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Bank Account Reconciliation Best Practices

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AFP Members and Guests:

We are pleased to provide the second installment in the *2014 AFP Treasury in Practice* content series. The subject of this guide is Bank Account Reconciliation, and it provides valuable insights on account mix and structure decisions, account-level controls, fraud prevention and much more.

KeyBank sponsors the *2014 AFP Treasury in Practice* content series as part of our commitment to providing treasury professionals with the latest industry insights. The series covers the latest thought leadership on important topics along with practical information on ways to strengthen treasury operations. A total of six guides will be released throughout the year.

We hope that you enjoy this installment in the series and as always, your feedback is welcome.

Best Regards,
Clark H Khayat
EVP, Enterprise Commercial Payments

Bank Account Reconciliation Best Practices

Advances in bank account reconciliation, along with expansion of the types of information banks can provide their customers, have made it much easier for companies to match their cash accounts to bank records. By automating the reconciliation process, treasury can identify discrepancies quickly, free up time to focus on more strategic issues, and better manage liquidity. And, by reconciling accounts daily, the monthly "hard" reconciliation becomes a much easier and less time-consuming process.

Best Practice Tips

Rationalize account structure. "We spent the past 18 months getting our arms around how many bank accounts are out there, and what activity takes place in each account," said the team lead of the insurance company. "We're looking at BAI files daily," she said. Treasury takes 10-15 accounts monthly and reviews them at the granular level. "We look at all activity, charges, contact information, and fee agreements." They do this in order to ensure that the right accounts have the right level of services, as well as to determine if new accounts that need to be opened or established accounts need to be closed. "Hopefully we will find accounts we can close. The goal is to reduce bank fees and to simplify reconciliation. You can't change what you don't know."

Identify Fraud. When reviewing exceptions "you need to be diligent," said Rosenberger. "Fraud prevention is very important." In the past, companies assumed fraud prevention was the bank's responsibility. She noted that everyone who's involved in the payment cycle has responsibility for fraud prevention. "If you get hit, it costs both time and money," she said. "Be knowledgeable about fraud and take advantage of the services that are available."

Automate. "As automation gets better, companies are becoming less reliant on their banks," Rosenberger said. "Banks will have to produce the data companies need, whether it's checks, ACH or wires, but clients will load the data and do their own reconciliation within their system. That process will continue to evolve, which puts pressure on banks to supply the right data in the right format."

Identify discrepancies quickly. "The daily routine is very important," the cash manager at the Canadian company said. "The sooner discrepancies are discovered and researched, the quicker they tend to be resolved."

Make it part of your routine. According to Durkin, every organization should make the reconciliation process part of its regular reporting and review process. "Talk to you bank about upgrading and leveraging the capabilities of your existing TMS and/or ERP," he said. "It's necessary to have a dialogue with your banking partners about making reconciliation part of the bank practice review and treasury scorecard."

Optimize account structure

"The first thing to do is go through the account structure," said Tom Durkin, managing director at Bank of America. "The key is to get clear agreement and, most importantly, to discuss how clients can move it [account structure] toward automatic reconciliation."

It could be a physical Zero Balance Account (ZBA) structure in the United States, Durkin said, or an international notional structure. "There has to be an agreement between the client and the bank in terms of where they want to go," he said. "The account structure defines how much granular detail they want and how much data they need."

According to Rosanne Rosenberger, senior product manager of enterprise commercial payments at KeyBank, a lot depends on the size of the client's organization—for example, bank account structure is more complex for larger organizations operating in different industries or geographic locations. The bank often works with companies to help them figure out the right mix of accounts for their organization, as well as to establish necessary controls for access and fraud prevention in each account.

Account structure also depends on what business the company is in. Some companies, such as real estate firms, have multiple legal entities and corresponding accounts for each. In that case, "opening different accounts to handle different transactions doesn't make sense," Rosenberger said. "You can't have three or four accounts for each legal entity. The structure has to make sense for the business they're in and what they're trying to accomplish as a company."

The process of bank rationalization, a process to concentrate accounts across a smaller number of banks, can help standardize the account reconciliation processes and lower costs, according to Durkin. Use of industry standard formats such as the ISO 20022 XML can help further reduce the complexity involved in locating critical data to perform automated reconciliation. A potential drawback is that over-consolidation of accounts limits the opportunity to enforce segregation of access to account details.

