

Electronic Checklist: Choosing the Right Electronic Check Solution

Implementing any electronic check solution will deliver significant financial benefits. But to maximize your return, you want a solution that is truly aligned with your company's goals and objectives. This "checklist" will help.

Contents

- 3 **Executive Summary:** Making electronic check solutions pay for you
- 4 **Introduction:** Electronic check delivers substantial returns
- 6 **The Decision Process:** Putting a stake in the ground
- 11 **Electronic Check Leadership:** Elavon brings unmatched experience to electronic check processing
- 12 **Conclusion:** Let electronic check make you a hero

Executive Summary

Making electronic check solutions pay for you

The use of electronic check processing is rapidly expanding. It offers so many benefits—reduced handling expenses, lower per-item costs, consolidated banking relationships, accelerated returns, and faster funding—that the vast majority of retailers in this era of high competition and narrow profit margins will simply find it too compelling to ignore.

But what type of electronic check solution should you implement? That is the big question. And there are real differences in features and functionality among the solutions being offered in the marketplace: various processing methods, conversion and imaging options, types of checks handled, risk and fraud management controls, and returns management capabilities.

These differences make it critically important that you match the electronic check solution you choose to your company’s specific goals and objectives. And that is not always easy.

The purpose of this white paper is to guide you in making up your electronic “checklist”—and help you successfully sort through the myriad of options you have to choose the right electronic check solution for your organization. This paper should enable you to:

- Understand the importance of involving the full range of stakeholders early in the process;
- Recognize that the full cost of check acceptance isn’t limited to per-item fees and processing/handling costs, but rather is determined by a host of cost implications affecting your enterprise;
- Focus on the key points to consider, whether your electronic check processing priorities are to improve your company’s operational efficiencies, enhance your cash flow, or reduce risk and check losses.

Whatever you decide, the right electronic check solution will pay big dividends for your business.

“It is critically important to align electronic check solution offerings with your company’s goals and objectives.”

Introduction

Electronic check delivers substantial returns

Electronic check processing has been rapidly gaining market share at the expense of paper checks since the adoption of the Check Clearing for the 21st Century Act, or Check 21 as it is known, in 2004—leading the world ever closer to the long-envisioned “paperless” society. There is no debating it anymore—with a solid foundation in place, electronic check processing is growing because it virtually ensures substantial benefits for any organization that implements it.

Converting checks to electronic transactions significantly lowers a retailer’s expenses in a number of ways:

- Reducing check-handling costs and the labor required to move paper checks from store locations to bank branches, processing centers, and ultimately, to storage facilities
- Decreasing transaction processing and per-item costs
- Enabling businesses to consolidate banking relationships across their entire footprint—no longer will retailers be forced to bank with brick-and-mortar financial institutions within reasonable driving distance.

In addition, because electronic check streamlines the processing of transactions, businesses gain access to funds much sooner than in the past with paper checks—with some solutions making funds available within 24 hours of acceptance of the check at the point of sale (POS).

Clearly, with these kinds of benefits, if you are a treasury manager or have direct responsibility for payments or banking relationships, recommending a move to electronic check processing can make you something of a hero within your company. But the decision to implement electronic check is really the easy part. The more challenging element of the equation is deciding what type of electronic check solution to recommend. Because today, there are a growing number of options and variations on these choices, and quite frankly, one size simply doesn’t fit all.

This white paper will review some of the choices in electronic check processing available to treasury managers today, and provide strategies for how to analyze the different alternatives and decide precisely what type of solution is ideal your business.

Learning to spell

POP, BOC, ARC—discussing electronic check conversion methods can be like taking a spelling test. But what do these acronyms mean?

Point of Purchase (POP)—A check is tendered by the customer at checkout and the information from the MICR line is used to immediately convert the item into an electronic transaction. Ideally, the image is captured at the POS. The check is then handed back to the customer.

Back Office Conversion (BOC)—Checks are tendered and accepted at check-out, but are converted later in the “back office” or at an offsite processing facility. In some cases, the transaction is not processed until the check is converted. In others, the transaction is processed at the POS, and only the check imaging takes place later.

Accounts Receivable Conversion (ARC)—This type of electronic check processing is used for lock boxes or other bill payment applications. The MICR data is captured and used to convert the item into an electronic transaction. Once the check is imaged, the original is destroyed.

