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# Cash Application

The Ultimate Guide




# Contents

The benefits of swiftly and correctly applying cash are plentiful: better straight through processing rates, lower processing costs, reduced days sales outstanding.

## Overview

Cash application is a critical component of your accounts receivable (AR) operation and focuses on matching incoming payments with customer accounts and the correct open receivable invoices. It is also **time-consuming and error-prone,** yet completely necessary to marry payments received with company billings and invoices. It impacts many aspects of the business—especially working capital and the utilization of resources.

With the advent of digital payments, the cash application process has become even more complicated. Whereas payments made by check are usually accompanied by a remittance slip that identifies which invoice has been paid, the remittances that accompany electronic payments are often sent separately (if at all), creating more work for cash application specialists. Finance teams now find themselves manually identifying what payments were for based on partial information.

The benefits of swiftly and correctly applying cash are plentiful: better straight through processing rates, lower processing costs, reduced days sales outstanding (DSO)—or AR aging, resulting in more timely financial closings—greater efficiencies, the reallocation of resources to higher value work, and improved customer service. Plus, by unlocking cash, you'll more easily meet operational expenses such as salaries and utilities, reinvest in the business, and fund expansion plans.

Luckily, with payment options growing in sophistication, so too have the solutions for helping finance teams manage cash application. By harnessing powerful tools such as AI and machine learning, you can **transform your AR team's cash application problems into smart processes** that are faster, more accurate, and more efficient, thereby improving your cash flow, bottom line, employee productivity, and customer experiences.

This guide will take you through all the steps of the cash application process and detail some of the key challenges finance teams face. You'll also learn how advanced cash application automation can transform your AR department to drive efficiency and make matching payments with open receivables simple and easy. This guide even offers tips on selecting the right partner for your advanced cash application automation solution.

# What is the order to cash cycle?

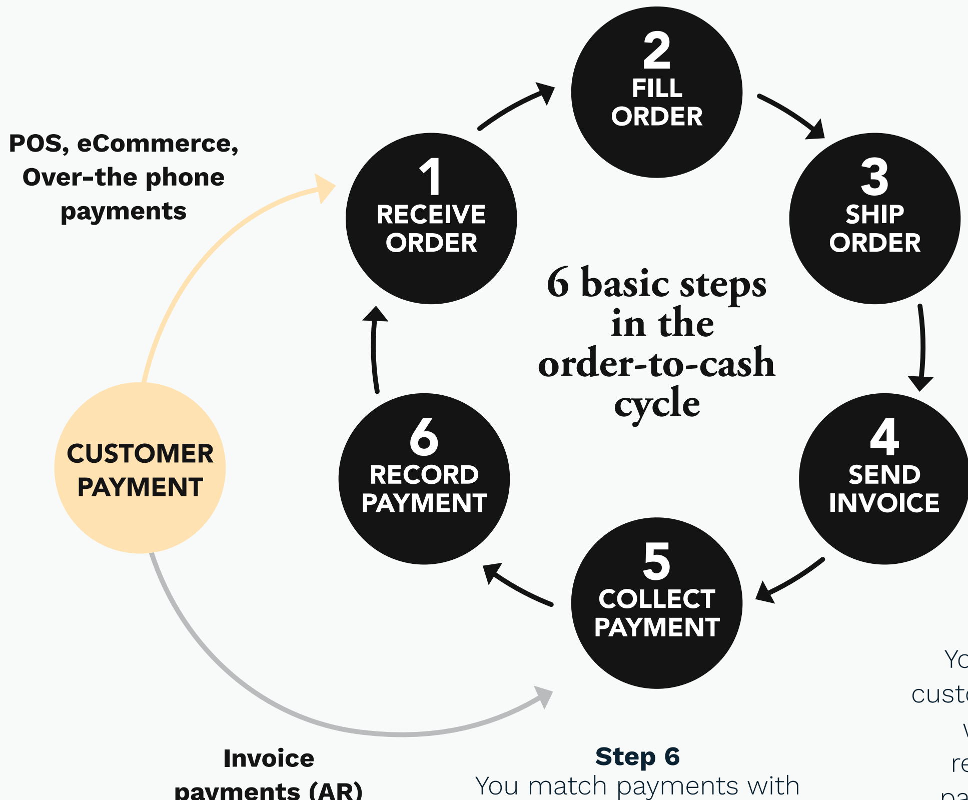
Cash application is one component of your holistic accounts receivable operation, belonging to a standard accounting process called **Order to Cash.** To understand more deeply what cash application is and why improving the way you manage it can significantly benefit your business, it's helpful to first comprehend order to cash. These are the steps taken from the time a customer places an order to when payment is collected and reported on. At its most basic definition, order to cash is the process of receiving and fulfilling customers' requests for goods and/or services and getting paid for them, recording payment, and managing the data.

Another term to be aware of is **Invoice to Cash** processing, which is a subset of the order to cash process—involving the steps taken from when you invoice your customers to when you collect and record payment.

**Step 1**
You **receive the customer's order.** This could be via email, internet, salesperson or some other form. It could be a simple one-time purchase request or an entire contract for goods and/or services.

**Step 2**
You **fill out their order** for the good or service. This needs to be documented with the specific details of the order and relayed to the appropriate department(s) that will be fulfilling the order.