"In general, the fewer accounts the better," said John Snyder, vice president of business development at Chesapeake System Solutions, a provider of reconciliation software. "As long as the company has a way to segregate data as needed within each account."

To facilitate reconciliation, companies can consolidate their accounts with fewer banks and create an account hierarchy. "If you have multiple accounts, group them together," Snyder said. "Then take those and roll up the reconciliation; if there's a discrepancy, companies can [more easily] drill down to the subaccount level."

A senior accountant and team lead for an insurance company with 250 enterprise-wide accounts in 10-12 different banks said her company uses ZBA accounts. "We have some money market accounts and separate accounts for payroll, AP, AR and credit cards. That structure evolved over time," she said. The company is now focused on centralizing and consolidating those accounts, which may mean maintaining separate accounts for separate activities, e.g., a disbursement account and an AR account. "But we will have one instead of five," she said. "The information we can now get from the bank does not necessitate so many bank accounts."

Make reconciliation a daily task

The most common use of the term is in reference to a periodic settlement between the book record and the cash record. While a "hard" recon is commonly done once a month, "it's critical that you keep up with daily activities and identify exceptions," Synder said. "Do a mini reconciliation every day and ensure the final settlement syncs with the accounting period."

"Clients typically get a recon file from their bank every month, matching their DDA statement cycle," said KeyBank's Rosenberger. "But I can't stress enough that from a transaction standpoint, no matter the payment type, reconciliation needs to happen on a daily basis." Most banks offer online systems, so "there's no reason not to look at posted transactions daily, even for a big client," she added. For a technically sophisticated client, that may mean uploading a daily file and running it through their treasury management system (TMS) or enterprise resource planning (ERP) system.

According to Warren Davey, senior vice-president of marketing and sales at GTreasury, a treasury management system vendor, companies that reconcile transactions to the general ledger daily can save a lot of time at the end of the month. "It's easier to find five transactions a day than to find 100 at the end of the month," he said. "You need to have a more consistent perpetual process, where you're doing a little work every day."

"We have many conversations with treasury teams that are looking for greater efficiency," Durkin said. "If reconciliation can be handled more efficiently, treasury can have the opportunity to spend more time on strategic activities versus dealing with tactical issues. It's not the best use of their time."

Maintain adequate controls

It's important that companies separate the ability to transact within the account from reconciliation. How duties are separated sometimes depends on company size, according to Rosenberger. "Smaller companies with less staff find it harder to separate duties," she explained. "One person could be wearing more than one hat." Whereas larger companies have the resources to ensure different people initiate, approve, and reconcile transactions. "Some companies handle reconciliation within treasury while others handle it within accounting—and sometimes both," she said.

Separation of duties is a requirement for compliance with the Sarbanes-Oxley Act (SOX). But even before SOX, most companies did not have the same people creating transactions and reconciling them. "There's a lot of concern with security within the system, and multiple authentication in terms of sign-in and multiple authorizations and approvals," Snyder said. "SOX accelerated and intensified the focus on that, and it's growing more and more."

With the proliferation of Automated Clearing House (ACH) transactions, there's an increased potential for fraud as volumes increase. "We handle that with ACH positive pay," said Snyder. "The system looks for suspicious ACH transactions. Another approach for preventing fraud is to implement account blocks. If it's a depository account, block any debit transactions. Auditing for fraud is generally done at the account level. It's difficult to identify fraud by going after random transactions. It's unlikely to provide meaningful results." According to Snyder, most discrepancies are a result of mistakes, not fraud, "but mistakes can be pretty serious as well."

"We have 31 banks globally and approximately 230 bank accounts," said the cash manager of a Toronto-based multinational corporation. The company maintains separate disbursement, collections and payroll accounts, and lockboxes, depending on the size of the office. "To a certain extent that makes it easier," he said. For smaller offices, the company uses a single account with subaccounts.

To enhance controls, the company is aiming to leverage its global Shared Service Centers (SSCs). "We have an AR team located in an SSC in Mexico that is responsible for all collections, and an AP team in an SSC in Asia that is responsible for global disbursements." The company is migrating reconciliation of accounts from site controllers to the SSCs. Right now, site controllers are responsible for reconciliation (the process is automated through an auto-feed into SAP) but are unable to "touch" the accounts. That activity is centralized within corporate treasury at headquarters or regional centers. While the SSC will handle the monthly G/L reconciliation, treasury does a daily cash recon to match in-flow and outflows through the TMS for liquidity planning purposes.

