Best-practice Guide to Intercompany Reconciliation

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Key Factors to the Successful Settling of Accounts Receivable and Accounts Payable

There are many ways to reconciling a corporate’s accounts at the end of a month, a period or a financial year. How efficient in terms of costs, time and risks the different options are and which type of company can benefit best from which option, will be the focal point of this paper.

Now that the time has come for the annual reports, corporates are involved with reconciling the accounts. Just as with monthly reports, it is often a challenge and a lot of work to achieve balanced accounts as there may be invoices for which no payment can be found, the invoiced amounts are different, fees and discounts have to be taken into consideration as well as exchange rate differences.

For many organisations there is great optimisation potential in the intercompany reconciliation at the end of each period. To unlock this optimisation potential, companies should implement best practices. In doing so, corporate treasurers and cash managers will benefit from significant efficiency gains to intercompany settlement as they can optimise liquidity and reduce risks and costs. It will be easier to achieve balanced figures at the end of each period and to produce reliable financial reports.

Often, for nationally operating companies there can be optimisation but as soon as there are more entities in different countries and currencies, the process becomes significantly more complex. It is not uncommon that the reconciliation is carried out via external bank accounts. Although being a very straight-forward process, this frequently leads to high service fees and exchange differences and a high number of banks has to be maintained. It is advisable to implement professional solutions that allow for an effective and cost-efficient reconciliation processes.

This best-practice guide will have a look at the different types of reconciliation processes and options there are for corporates and provide guidance on how to find the best solution for the individual company setting.

Intercompany Reconciliation in Different Corporate Settings:

A Company with only one or a few Entities, one Currency, one System

If the head office and the entities all use the same ERP system, the reconciliation can be carried out simply via this system, as it provides a central overview. In case of any disagreements between the entities concerning an invoice, however, this approach does have limitations. If one entity questions the correctness of an invoice, or if there are inconsistencies due to exchange rate differences or different accounting periods, such disputes need to be settled in order to achieve balanced accounts. Usually, the two parties involved in the dispute exchange e-mails including the relevant attachments. It may be difficult to keep track of the status of the clarification with increasing numbers of e-mails exchanged, and – more importantly – sending the documents in question via e-mail is usually not fully compliant with government regulations or accounting standards. This requires a solution that enables full audit trails for such cases.

A Company with Multiple Entities, High Number of Transactions, Several Currencies, Different Systems

As long as there is a homogenous IT landscape in place at the company, the ERP system serves its purpose well in terms of reconciling the corporate’s accounts. However, as soon as there are a number of different systems in use at the company, the situation becomes less straightforward. Instead of following automated processes of the ERP system, the company now has to collect all relevant data from its different entities. Usually, different e-mails, forms or spreadsheets are used for the collection and lead to manual processes. Thus the settling of accounts between the entities becomes time consuming and increasingly risk prone. This also leads to rather decentralised processes where a central process would be more beneficial to the company. A central payment platform or payment factory that is both integrated in the central ERP system and able to include all the different systems in use at the entities can bring the desired centralised and integrated approach. Such a solution provides key features that simplify the reconciliation processes: Due to the central approach, all invoices and payments can be viewed and reconciled centrally. Instead of each entity paying invoices locally via an external bank account, corporates can bundle such payments centrally and even carry out payments-on-behalf of their local entities thereby reducing the number of external transactions and thus saving banking fees. Payments abroad can be turned into domestic payments, and internal liabilities and debt claims can be settled via this centralised payment factory approach. Prerequisite for such a solution is a central hub in the company which in fact, acts as an in-house bank for all entities.
Key Benefits of a Payment Factory for End-of-Period Settlements

- Centralisation of transactions
- Better corporate-wide overview of payment flows
- Automated processes even for heterogeneous system landscapes
- Reduced number of transactions and safe bank communication, particularly in case of integrated solutions

Payment factories significantly optimise the payment processes and bank communication of a corporate, however, they usually do not focus on solutions for solving any disputes and thus, there are still a number of manual processes involved in the communication between the different parties to finalise the settlement. Expanding the payment hub by integrating a netting solution can bring the desired tool for a professional dispute settlement, particularly when the corporate has many entities with different systems.