**Step 3**
You **ship the order or fulfill the service.** This could be done through an internal department or a third-party such as the postal service, private delivery service or other subcontractors.




**Step 4**
You **prepare and send the invoice**. Once the product has been shipped and delivered, or the service performed, next comes the creation of an invoice that matches the specific order.

**Step 5**
You **collect payment** from the customer (often long after the order was received, or the service rendered). Payment methods, particularly electronic ones, are varied and can make cash application more challenging as remittances are often sent separate (if at all) from the digital payment.

**Step 6**
You match payments with the correct remittances, customer accounts, and receivable invoices, **record the payment** and enter it into your ERP.

The order to cash cycle is no small part of your company's success. Managed well, it plays an important role in your cash flow and your relationships with customers. Think of this cycle as a crucial part of your entire sales operation—you can sell as much as you like, but without proper invoicing and collections, you're not making revenue or profit, or able to apply your earnings to other aspects of the business. And without a solid cycle that delivers for your customer in a winning way, you're also unlikely to obtain repeat business or acquire referrals.

***What are the benefits of streamlining the order to cash process from start to finish?***

Businesses large and small face challenges when making sure payments are correctly posted—think of the times you needed to apply a discount, a customer paid multiple invoices at once, or a balance was paid through multiple accounts. Manually managing that can require a lot of work and there is potential for error, cost overruns, delays in getting paid, and customer dissatisfaction.

And while manual processes—often involving reams of paper and many labor hours—have been the standard in B2B accounting for decades, forward-thinking companies are now turning to technology and automated software solutions more than ever in order to drive greater efficiencies across the entire order to cash cycle, cash application included.

## Here are four benefits of streamlining and automating order to cash

**1.** Customers are served more quickly and efficiently

**2.** Fewer errors are made, and less delays are incurred

**3.** Cash flow is vastly accelerated

**4.** Data captured is more thoroughly analyzed, and opportunities for improvement are identified

***What two crucial functions of a business does efficient cash application impact?***

**1. Financials**—It increases straight through processing rates, lowers accounts receivable processing costs, reduces DSO, and results in more timely financial closing.

**2. Non-Financials**—It increases efficiencies and reduces time spent manually applying cash, enables the reallocation of resources to higher value work, and improves customer service.

While no two companies follow the same cash application process—because companies vary in nature, size, volume of customers, quantity of invoices, and delivery and payment methods—there are general steps common to most.

## What is cash application and how does it work?

Cash application is a process that's key to the entire order to cash cycle. It's the part of the AR process that involves matching incoming payments to remittance information and their corresponding invoices. It involves reviewing payments made by check, credit card, electronic fund transfer (EFT), automatic clearing house (ACH), and many other payment methods, matching them to open invoices and marking them as paid.

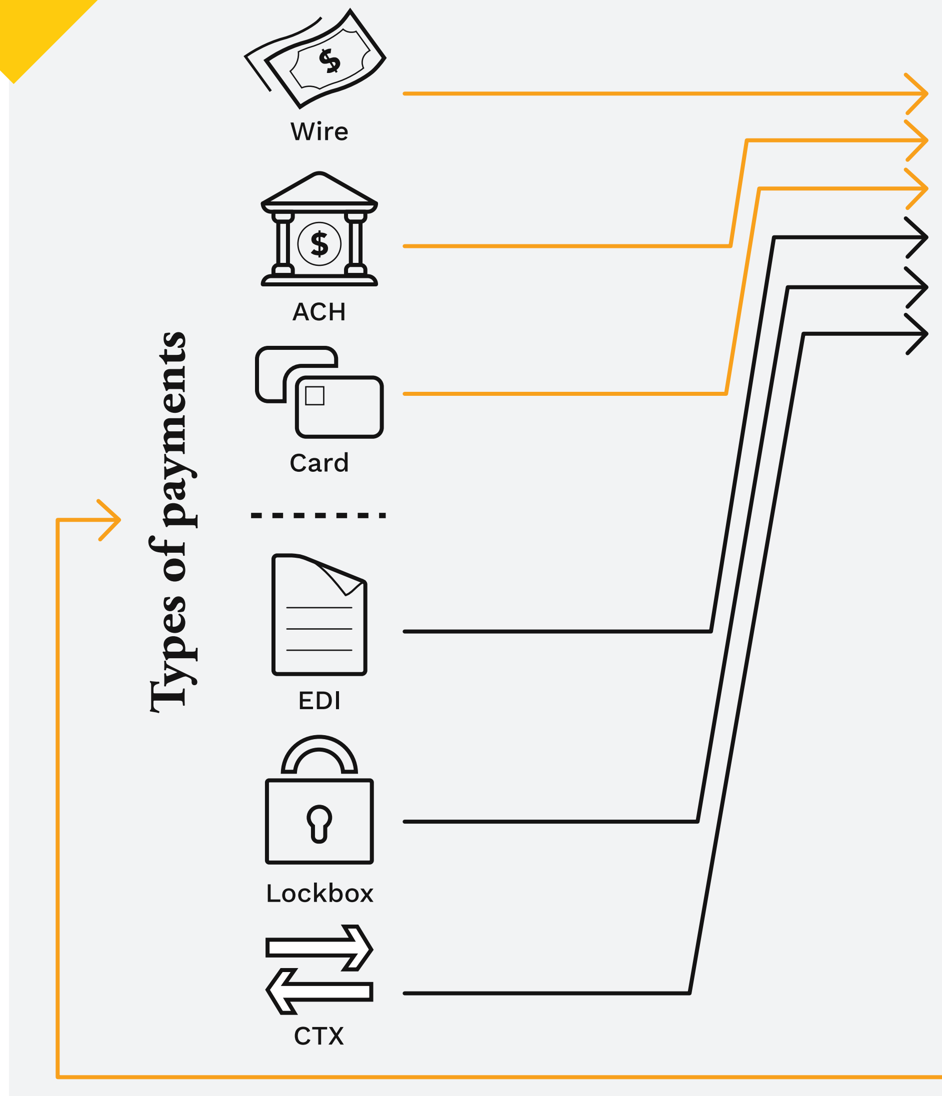
## What your cash application system should provide