At the aforementioned insurance company, cash accounting is a separate function within treasury, and corporate accounting handles the monthly book/cash reconciliation. "SAP really changed how we reconcile accounts," said the senior accountant and team lead. "We get a BAI file and reconcile on a daily basis." The company has 60 field offices, some of which hold accounts with small banks that still issue paper statements. For these field offices, reconciliation is performed monthly.

According to Snyder, another approach to separation of duty is to outsource the recon process to banks, especially for smaller companies with limited staff, those that don't have enough staff to segregate the duties effectively. When outsourcing to a bank, the company provides transactional data ("the book side") via a file transmission format, and the bank does the record-to-cash reconciliation. "The bank takes care of everything," Snyder said. "Once the bank has the book side from the customer, they take care of matching and researching discrepancies and communicate back any exceptions. The banks are very interested in this fee-based service—and it benefits the company," which ends up only working the exceptions and thus finding more productive ways to spend their time.

Seek automated solutions

Automation is critical to shortening reconciliation time. It also allows companies to keep track of transactions on a daily basis. "Without a system, that's very difficult," Snyder said. If soft recon is not performed daily, the exceptions show up at the end of the period and accumulate over time.

"Spend a little bit of time each day on eliminating exceptions," Snyder said. "This way you're not trying to do it all at once and dealing with something that happened three weeks ago." By doing matching, exception identification and research daily, the end-of-month reconciliation process goes much quicker. "All you're doing is recording the final results," said Snyder.

With an automated environment, companies spend 99.99 percent of their time on the exceptions, but if the process is manual, treasury spends significant additional time moving and rekeying data. "The more robust the system, the fewer exceptions you have," said Snyder.

Smaller companies tend to work within a manual system, using spreadsheets or perhaps an accounting package. While larger companies typically rely on ERPs and treasury management systems. "They compare bank transactions to internal data, match payments to invoices, and it all happens automatically," Rosenberger said. "Companies are demanding more and more automation and systems are becoming much more sophisticated. We've seen many of our clients upgrading their systems, moving toward better automation and better controls. This saves time on reconciliation as well as cost in terms of fraud losses."

While it's surprising just how many companies still work with spreadsheets—even large companies—more and more are opting

Reconciling Global Accounts

Reconciling global accounts can present taller challenges. "Companies with global operations are dealing with different banking environments," Rosenberger said, "so reconciliation can be more complicated." It helps that there are now standard reporting formats, like BAI files and information delivery via SWIFT.

Rosenberger urged companies to take advantage of advancements in reporting standardization. "Data reports can be sent in the exact same format, which helps companies build the process in their systems and do more apples to apples processing of data. It makes it much easier when you're dealing with multiple banks, different countries, and multiple currencies," she said.

Global recon is driven by an even greater complexity of accounts in addition to the challenge of managing across multiple time zones. "A lot of treasury management systems and ERPs can support global standardization," Durkin said. "But not every bank has harmonized its output across the U.S. and globally. Therefore, when companies try to work with the same bank across regions it can be a challenge."

However, reconciliation of global accounts doesn't have to be any harder than reconciliation of domestic accounts. According to Durkin, there are banks that provide globally consistent, prior-day information reporting and electronic statements in support of a single, automated account reconciliation process across a corporation's global account structure.

BAI codes can facilitate corporate global account reconciliation. For example, clients who are more familiar with the SWIFT MT message format may ask that BAI2 codes be delivered inside one of the MT9xx-level messages. Formats such as ISO XML 20022 also address some global account reconciliation challenges.

According to Snyder, for global companies, the biggest challenge is consolidation of data across locations. "It's difficult when they need to bring it all together," Snyder said. "For management reporting and review, you have to pull the data together. The question companies face is whether to run a single system globally or locally. For most it's a hybrid with some local and some centralized functions. You need a flexible system to have the infrastructure in place to move the data very quickly. That's further complicated by different deadlines depending on time zone, different currencies and different banks. You want to support the local language, currency and time zone."

for technology-based solutions. "As more and more people using systems move to companies where systems are not being used, and the younger generation comes in, treasuries are slowly moving toward the technology realm," said Davey.