How does such a solution work and what are the general benefits of a netting solution? Multilateral netting provides the largest benefits for a multinational company. A central treasury is required to bundle the liabilities and debt claims of the individual entities and settle them against each other. That way, each entity only has to deal with one counterparty, i.e. the treasury centre, instead of a multitude of fellow subsidiaries. During a typical netting cycle – usually once a month – all participating entities of a corporate thus state all liabilities and debt claims to a central treasury centre. In doing so, they provide all the required details including payee or payer, invoice number, billing amount and the relevant currency to the treasury centre. The centre usually maintains, for a certain period of time, a constant exchange rate for the settlement which serves to determine the respective net debt or net assets of each entity. Subsequently, the resulting net amounts are converted back into the different local currencies to finally reconcile all the positions. Only the remaining clearing amounts are physically transferred and settled.

Hence, the netting process brings added value to the company as it can significantly reduces the number of bank accounts and banks required as the number of transactions is reduced to one single cash flow per entity – this process is called multilateral netting. While also bilateral netting between the individual entities is possible and already brings benefits to the settlement process, the greatest savings can be achieved with the earlier described multilateral netting. Saving bank transaction fees is not the only positive effect; even larger savings are achieved in terms of exchange rate effects, and, moreover, the individual entities can focus on their core business while leaving any currency risks with the central treasury. In order to fully benefit from all these effects, the treasury centre plays a key role in ensuring that all positions have been settled correctly. If any disputes arise, it would be quite complicated for the treasurer to handle such disputes by exchanging e-mails with the different entities involved. As mentioned above, such a procedure is difficult to oversee and is likely to be not in compliance with regulations.

Netting, on the other side, is more focused on solving any disputes than a payment factory and solutions usually provide specific dispute management features that automate the verification process of the different positions. With such a feature, disputes can be initialised automatically (matching process) when, for example, a debt claim is found by the system but no matching liability can be automatically identified. A dispute management case should be able, of course, to be launched manually. A professional solution allows the central treasury to maintain a clear overview of the number and amounts of the receivables and payables. Automatic processes can be steered via different escalation levels that involve different groups of persons. The features should include the possibility to conduct test runs prior to the final netting settlement.

When implementing a netting solution, corporates need to take into account that some country regulations limit the use of netting. A professional solution should enable the country-specific setting of netting rules to maintain automatic processes.
Key Benefits of Netting Solutions for End-of-Period Settlements

- Balanced figures at the end of each accounting period
- Easy dispute management
- Improved internal payment discipline
- Significant reduction of exchange rate effects
- Optimisation of cash flows
- Avoiding “Cash in Transit” positions (particularly at the end of the month)
- More efficient allocation of liquidity within the Group Treasury

So, how to go about the search for a solution that suits the corporate situation best? In the following chapter, some key criteria are described that will help to focus the search.

Technology Solutions – What to Look for

A sound analysis of the company structure, transaction flows, banks, business partners, and objectives should be the starting point for any decision. When evaluating the different options, corporates should look for the following key criteria to find the right payment factory or netting solution for the company:

- A solution that is fully embedded in your central ERP system and that can integrate all your other systems
- Automated processes and workflows to eliminate manual handling
- An intuitive surface ensures user-friendliness
- Support of auditable and compliant processes
- Flexible customising helps to respond to the individual corporate requirements

Conclusion

As described in this paper, it can be said that the more complex and global the company structure, the more beneficial is the implementation of specialised solutions that enable a full netting cycle and an efficient dispute management. As a result, companies can drive significant efficiency gains: By deploying a netting solution, corporates can significantly reduce the number of financial transactions via external bank accounts as well as the number of bank accounts, and subsequently save on bank service fees. An even larger positive impact is achieved by reducing the exchange rate exposure: by reconciling the majority of internal transactions via internal accounts, only small sums will be left for transferring via external bank accounts and using the exchange rates on the market. When looking to implement a professional solution, corporates should ensure that the solution can be fully embedded into their ERP system and integrate all other systems of the company. If all entities can be included in the payment factory or netting solutions, processes can be automated and optimised across the entire company and bring the greatest benefits.

The Benefits of Netting:

Previously: innumerable bilateral relations and transactions between the entities

With (multilateral) netting: one entity becomes the central treasury centre via which all others settle their accounts in order to reduce the number of transactions
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