**Accuracy**—Your accounts receivable should not have errors. Errors can lead to delays and poor customer experiences.

**Speed**—In applying cash more quickly, you're able to reduce your DSO, significantly lower AR processing costs, and ensure your business has access to its cash more quickly.

**Standardization**—Standard cash application processes eliminate inefficiencies and reduce compliance issues.

# The Cash Application Flowchart




## What are the 3 crucial pieces of data for cash application?

**Invoices** are the original bill that prompts payments to be made.

**Payments** are the funds transferred from your customer to you.

**Remittances** describe why a payment is being made (either through an invoice number or—in some cases—payment information detailing why a customer made a partial payment, whether discounts have been applied, or what the payment terms are).

So, you have a variety of payment sources and then a variety of remittance sources—and all that information needs to be matched up and reconciled.

**Step 1**

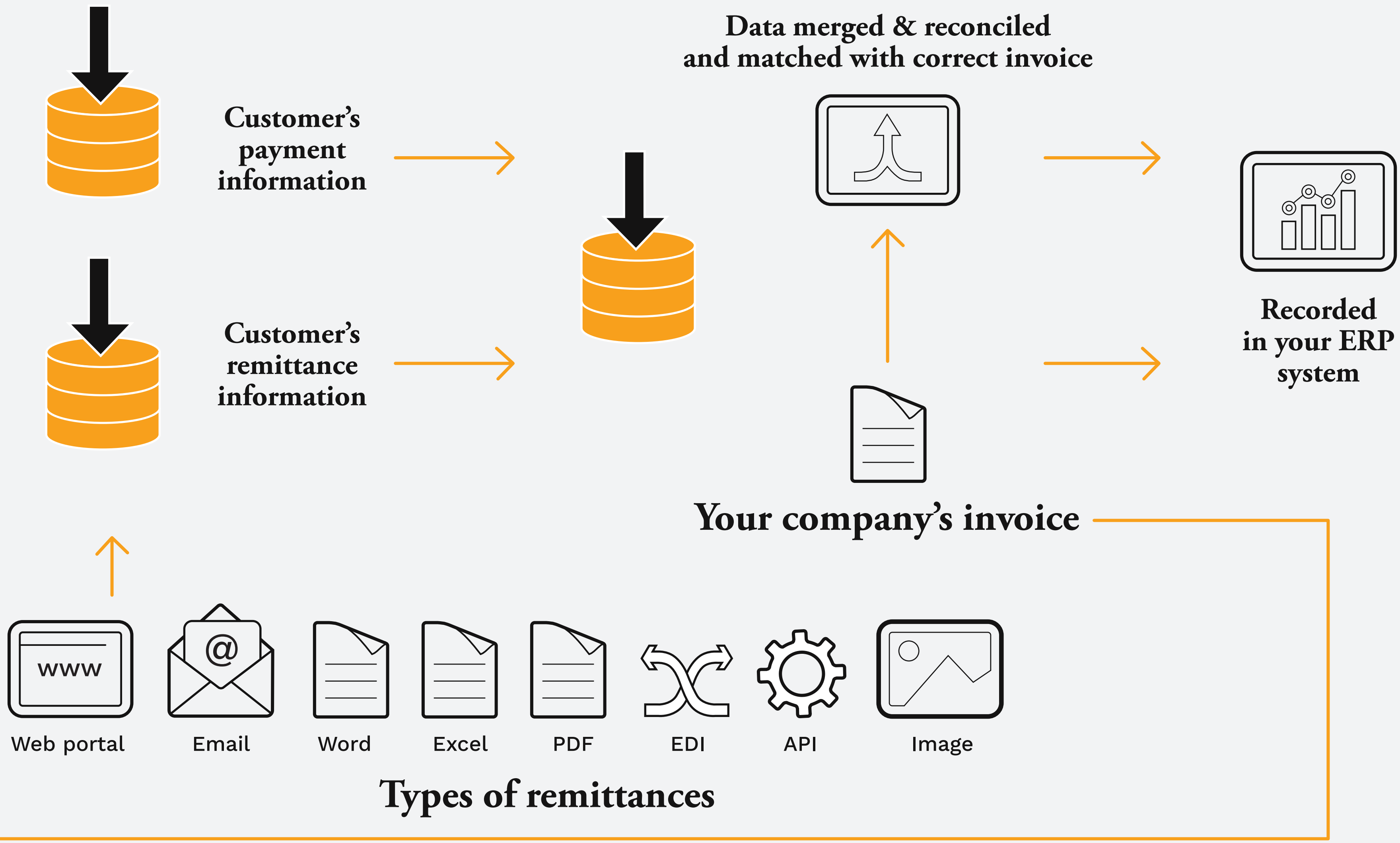
Your AR team **prepares an invoice** requesting payment for a goods or services order and sends it to your customer—via email, mail or courier, fax, cloud-based portal or in person.

