BEST PRACTICE

Use of Lockbox Services (2003, 2007, and 2009) (TIM)

Background. Lockbox services are designed to expedite the collection of paper-based payments and provide timely payment information to update accounts receivable records. Lockbox services are usually provided by a third-party processor (usually a bank) that receives, opens, and processes payments for a government or business. For most governments, lockbox services should increase payment and posting accuracy, improve cash flow by reducing processing time between delivery of mail and depositing of payments, and increase staff productivity by freeing personnel from the labor-intensive process of manually handling mail, making daily deposits, and posting manual payments.

There are two basic types of lockbox services: wholesale (used for high dollar, low volume payments) and retail (used for high volume, low dollar payments, such as taxes, utilities, licenses and fees, and accompanied by standardized remittance documents). Governments usually have more need for retail lockbox services.

Recommendation. The Government Finance Officers Association (GFOA) recommends that governments evaluate the benefits and costs of using lockbox services to determine if advantages can be gained in the areas of accuracy, cash flow, internal controls, and efficiency. The evaluation should consider:

1. **Availability of Lockbox Services.** Lockbox services have become a mature banking service and most areas typically have multiple banks and companies competing for lockbox processing accounts. Governments seeking a lockbox processor should investigate the efficiency models of local utilities and cable television firms process their payments. In areas that are not serviced, governments should evaluate the use of regional lockbox processors. Other than overcoming the public confusion about sending local payments to an out-of-area address, there is normally no technical requirement for lockbox processing to be performed locally.

2. **Workflow and Cash Flow.** Any evaluation of lockbox services must include:
    - an analysis of the existing workflow from receiving mail to depositing payments and posting receivables,
    - volume of transactions,
    - staffing requirements,
    - time necessary to complete,
    - lockbox service charges,
    - enhanced cash flow and increased interest earnings from using a lockbox,
    - ability of the provider to accept payments other than checks (i.e., credit cards),
    - security of the process,
    - employee accuracy,
    - customer service,
    - any capital requirements, and
    - service charges associated with any required bank accounts.

The costs of performing these processes internally should be weighed against the costs and benefits of outsourcing to a lockbox processor. Particular attention should be paid to any delays in depositing funds or posting of receivables. Most lockbox processors guarantee that payments received are deposited into the organization's bank account the same day they are received.

Some lockbox processors offer the conversion of checks into Automated Clearing House (ACH) payments at the lockbox site to decrease processing time. ACH processing may result in a cost savings as compared to check processing and should be evaluated as an option for future and existing lockbox services.

3. **Technical Requirements.** Technical requirements include the processor's specifications, such as the character recognition scan line (for identification and payment information), form size, character placement, inclusion of a check digit, ink type, and paper quality. In addition, the type of printer used to generate the remittance document can affect processing error rates and overall costs. Laser printing with non-magnetic ink is recommended.

   The transmission of data between the processor and the government can range from the exchange of hard copy records to electronic transmission via the Internet and depends on the needs and capabilities of the government. Other options include direct electronic transmission of data and data on CD-ROM. Changes to existing software may be necessary to upload the information electronically. Lockbox processors can also offer data storage services by converting remittances to electronic data. Some lockbox processors offer on-line access to digital images of remittance checks and documents.

4. **Other Considerations.** Government billings and cash flows are often cyclical, creating peaks and valleys in cash management staffing demand. Shifting payment processing responsibility to a lockbox processor alleviates the challenges of staffing to meet a limited number of peak periods or overburdening a small staff during critical periods. Governments should analyze the efficiency and cost/benefit of using payment consolidation services to expedite the processing of on-line payments processed through the customer's financial institution. Governments should also consider the benefits of remote deposit capture compared to the benefits of lockboxes.

Contract. GFOA recommends that any contract entered into by a government and lockbox provider, at a minimum, include the following:

- treatment of exception (non-standard) items,
- ability of the lockbox provider to handle payments containing multiple remittance advices,
- turnaround time,
- disposition of documents (including imaging capabilities),
- funds availability schedule,
- technical specifications for transmission of data to the government,
- error tolerance, and
- bonding requirements of lockbox personnel, including subcontractors (e.g., courier service).

In the event that these services are procured through the use of a request for proposal, the request for proposal and the vendor response should be included as part of the contract.

References

- *An Introduction to Treasury Agreements for State and Local Governments*, Linda Sheimo, GFOA, 1993.
- *An Introduction to Treasury Management Practices*, GFOA, 1998
- *Banking Services: A Guide for Governments*, Nick Greifer, GFOA, 2004.

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