Under all three methods, transactions can be cleared and settled in several ways.

- The MICR data and other transaction information can be sent through the Automated Clearing House (ACH).
- The MICR data and other transaction information can be sent real-time through the debit networks to the paying bank for authorization and risk assessment. The item is settled directly to the consumer’s DDA.
- Under Check 21 truncation, a duplicate substitute check created from an image of the original check can be sent through the traditional clearing process.
- Some financial institutions may choose to exchange electronic check images instead of paper-based substitute checks.

There are also other factors to consider. With POP, only consumer and small business checks drawn on U.S. banks are eligible for electronic processing. Other paper items, such as corporate checks, money orders, Women, Infant and Children (WIC) checks, and so on, must be identified by cashiers, separated, and processed through the traditional check clearing system. In addition, with each of the methods, businesses must decide what type of risk management to opt for—from conversion only to verification or guarantee services—and this decision will be driven by cost as well as what level of risk an organization is willing to accept.

When considering electronic check processing, it is critical that you align the electronic check solution you choose with your company’s goals and objectives.

“Direct DDA access provides real-time access to checking accounts, utilizing the existing infrastructure of common debit networks.”

The Decision Process

Putting a stake in the ground

If you are considering implementing electronic check processing for your business, the first step is to obtain companywide buy-in. This means you need to get the right stakeholders involved in the decision-making process from the very beginning. These stakeholders may include:

- Finance—Finance and treasury people handle your banking relationships, manage funding windows for payments, and often oversee returns and presentment of exception items
- Store operations—These people manage the cashier checkout process, cash drawer reconciliation, and back-office end-of-day settlement procedures
- Systems and IT—Any change you make to POS systems will need to be implemented by your systems and IT professionals, as will changes to the accounting system your store relies upon
- Other parties—Others who may have a vested interest in and desire input into your electronic check decisions include your security/fraud protection team, legal department, and collections managers.

It is also critical to go beyond just the fees for credit authorization and transaction processing to understand the true cost of check acceptance and calculate an accurate ROI for an electronic check solution.

For example, in addition to processing fees, there can be bank fees such as deposit fees (per item and per deposit), per-check re-presentment fees, returned item and insufficient funds (NSF) fees, plus collection percentages.

Float must also be considered—it's important to understand how deposit windows impact cash flow. Every day a deposit is delayed represents lost revenue to you and the opportunity to invest those funds to earn a better return. And returned-item handling processes should be considered—the ability to stop bad check writers and speed the collections process can significantly improve collections lift and the associated dollars recovered.

Capital costs for required encoding/imaging equipment and other related expenditures must also be factored into the equation, as will labor and handling costs for such tasks as reconciliation, deposit preparation, and even your trips to the bank. And don't forget to add in the cost of your POS and back-end accounting systems.

“You need to get the right stakeholders involved in the decision-making process from the very beginning.”

Aligning your solution with company goals

To choose the best electronic check solution for your company, you will need to align the solution with your company's goals and objectives. This requires understanding your organization's primary reason or reasons for implementing electronic check. Is your chief objective to:

- Improve the efficiency of check acceptance and processing?
- Enhance your cash flow by gaining access to funds sooner?
- Reduce fraud and other risks inherent in the check acceptance process?

Goal: Improve efficiency

If your primary goal is to improve the efficiency of check acceptance and processing, you'll want to implement a solution that optimizes productivity throughout the entire check-handling process—from the POS to remittance and accounting.

First, it is critical that the electronic check solution you choose allows you to accept *all* checks—consumer, business, money orders, government, travelers, convenience, and even items such as WIC checks—using one process. This will greatly simplify your POS operations requirements—minimizing additional training and payroll costs, decreasing cashier mistakes, and most importantly, reducing the impact on your customers. If you were to implement an electronic check solution that handles some checks, but not others, you would significantly increase the complexity of the process and potentially set yourself up for operational difficulties, cashier mistakes, multiple deposit reconciliations daily, and fraud.

Keep in mind that if you want the simplest solution for your cashiers, you're probably going to opt for a BOC solution over a POP solution—the latter of which changes POS procedures by requiring clerks to hand checks back to customers immediately after processing. This change in procedures is not a huge consideration if a POP solution offers you other benefits you desire, but it *will* require retraining of your cashiers. Plus, any items that can't be processed through the POP process must be placed in the cash drawer and processed as paper items, opening the door to mistakes that can negatively impact cash flow.