**Step 2**

You **receive a payment** via a check, wire transfer, credit card payment, automated clearing house (ACH), electronic data interchange (EDI) or corporate trade exchange (CTX).

**Step 3**

Your **customer sends remittances** (which specify why the payment was made or for what invoices) either with the payment in the case of checks or separately via emails, Excel files, PDFs, web portals or image scans.




**Step 4**

**All the data needs to be reconciled** to ensure the information from the invoices and remittances matches with the payments made, either manually or through an automated process. Any discrepancies (for instance in the event a customer has made a partial payment) need to be investigated and resolved.

**Step 5**

Once reconciled, the payment **gets officially recorded** in your company's enterprise resource planning (ERP) system, where day-to-day business operations such as accounting are managed.

**Step 6**

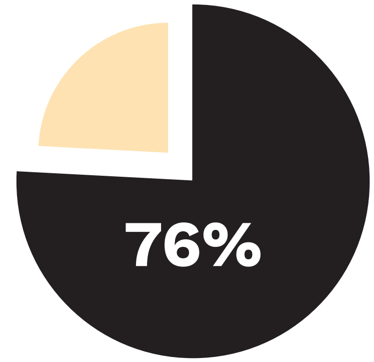
The **finished work and process is reviewed** to look for any ways to optimize it. Your AR team might also send receipt of payment to customers.

## How are payment trends changing and what is the impact on cash application?

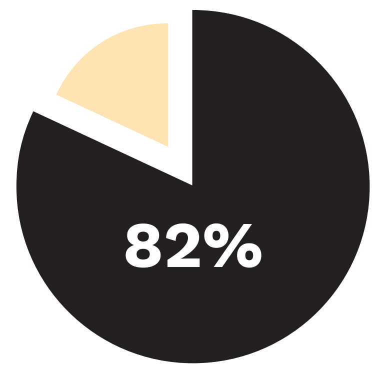
Electronic payments have a long history—dating back to 1871 when Western Union debuted the first EFT and the 1910s, when the Federal Reserve began using the telegraph to transfer money. In 1959, American Express introduced the world to the first plastic card for electronic payments and, in 1972, the Automated Clearing House (ACH) was developed to batch process large volumes of transactions. But the rise of the Internet, cloud technology and online payment service options changed the game even further.

The move to digital payments has been fueled by such factors as the need for cost savings and improved efficiency (ACH payments are cheaper and take less time to process than checks), the need for improved cash management and reporting capabilities, regulations making electronic payment methods easier and more secure, large players like Walmart and Amazon mandating digital payments with suppliers and customers, and the general growth of ecommerce in the B2B space. Customers, too, are driving this trend with increased demand to pay using digital methods that they are accustomed to using as consumers, which is more convenient and results in a better customer experience.

With payment trends increasingly going digital due to COVID-19 restrictions, AR departments and their cash application processes are undergoing a massive shift. Moreover, as the crisis increased payment delays and extended DSOs, more executives are looking for opportunities to optimize their AR practices.




the percentage of business that say the COVID-19 pandemic has pushed them towards digital payments




the percentage of businesses that say they're changing their processes for sending and receiving payments

**7.1 billion**
the number of ACH payments made in the U.S. in the first quarter of 2021, up 11.2% from the same period in 2020

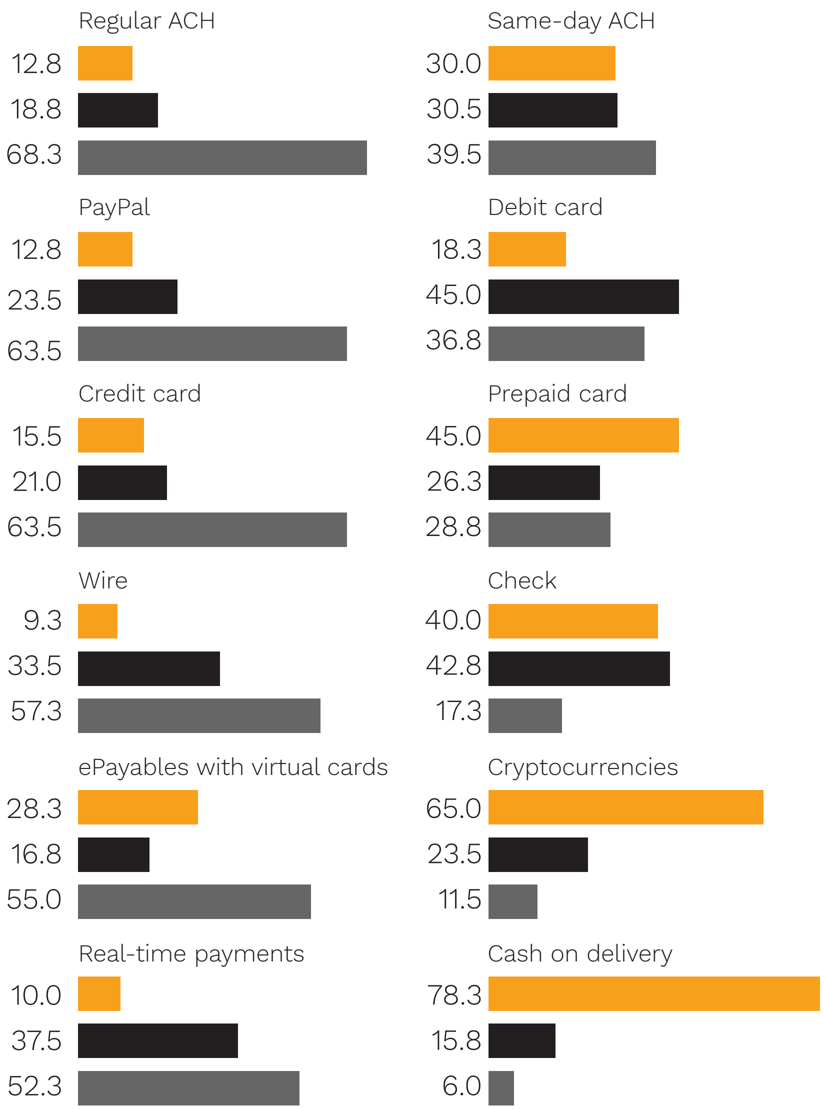
**$17.3 trillion**
the value of those ACH payments in the first quarter of 2021, up 19% from a year earlier

