Preserving the Invoice from an ACH Perspective

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In the midst of this economic crisis, many service-based businesses are looking for new ways to tighten down their internal policies and procedures to avoid additional losses to their business. Now more than ever, PEOs may end up holding the liability for the unfunded invoices caused by the financial demise of client companies. Unfortunately, the size of a company is no longer an indicator of its strength or stability. Therefore, PEOs and other service-based businesses that handle payroll, benefits, and HR-related transactions are being forced to take extra safeguards to prevent these uncollectible situations. Despite the difficulty of these economic times, PEOs can help reduce their risk exposure by taking a few simple precautions.

PEO invoice-related electronic funds transfer (EFT) items represent a huge risk exposure. Establishing new methods of handling these EFT items can be helpful in reducing a PEO's financial risk. However, the challenge is to do this without edging your company out of the competitive marketplace.

Selecting the right approach to determine the viability of a new client is crucial to a PEO business. Servicing existing clients can also be risky in these difficult economic times. Taking a proactive approach by following standard industry policies and procedures such as conducting due diligence on all new clients, requiring ample time between the collection and the direct deposits for EFT items, instituting new internal procedures on how to deal with insufficient funds, establishing open lines of communication with clients, and working with the right ACH processor, can be extremely helpful in reducing risk exposure.

Know Your Client (KYC)

The banking industry has always been very strict about monitoring the process of electronic funds transfer items for businesses. Due to the changes in the market over the last few years, many banks are now strictly enforcing the KYC rule because of the vast number of fraudulent transactions and companies that have recently failed. PEOs can implement the KYC rule by simply conducting due diligence on a new client prior to placing it on direct deposit service.

Paying a site visit to a prospective client's office is an important part of KYC and an effective step in ensuring the legitimacy of a business. This should help a PEO determine if the prospect is a genuine brick and mortar business or a potential fly-by-night operation.

Requiring corporate and officer credit checks on any new clients should also be a mandatory procedure for all PEOs. Credit checks should not just be relegated to new clients, but annual company credit checks should be pulled for all existing clients as well. If there is a concern about the additional cost to complete these credit checks, a logical solution is to turn this cost over to the client. An easy way to disclose this fee to potential clients is to include it in your client service agreement at the beginning of the business relationship. During the sales process, your sales representative will have the opportunity to explain the necessity for the initial and annual credit checks. Most clients will not balk at the nominal annual charge for this service. However, if they do, simply explain that to meet the increasing requirements of many financial institutions and ACH processors that are cracking down and requiring these checks in this economic market, the PEO is required to do likewise.

For your existing client base, distribute a letter advising clients of the new annual credit check policy your company has instituted. The basis for this letter can be to accommodate the new requirements from your ACH processor due to the recent changes in the market.

Alerting clients in advance that you will be monitoring their credit standing on an annual basis will send the message that your business is strictly enforcing these policies and procedures. This will serve as a deterrent to any offenders. By performing these two simple steps, a PEO can often prevent scam artists from taking advantage of its business and help prevent an uncollectible invoice.

Establish Internal Procedures

The PEO should always try to verify that the funds sent by the client are good prior to distributing the direct deposits to the employees. The best way to verify funds is to collect prior to the payroll check date.

Offering same-day collection (i.e., collecting and direct depositing on the same day) is the most certain way to expose a PEO to undue risk. This method does not give a PEO sufficient time to verify if the invoice funds are valid.

A great way to minimize a PEO's risk exposure on collecting funds for direct deposits is to establish a standard policy for collection timelines. The majority of your client base should be collected a minimum of one banking day prior to the payroll check date. Although this timeline will not prevent an NSF situation from occurring, it does reduce the risk by one day, as shown in Figure 1.

If you have any high risk clients, increasing the timeline between the collection portion and the direct deposit date will help reduce your risk exposure tremendously. It is strongly recommended to require collection at least three banking days prior to the payroll check date for any client with a bad credit report or insufficient funds history for a prior payroll. For example, the payroll should be processed on Monday for a Friday payroll check date. The collection for the invoice of that pay period should then occur on Tuesday, which allows the PEO to verify if the funds are good by Thursday.

Figure 1. Standard timeline for Friday payroll check date.

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
			Send ACH file	Collection	Direct deposit	

Figure 2. High risk timeline for Friday payroll check date.

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
	Send ACH file	Collection			Direct deposit	

If an NSF notification is received for the invoice on Thursday, this timeline gives the PEO the opportunity to require an immediate wire transfer from the client to cover the invoice. As the employer of record, the PEO is obligated to pay the worksite employees. However, advance notice also allows the PEO to use contract termination and last paycheck notices to employees in order to leverage payment from the client.

While the PEO model is preferable, one option for a PEO is to convert any high risk clients to ASO services. An ASO can offer many of the same services to a client, but without the status of "employer of record." In the timeline shown in Figure 2, an ASO, acting as a payroll agent of the client, would have the ability to stop the direct deposits from going through to the employees.

When possible, a good option is to require a reserve from the high risk client, equal to one invoice. The reserve then provides the PEO with a level of "insurance" so it is not out of pocket if a client creates an NSF situation.

As most PEOs want to remain competitive in the marketplace, this timeline may be difficult to enforce with all clients. However, this procedure is helpful in monitoring higher risk clients or when processing brand-new clients until they establish a history with your company.

Offering direct deposit services for brand-new clients can create problems for a PEO. Processing manual payroll checks for new clients for their first 30 to 90 days can be a deterrent for disreputable companies. This method may prevent "payroll hoppers" from jumping from one PEO to another and leaving a trail of uncollectible payrolls/invoices.

Another method is to require high risk or new clients to wire transfer the collection portion of the invoice directly to the PEO's bank account. This will ensure that the funds are valid and enable the PEO to offer direct deposit service to any new or high risk clients. The collection portion should be wired a minimum of one banking day prior to the payroll check date in order to verify the funds and give the PEO ample time to transmit the direct deposit funds through the EFT system.

NSF (Insufficient Funds) Procedures

Financial institutions and ACH processors receive an NSF notification for insufficient funds within two banking days following the original collection date and/or settlement date. This two-day delay creates more pressure on a PEO, because in most cases, the direct deposits and tax payments have already been distributed.

In the event an existing client does not fund an invoice, require him to immediately wire transfer the funds to the PEO account. Stiff penalties should be placed on the NSF client to deter him from repeating the offense. Failure to wire funds should trigger immediate steps by the PEO to protect itself. A client should understand that workers could be terminated from PEO co-employment and that loss of PEO services could occur. Often, this will cause the client to make the wire transfer. Fees ranging from $50 to $200 per NSF notification are standard within the industry and should be strictly enforced. Increasing the fee each time the same client has an NSF can also be a deterrent. In conjunction with the incremental fees, establish a "three strikes and you're out" policy. Once a client has had three NSFs, remove him from direct deposit service, or place him on alternate processing methods. Placing boundaries for repeat NSF offenders will only serve to strengthen your business.

Once a client has been labeled "high risk," a PEO can continue to service that client with alternate methods. Requiring a high risk client to wire transfer the collection portion of the invoice, or collecting from the client a minimum of three banking days prior to the payroll check date, can virtually eliminate the risk for a PEO.

Finally, establish a relationship with an ACH processor that understands your industry. Service-based businesses, such as PEOs or payroll service bureaus are often subject to the same rules as individual corporations. By selecting the right ACH processor, a PEO can minimize the hassle in processing its clients' EFT transactions.

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