Second, you want a solution that will simplify your POS reconciliation by automating as many tasks as possible. For example, a good electronic check solution should eliminate manual balancing. Although retailers accustomed to traditional end-of-day procedures sometimes find this difficult to grasp, with electronic check transactions, you will reconcile check transactions the same way you reconcile your electronic credit and debit transactions. The paper checks in the drawers will essentially be like receipts, because the check transactions will have already been processed electronically and will be reconciled automatically. The checks will just be there because if you're using

“With the right electronic check solution, paper checks in the drawer become like debit or credit card receipts. They do not need to be counted and reconciled manually—the electronic transactions will be automatically reconciled at the end of the day.”

BOC, you will need to image them to meet regulatory requirements. So when reconciling their drawers at the end of the day, your cashiers won't have to manually tally any of the paper checks—resulting in a big savings of time and money.

Another important consideration is to select a solution that will simplify your back room and headquarters accounting and reconciliation functions. You should image where it makes the most sense for your company—at the POS, in cash offices at each store, or at a regional or headquarters processing facility. Or you can outsource the imaging to a third-party processor, if you prefer.

A central archive of the check images will provide you with a single repository for more efficient transaction analysis and look up of individual items. Note that your IT group may need to add logic to your back-office accounting systems for exception handling and reconciliation monitoring and tracking.

Finally, it is important to consider returned-item handling when evaluating electronic check solutions. Both administrative and monetary returns can impact funds availability. You should not have to become an expert in the area of check processing, returned-item handling, collections, and originating depository financial institution (ODFI) submissions. Look for fully automated solutions that handle returns on your behalf—keeping you financially whole throughout the entire process. Avoid solutions that simply streamline the electronic check acceptance process, but then revert to traditional paper returns management—forcing you to manually handle all exception items and even pay ODFI charges.

Goal: Enhance cash flow

If your priority is to improve your cash flow, you will want to implement a solution that optimizes funds availability, while reducing your check acceptance costs.

To begin, you will want a solution that converts *all* types of checks into electronic transactions at the earliest possible point of entry into your check-processing stream. Real-time processing results in much faster funding, with virtually all checks processed and approved at the POS posting the next business day in a single deposit. These transactions should be dynamically routed, using the lowest-cost methods available—whether that is the ACH or another clearing and settlement process. The goal is to get the funds into your hands as quickly as possible, so you can invest them and earn a return on your money.

If you settle for an electronic check solution that only processes certain kinds of checks—for instance, just consumer checks—you won't realize the full potential of faster funding and you may incur additional hidden fees. While ACH items may fund the next day, non-ACH items will likely be delayed—in some cases up to 7 days. In addition, some electronic check solutions only fund

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transactions upon final resolution—which can further delay access to a portion of your money.

Additional expenses can range from ODFI fees to fees for handling exception items or charges for à la carte services such as image uploads and administrative returns. Also, you will want to avoid services that charge float fees of 2% to 3% of a check's value for handling non-ACH items.

Next, you should ensure that you can process all checks when presented, rather than when imaged. This optimizes your settlement windows, with check transactions settling along with your other electronic (credit and debit) transactions—and provides next-day funding for most ACH *and* non-ACH items. In addition, it minimizes your sources of funding, providing you with one deposit for all checks accepted, so you can manage your funds through a single settlement account.

Finally, it is important to look for a solution that will integrate easily and inexpensively with your existing payment infrastructure—minimizing POS and accounting system changes.

Goal: Reduce risk and fraud

If your focus is to improve your risk management and limit check fraud, you will want to implement a solution that gives you the confidence to accept more checks, while reducing the costs associated with check losses.

With the growing percentage of bad checks being written in the U.S., your first task should be to map the service level you choose—from conversion only to full check guarantee—to your company's requirements or even individual store needs. With some of the best electronic check solutions, you can choose from a variety of risk management levels such as:

- Conversion only
- Conversion with verification
- Conversion with verification and collections
- Conversion with guarantee

You will want to use your internal customer information file databases as much as possible for verification or guarantee. Direct access to the actual DDA balances of customers for check acceptance decisions ensures the timely availability of funds—regardless of the service level you choose. In addition, typically 20% to 40%, and as high as 60%, of consumer accounts can be accessed through common debit networks—rates vary based on your specific geographic footprint.