**118 million**
the ACH daily average volume record set in February 2021

# The shift in payment methods

Share of CFOs who say select payment types became less or more frequent due to digitization

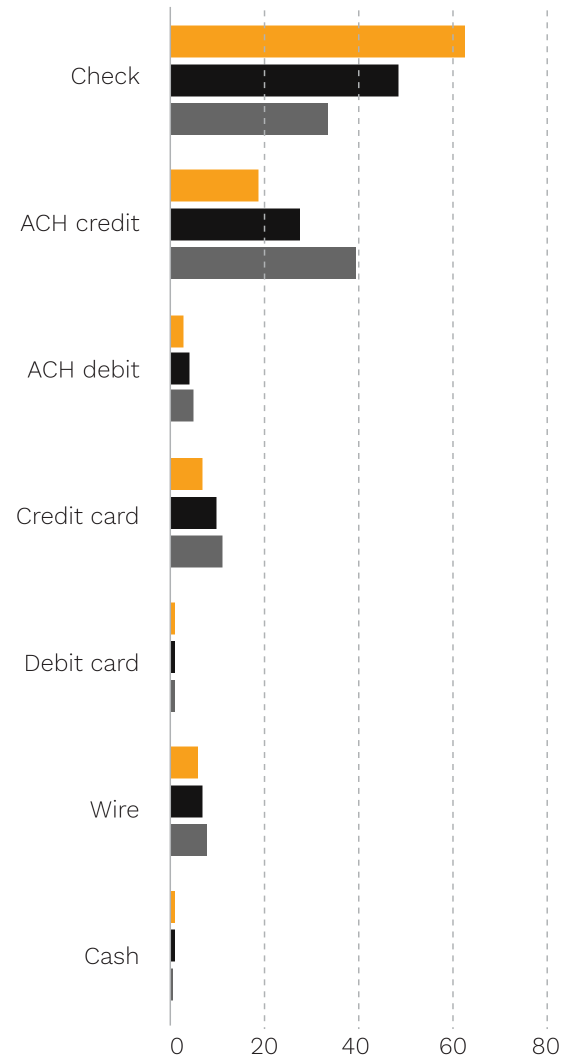
**This type of payment is used...**
- less frequently
- same type of frequency as before
- more frequently




Source: PYMNTS.com | Versapay 'The Strategic Role of the CFO

# Payment trends

- 2014
- 2017
- 2020




Source: Payment Trends, Preferences & What Works for Credit-Receivables Professionals, NACHA-CRF Survey

**"Checks have historically been the primary payment method for B2B payments for many decades. With remote work and AP automation on the rise, suppliers are experiencing a dramatic shift toward digital payments and remittances. Whether it be checks, ACH, credit card or virtual card, this shift puts a significant strain on AR departments to reconcile and apply incoming payments and remittances to invoices."**

Chad Nicholson,
Director, Strategy, Versapay

**"When payments are not automatically applied to invoices, the impact is significant. It costs staff time, delays access to cash, ties up customer credit with open invoices, and creates customer frustration the longer payments sit unapplied. Automated and effective cash application saves money, improves cashflow, and improves customer satisfaction."**

**John Warner,**
Vice President, Sales Engineering, Versapay

## What are the challenges and complexities associated with cash application?

The goals and basic steps of cash application may sound simple, but there are many players involved—accountants, data entry clerks, bank personnel, postal and delivery workers, IT support workers, as well as software like payment processors and ERPs. When it's done manually, cash application is labor-intensive, with many specialists relying on Excel to perform data entry and analysis. The nature of these processes is time-consuming and prone to errors, leading to losses in productivity and increases in costs. These are the challenges you'll want to conquer in your cash application process.