At a large asset management company with over 1,000 legal entities and 1,500 bank accounts, the treasurer said his organization has five key banking relationships in which most of its activity is concentrated. "There are a total of 25 banks, most of which handle a lower level of activity," said the treasurer. "We typically open an operating account for each entity. Some entities have multiple accounts for different currencies or a ZBA for core balances."

The company has a separate reconciliation team that stewards the reconciliation process. "The reconciliation team controls whether the account activity is reconciled on a timely basis," said the treasurer. "The actual reconciliation is distributed more broadly and is done on a completely automated basis where each finance team owns the accounts related to their business. The businesses in turn rely on the company's centralized treasury management system to expedite the process, which occurs in a distributed model within our TMS."

The company's TMS utilizes the Society for Worldwide Interbank Financial Telecommunication (SWIFT) as the backbone for its communication. Each bank sends an MT940 daily in addition to other SWIFT messages related to the actual payment flows. "We do a hard reconciliation based on the MT940 on a daily basis, which is auto-reconciled using the TMS," said the treasurer. "The system will handle the reconciliation and output exceptions, which are then handled on a manual basis, i.e., using the system to review specific transactions online. Exceptions require investigation and remain tagged as un-reconciled until they're sorted out."

All transactions are reconciled. "The reconciliation is handled by a separate team from the one that generates the activity," the treasurer said. "Because the TMS is globally implemented and the company uses SWIFT, international accounts are reconciled exactly like domestic accounts."

Deal with exceptions promptly

Bankers and treasury practitioners alike stress the importance of identifying and researching any discrepancies as soon as they occur. Through positive pay, the bank can speed up the daily process by providing the client with a daily report of check items that appear to be exceptions, according to Rosenberger. "We at the bank try to repair micro-coding errors in order to present the cleanest data possible to the client for review," she said. Then clients review the exceptions presented and decide whether or not to pay the item.

While some companies pick random transactions to check, best practice calls for review of every transaction. "Reconcile the account as if it's your own checking account," said Rosenberger. "While random transactions may work for some companies, accounting for everything is the better way to go, using services like positive pay and account blocks." *All of the companies interviewed for this report said they review 100 percent of the transactions in their accounts, pursue exceptions immediately, and keep un-reconciled items in a separate account until resolved.*

Another advantage to this practice is that exceptions, if questionable, often have a set reporting/return timeframe with the bank. It's important to know what the return parameters are for checks, ACH payments, wires, and any other payment type in case, after performing your internal research, you find them to be fraudulent.

"We're having a lot of dialogue about push notification," said Durkin. If the bank identifies an exception or has parameters that define what may be an exception, it can generate an email or text message to alert treasury. In addition, generating reports with more granular data means companies can better automate the process, leading to quick identification of any discrepancies.

The cash manager of a retail company with nearly 300 stores said his organization has a sub account at each location. "Plus, there are separate accounts for AP and payroll with six separate banks, which all roll up," he said. The company gets a Bank Administration Institute (BAI) file from each bank and reconciles cash inflows and outflows daily. Anything that doesn't match is looked at carefully.

For those items that don't match, the first step is to contact the store to track it down. If that doesn't resolve the question, the company contacts the bank to get the answer.

Conclusion

As companies revisit their account structure, they keep an eye on how to automate and facilitate their reconciliation process, starting with a daily soft recon that saves time later in the month and allows for improved liquidity management. The level of details banks can now provide means companies can achieve better recon even with single accounts broken into subaccount hierarchies that allow them to dig deeper and identify discrepancies fast and effectively. Experts and practitioners see a growing trend toward greater automation through ERPs and TMS utilization to make recon a daily task to cut back on the monthly hard recon that can slow down the closing process. Collaboration between banks and their clients are making this possible.

About the Author

Nilly Essaides is Director of Practitioner Content Development at the Association for Financial Professionals. Nilly has over 20 years of experience in research, writing and meeting facilitation in the global treasury arena. She is a thought leader and the author of multiple in-depth AFP Guides on treasury topics as well as monthly articles in *AFP Exchange*, AFP's flagship publication. Nilly was managing director at the NeuGroup and co-led the company's successful peer group business. Nilly also co-authored a book about knowledge management and how to transfer best practices with the American Productivity and Quality Center (APQC).

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