Supplementing your own databases with direct DDA access, access through debit networks, and other verification services greatly minimizes your exposure to NSF items. It's important to remember: if you choose an electronic check

“Direct access to the actual customer DDA balances for check acceptance decisions greatly minimizes your exposure to NSF items.”

solution that doesn't incorporate some sort of risk mitigation, the solution won't be able to reduce the number of NSF items or your risk of loss due to fraud *in any way*.

Another goal should be to accept and convert all checks by leveraging the dollar total calculation from the POS, rather than relying on cashier key-entered amounts. This will provide you a significant savings in time and labor costs. You should also be able to use your electronic check solution to automatically resubmit NSF items at least twice as priority items, greatly increasing the chance of clearing.

And last, you will want a solution that gets checks out of your stores as soon as possible for centralized or outsourced imaging—reducing your exposure to fraudulent schemes.

When it comes to managing risk and fraud, avoid having to support two separate, but parallel, check processing methods—which often only serve to increase the work involved in making deposits and boost the potential of check losses.

Another risk is processing check transactions outside of the company. With some electronic check transactions, checks are sent by courier, U.S. mail, or other parcel carrier methods to regional or headquarters locations. The items are not converted and processed until reaching the processing facility. This can result in enormous funding delays, as well as the danger of losing entire courier batches due to accidents or other incidents. It should be noted transactions that are financially processed in real time at the POS and simply sent offsite for imaging and destruction will not incur these risks.

Finally, you will want avoid electronic check services that only offer “batch” processing for ACH transactions. Batch file submission causes reconciliation issues due to “tender errors”, requiring downstream customer-facing corrections.

Electronic Check Leadership

Elavon brings unmatched experience to electronic check processing

Elavon, formerly known as NOVA Information Systems, is a recognized leader in electronic check solutions. Elavon's ECS solution is relied on by more than 40,000 U.S. merchants of all sizes, which can choose the right mix of processing methods, risk management, efficiency, and convenience. Elavon is the number one processor of BOC electronic check transactions. The company is also the third largest credit card acquirer in the U.S., processing more than \$2 billion annually for one million merchants.

Elavon's flexible ECS solution can be used to process *all* checks—consumer, business, government, and other special items (i.e. WIC), electronically at the POS—eliminating the need for multiple acceptance and handling processes. Check transactions are financially processed in real time at the earliest point of entry. The solution leverages all three processing methods—direct DDA access, ACH, and check-replacement documents—automatically through the appropriate rail.

With ECS, you can choose the type of conversion solution—POP, BOC, or ARC—you need. With POP, Elavon's electronic check solution efficiently images checks at the POS. And with Elavon's BOC and ARC solutions, checks can be imaged in your back office, at a centralized location, or through outsourced ECS centers nationwide.

The solution supports customizable risk levels—from conversion only to bank guarantee. And ECS incorporates automated returned-item handling that keeps retailers financially whole throughout the entire process. Best of all, funds for all checks are available the next day!*

“Elavon’s flexible ECS solution can be used to process *all* checks... and is relied on by more than 40,000 U.S. merchants of all sizes.”

* Funds availability will vary depending upon the deposit institution used.

Conclusion

Let electronic check make you a hero

So go ahead—recommend electronic check for your company. And watch yourself become a “hero” for all the time and money you will save.

But before you begin, it is best to analyze the alternatives and select the best option for your organization—one that meets your specific goals and objectives.

Now you know there is no one right solution for every business. POP can get transactions and check images into the processing stream early. But it also requires the expense of a check imager in every lane, forces retailers to make changes to POS check-handling procedures (to return blank checks to customers), and for some solutions, requires a subsequent parallel process for handling non-ACH items.

BOC can process transactions in real time at the POS—if you choose the right BOC solution. But it can also require additional reconciliation at the point of sale, additional labor and associated costs for returned items and exception handling, and ODFI registration—as well as subsequent parallel processing for handling non-ACH items.

Not every electronic check solution is the same, and not every similar electronic check solution has identical characteristics and benefits.

By combining the best elements of POP and BOC—and getting all stakeholders to the table—your organization will realize operational efficiencies, improved cash flow, and reduced risk.

Elavon’s experts are ready to work with you to review the considerations, benefits, and potential shortcomings of the various electronic solutions that relate to your specific organization—to help you maximize the benefits for the long haul.

“Go ahead—
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