If your B2B operation is small—fewer than 1,000 invoices processed each month—the complexities of cash application might not be as onerous, even with a manual system. But what if you have thousands of customers, operating in different jurisdictions and whose payment methods, such as ACH, have remittances that arrive separately from multiple sources? Another somewhat recent challenge for AR departments has been extracting remittances from web portals, which started when many large operators such as Walmart and Amazon set up web portals as a cheaper way to deliver remittances, forcing suppliers to comply.

All these nuances and complexities can make it difficult to track what information corresponds with what. As well, errors and payment processing delays are more likely to occur, affecting how much capital your business has available to use in its operations. Even if there aren't errors, the time and energy spent on manual cash application could be better utilized elsewhere in your business.

**Complex payment methods**

Certain electronic payment methods, like ACH, add a level of complexity because the remittance arrives separately from the payment and it's not always obvious what it corresponds to. Trying to link them up manually is time-consuming and labor-intensive.

**Manual linking of customer payments with remittances**

When customers pay electronically, their remittances are sent via emails, EDIs or uploaded to their AP portals. If your team must manually download remittance information from various sources in various formats and match them to the corresponding payments, that's work that eats up a lot of time and reduces the efficiency of your team.

**Manual linking of invoices with different remittance details**

This can be fraught with problems. If your team must match invoices with payments based on invoice numbers, purchase order numbers, shipment details and payment information is missing, then forensic work needs to be done. The customer might have to be contacted and the entire payment process gets delayed, costing your business money and time.

**Partial payments or payment exceptions**

Customers don't always pay in full. That might be because the order or payment is in dispute or there's an agreed-upon promotion or discount. These kinds of exceptions, in which the payment might not 'match' the invoice amount, can cause headaches for your cash application team as they must search for the reason for the discrepancy and then appropriately record them in the ERP.

**Lockbox fees**

Lockbox services offered by banks collate all the checks from a single customer in one place—processing every check and keying in all the information electronically which is then shared with your cash application team. But these services are charged based on keystrokes—which not only gets expensive but can introduce yet more errors and demand further forensic research.

**Impacts on other departments and processes**

Delays in cash application can affect other AR processes. Imagine if payments that were expected to be applied on a certain day were delayed. This delay could trigger the collections process, thereby notifying your customers, potentially affecting their credit. Your customer would not likely be pleased.

## What challenges might you face when matching payments with open receivables?

## How do you measure the effectiveness of your cash application efforts?

As you can see from some of the challenges we've discussed, or perhaps from your own painful experiences with cash application, highly manual and inefficient processes harm your business and create poor customer experiences.

***What are the signs you need help?***

If you're noticing any of these symptoms in your organization, you should look into a better cash application solution:

1. Complications from an increase of electronic payments—such as remittance data being sent separately from payments or not at all—single payments being made for multiple invoices, partial payments, and the time and resource requirements involved with retrieving remittances from web portals. You might also notice that these difficulties are preventing your organization from embracing a diverse mix of payments—further emphasizing a reliance on checks.
2. There's little automation within your reconciliation activities and/or a lack of IT support.
3. You have several unapplied payments that haven't been matched to outstanding invoices. For example, if your customer pays you $100 for Invoice #111, but there is no open Invoice #111, then that $100 is an unapplied payment.
4. A lack of high-level reporting capabilities is resulting in difficulty determining what payments are left to be applied.
5. Multiple customers are reporting payment issues, such as receiving outstanding invoice notices even though they have paid or missed discounts. Poor customer feedback increases the more frequently cash is applied improperly.
6. Your cash application team is stressed out.

***How can you monitor if your cash application efforts are working well?***

**The speed at which payments are being applied**—Once remittance data has been received, how quickly are payments being applied? Is it the same day? The next day? The following week? Ideally cash is applied as quickly as possible. The longer cash goes unapplied, the less readily available cash you'll have on hand.

**Whether or not cash application errors are present**—The more payments you receive, the higher the likelihood of cash application errors occurring. While cash application specialists are exceedingly diligent, meticulous and thorough, any matching work that's performed manually is still subject to errors. Automation can significantly decrease the likelihood of errors—striving for zero errors is recommended.

**The volume of remittances received**—A lack of remittance data means further clarification is required on behalf of the cash application specialist before they're able to match payments with the correct customer account and open receivable. To prevent slowing down the cash application process, you'll want to monitor what percentage of payments are received without remittance data and work at reducing that volume.

# What are some advanced automation approaches?

**OCR Template Approach:**

- Ingests data from lockbox files.
- Mines AP portals and emails for remittance data.
- Configures payment application rules.
- Matches buyer codes with supplier codes.

**AI-Based OCR Approach:**

- Uses intelligent OCR and machine learning to quickly match payments to invoices without manual intervention.
- Works with all these formats: traditional checks, image scans, lockbox files, wire transfers, emails, ACH, ETF, and AP web portals.
- Streamlines exception handling—identifying payments that need human intervention and offering collaboration tools.

## What is advanced cash application automation and how does it work?

Improving the cash application process has become increasingly important. The solution lies in advanced cash application automation tools that reduce the amount of time, money, and resources previously needed for manual cash application.

***How do the most sophisticated advanced cash application automation solutions work?***

Advanced automation in cash application has become increasingly sophisticated, using modern technologies such as robotic process automation (RPA), artificial intelligence (AI), and other machine learning capabilities. These can help you retrieve and aggregate remittances from various sources, such as emails and web portals, and put them all into a centralized archive, sparing cash application teams from having to go through many sources of remittances manually. These smart technologies can also match invoices, automatically identify and validate deductions and discounts, and map customer reason codes back to ERPs.

