department – Benchmarks and Analysis 2003

The value of prompt-payment discounts should not be underestimated. Many government agencies have some form of discount policy, but few are proactive in pursuing the opportunity. This example from a meeting of the National Association of State Comptrollers indicates that significant discount opportunities are often missed (see Figure 4).

Analysis of publicly available data⁴ suggests that \$22.3 billion of 2002 state expenditures⁵ could be subject to prompt payment. Assuming a 2 percent discount for payment of invoices within 10 days, this presents a potential early-payment opportunity

of \$308 million per year, taking into account the interest income forgone by accelerating payment.

The Accenture case study also showed that the organization in question only realized one fourth of the prompt-payment discounts that it had negotiated with suppliers. Or, to put it another way, for every million dollars in spend, the organization saved \$4,000 in discounts but lost \$16,000 due to its inability to pay within terms.

In the public sector, the potential benefits of electronic invoice presentment and payment solutions can even extend beyond the basic hard and

soft dollar savings. Accenture's research has shown that government's high performers are those that provide increased value to citizens by increasing and improving service delivery and carefully weighing the costs of such initiatives. The Accenture Public Service Value Model, which was developed out of this research, has shown how organizations can track their progress in achieving agreed-upon outcomes as they relate to cost-effectiveness. By providing significant savings in the area of accounts payable, electronic invoice presentment and payment solutions can allow organizations to redirect resources into highly visible and citizen-focused services without an associated tax burden.

Figure 4: Potential prompt-payment savings

Annual spending relevant and appropriate to quick-payment discounts	\$1,200,000,000
Monthly volume	\$100,000,000
Annual interest income rate	.05
Daily interest rate	.000137
Change to bill paying from 35 days to 5 days	-30 days
Interest income foregone	
Per month $\$100,000,000 \times 30 \times .000137 =$	\$411,000
Per year	\$4,932,000
Discount on annual spending	.02
$\$1,200,000,000 \times .02 =$	\$24,000,000
Net hard dollar cost savings benefit	\$19,068,000

⁴State Government Finances: 2002 (updated at July 2004) <http://www.census.gov>

⁵Based on expenditure of California, New York, Illinois, Ohio, Michigan, New Jersey, Massachusetts and Tennessee state governments

Challenges to realizing benefits in the public sector

Most of the challenges associated with accounts payable processes in the public sector are similar to those experienced in the private sector. However, there are some organizational characteristics that are more predominant in the public sector, and they can complicate the realization of both soft and hard benefits:

- The impact of invoice late-payment penalties forces an organization to be reactive and focus on minimizing cost rather than driving value through savings.
- Process-oriented challenges relating to the diffusion and decentralization of invoice processing across multiple agency locations complicate any attempts at re-engineering or automating processes.
- Different systems (enterprise resource planning, non-enterprise resource planning) and disparate processes across government agencies and departments hinder the value from shared services.
- Many agencies fail to maximize investments in existing technologies and take advantage of the latest capabilities.
- There is almost no emphasis on programs to encourage supplier participation in e-initiatives.
- Internal change management must also be considered as it relates to interactions between procurement and accounts payable.

In addition, there are other challenges surrounding the inter-relationships between buyers and suppliers:

- Suppliers not taking early-payment terms seriously because of the history of slow approvals.
- Suppliers' skepticism that discounts will be taken when not earned.
- Buyers who don't establish early-payment terms with all suppliers.
- Accounts payable departments that do not currently value the returns associated with the effort for realizing discounts.
- Multiple policies that can be difficult to administer and communicate.
- Suppliers with very different cash needs, and therefore, varied levels of willingness to agree to payment terms.
- Enterprise resource planning systems that have limited discount capabilities and cannot administer adjustable discounts over the payment cycle.
- Supplier discounts that vary over time.
- Cash requirements that change over financial cycles, thereby driving the financial capacity for and attractiveness of prompt payments.

Fortunately, the public sector can leverage the private sector's growing experience in efforts to automate manual and paper-based processes and confront challenges like these. This includes proven methodologies and technologies that have now matured to the point that they are suitable for adoption without significant risks. By combining leading electronic invoice presentment and payment capabilities together with an emphasis on targeting early discounts, government organizations can realize significant rewards.

The implementation road map

Government organizations can realize the benefits associated with prompt-payment discounts through a structured approach.

Assess opportunities. An organization looking to realize prompt-payment opportunities must understand the relative efficiency of its current invoice-to-payment process and have an accurate view of the opportunities available or forgone. Analysis of transaction payables data will help the organization to baseline current performance and provide insight to maximize opportunities when developing a benefits realization campaign (for example, targeting suppliers with the most paper invoice volume or targeting supplier/spend categories that offer the most favorable discount terms). Immediate opportunities can be derived from initiatives that do not require technology investments.

Leverage current capabilities. Few organizations take full advantage of their existing technology. Understanding how these capabilities can be applied in pursuit of prompt-payment opportunities is a pragmatic approach that maximizes return on technology investment (for example, configuring procurement approvals to reduce

retrospective accounts payable approvals, implementing electronic data interchange for large volume suppliers or developing interfaces for scanning and optical character recognition solutions).

Undertake technology-driven transformation. For organizations that can demonstrate a substantial business case for investing in technology, the adoption of leading electronic invoice presentment and payment capabilities should be considered a means to transform the fundamental invoice-to-payment process and realize prompt-payment discounts. Eliminating physical paper flows from the process will require investments in technology that supports the transition to electronic processes and also provides the necessary tools from the security, internal controls and audit perspectives. The electronic invoice presentment and payment solutions should also include capabilities that not only make the process more efficient (and therefore compress the invoice-to-payment cycle), but also target supplier participation in the initiative.

Take advantage of government processing services. Private sector organizations have started to embrace the concept of business process outsourcing. Accounts payable and purchase-to-payment are two areas that have gained significant attention for both ease of outsourcing and subsequent benefits.

The acceptance of government processing services in the private sector and the basis under which organizations decide to outsource may be different. However, the imperative to release resources traditionally deployed to "back office" administrative tasks and refocus them on providing citizen-related services is in the spotlight. Working with a government processing service provider to handle the purchase-to-pay process means that a government organization can contract to pre-agreed costs and therefore realize the savings that translate from a lower cost per transaction.

To be competitive, service providers have invested in capabilities that enable them to deliver service at a lower cost. For those that have invested in prompt-payment discount opportunities, there is the added incentive to the service provider to manage processes efficiently and share in the economic value associated with realizing supplier discounts.

Conclusion

Public sector organizations lag their private sector peers in the deployment of innovative electronic invoice presentment and payment solutions. These forward-thinking practices not only enable the compression of the invoice-to-payment cycle, thereby facilitating prompt payment, but they also provide new capabilities that focus on maximizing the returns from supplier discounts.

The ability to pay a supplier within terms and realize prompt-payment discounts can be elusive for organizations that have not previously focused on these opportunities. Yet the potential for releasing value back to the public sector by pursuing such discounts represents a significant source of untapped funds.

Public sector organizations lag their private sector peers in the deployment of innovative electronic invoice presentment and payment solutions. These forward-thinking practices not only enable the compression of the invoice-to-payment cycle, thereby

facilitating prompt payment, but they also provide new capabilities that focus on maximizing the returns from supplier discounts.

The immediate task facing public sector organizations is to channel the resources that are currently focused on minimizing penalties associated with late payment of invoices toward maximizing available discount opportunities through the use of technologies like electronic invoice presentment and payment.

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