Optical character recognition (OCR) technology helps auto-extract check stub information with ease and accuracy, by either using templates to map out which regions of an image contain needed data or with AI to search for specific items that indicate areas of interest. With AI, the longer and more often an advanced cash application system is used, the more it learns and becomes smarter over time.

***What are the benefits of advanced cash application automation over manual application?***

**It's faster**—The faster payments are matched to invoices and remittances, the faster a company can use that cash for business expenses. As soon as an invoice is marked as paid, the customer's credit is replenished, and they can buy more.

**It's smarter**—Manual cash application errors can lead to negative customer experiences and disruptions to cash flow. Advanced cash application automation greatly reduces error. It helps companies accept a greater variety of payment channels more easily, helping them meet their customers' payment preferences.

**It's scalable**—Advanced cash application automation allows companies to be flexible in their payment acceptance policies. If market conditions are pushing customers to want to pay with credit cards, for example, a company with automated cash application can easily accommodate them. Companies with automated cash application can serve their growing customer base without needing to increase their AR budget or team size.

**It's more efficient and cost-effective**—Fewer human resources deployed to tedious, manual tasks allows you to:

- Reduce the total time spent on cash application by up to 75%
- Reduce AR costs by up to 50%
- Centralize 100% of your invoice-to-cash process
- Maintain existing AR staff levels while gaining 3X the business growth

**It results in higher customer satisfaction rates**—When your system is faster and more accurate, there are fewer disputes, and your customers are more open to using additional payment methods. The simpler the payment process is for them, the fewer hurdles they'll face in paying. Also, by automatically capturing reasons for deviations from invoice amounts, it's easier to offer flexible payment rules so you can incentivize customers with discounts or other perks if they pay early, reducing your AR aging.

**It offers more transparency and accountability**—Advanced cash application automation software that encourages collaboration between you and your customers over the cloud lets your entire team interact with one another and customers in real time, speeding up any delays, handling problems, and delivering a better experience.

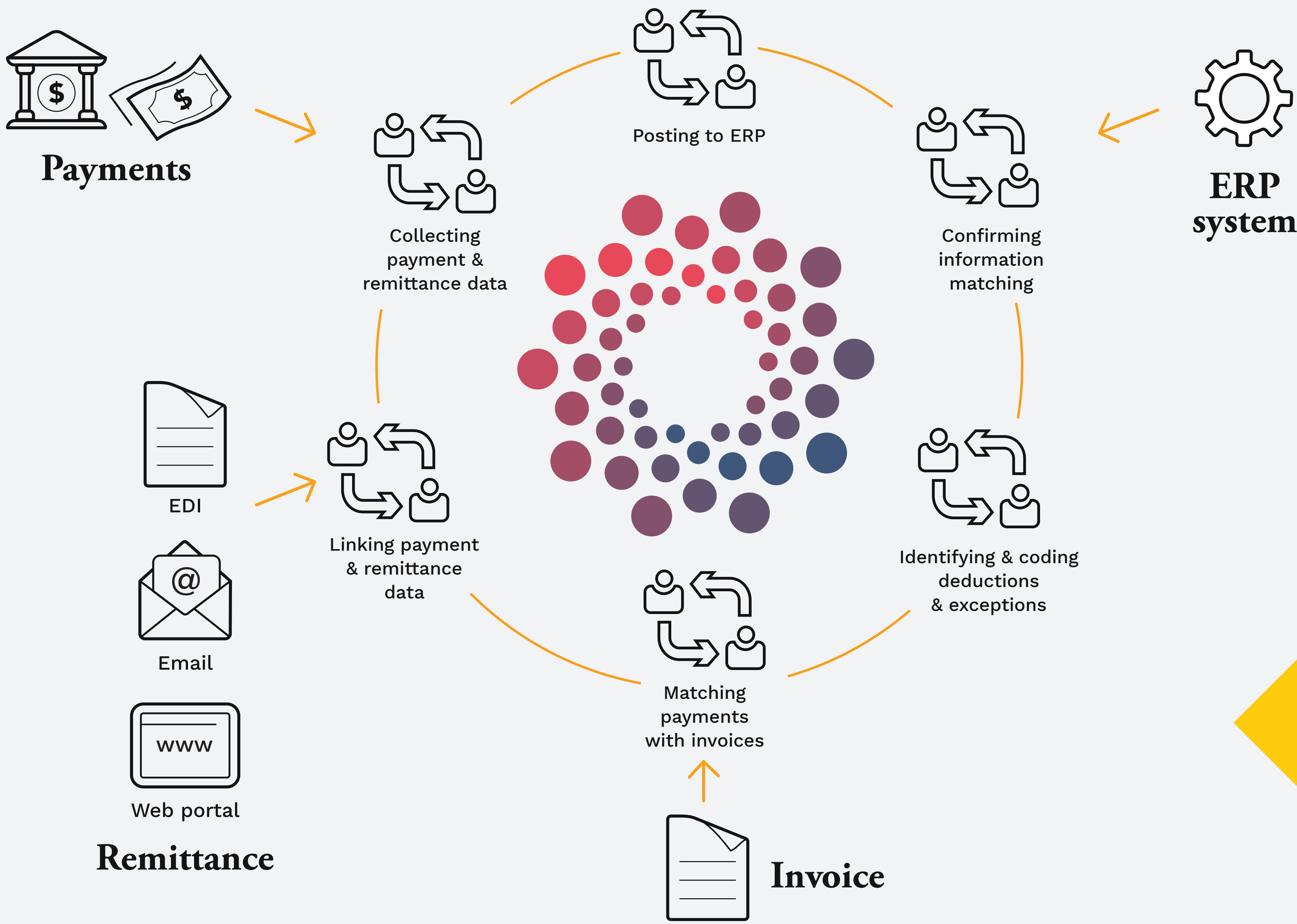
**It generates an audit trail**—All your processes and interactions with customers are recorded, making notes of any credit terms, payment deadlines, late payment charges or discounts.

**It allows for more accurate and meaningful financial reporting**—With advanced cash application automation solutions, senior management can access dashboards and reports to analyze the process' performance and look for ways to optimize it.

**"An efficient cash application process improves cash flow, productivity and customer satisfaction. Automation reduces manual review and applies payments to accounts more quickly, improving cash flow and replenishing customer credit. A collaborative portal further improves your cash application efforts by centralizing all payments and communications (whether digital or paper), empowering your customers via self-service and making it easy to work with you."**

John Warner,
Vice President, Sales Engineering, Versapay

# Where automation can help you



# What should you look for in an advanced cash application automation solution?

The best cash application solutions solve all the challenges discussed in this guide and drive major efficiency improvements by automating the majority of manual work. That way you can reap the benefits—resulting in a better operation for you and your customers.

***The cash application checklist:***

**A smart, efficient and high-tech matching system that gives you all the tools you need**
You want to be able to customize your matching to your specific needs. Great matching systems can match **90%+** of your payments and handle millions of transactions quickly. Examples of technology and tools you want to look for are:

- OCR and AI technology
- Remittance scraping tools
- Short payment identification and application of reason codes
- Configurable payment application rules
- Exception handling
- Open AR invoice mapping and automatic EDI parsing

**Ability to import and aggregate data from various sources**
Whether it's traditional checks, image scans, lockbox files, wire transfers, emails, ACH, ETF or AP web portals, your software should be able to aggregate and import the remittance information you need from any payment source.

**Continued improvements**
Your software should learn your customers' banks, payment information, and habits over time to improve their matching. After doing something once manually, the system should learn.

**Reporting**
Visual, customizable, and easy-to-understand dashboards and other analytics tools will help your AR department be more efficient and give executives useful high-level information.

Great matching systems can match 90%+ of your payments and handle millions of transactions quickly

**User audit trail**

Your software should include a strong trail of what all your users are doing, helping you track down errors when they occur.

**Platform scalability**

This feature is crucial as it determines the long-term value of your software, saving both time and money in the long run. A scalable system doesn't have to be redesigned for optimal performance during or after a big increase in workload such as number of users, transactions, or storage capacity that pushes it past its original capacity. It allows you to purchase what you need at the outset and scale up with more functionality that can be added to it, rather than having to deal with multiple programs or switch to a new system. Also, you want to be able to scale the levels of automation you need or want.

**Bank integration**

Your software should offer banking integration (also known as bank reconciliation), which is the process of linking each of your customers' financial accounts in one place in your ERP. It should be able to handle different currencies and transcend borders.

**ERP compatibility**

The cash application solution you choose must be compatible with your ERP—or have an open API that allows for building a connection—or else the end stage of posting payments to your ERP will still be relegated to a manual process and your financial reporting won't reflect the real-time status of accounts.  You need your cash application software to not only reconcile across multiple environments but also post to your ERP system.

**Vendor support and resources**

You don't want to work with an advanced cash application vendor that just sells you the product and walks away. You'll want support not only during the implementation of the solution, but post-implementation on an ongoing basis, providing your team with a team in place to offer additional and ongoing general support, training and troubleshooting.

## Introduce automated cash application into your AR process today

Cash application is an important part of your business but doing it manually brings challenges, such as decreased speed and accuracy, longer DSO, less working capital when you might need it most, and compromised relationships with your customers.

Digitization is enabling the use and acceptance of more digital payment methods—a shift that delivers to customers a more integrated and enjoyable payment experience and that gets suppliers paid faster and drives higher retention rates and sales growth. However, with this rise of digital payment systems, cash application has become much more complex, making manual processes even harder.

With advanced cash application automation technology, you're able to harness powerful high-tech tools that can make your cash application process smarter, faster, and stronger. Matching payments with remittance data for cash and account reconciliation should be easy, and the software you evaluate should substantially increase the efficiency of your accounts receivable teams. You'll want to partner with a cash application automation provider who understands your needs and will help you move your business forward.

If you're looking for a better cash application process, Versapay can help. **Visit www.versapay.com** to learn more about our advanced cash application automation solutions and contact us for a free demo or consultation.

"Inefficient and antiquated AR operations have company-wide implications. We've repeatedly seen instances where invoices of minimal dollar value take 75+ days to collect, and multiple departments outside of Finance are called in to assist. To remain competitive, companies must transform their AR department—especially their cash application processes! The costs and challenges of not doing so are too great."

**Carrie Barkes,** CFO, Versapay