Risky Business: Navigating the Financial Minefield with Confidence

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According to the Federal Reserve's 2024 Survey of Salient Risks to Financial Stability, financial risks are expected to increase over the next 12 months, largely fuelled by elevated asset valuations and a high-interest rate environment. This is not just a US issue; on the other side of the Atlantic, the Bank of England's July 2024 Financial Stability Report has revealed that parts of the global financial system remain vulnerable to financial stresses, with a challenging risk environment here to stay.

The adjustment to the higher interest rate environment is continuing globally, and important vulnerabilities in market-based finance have yet to be addressed, meaning businesses must now crucially consider and evaluate their areas of highest exposure.

In light of these conditions, organizations must be aware of and prioritize the key areas of concern to successfully emerge from the other side.

The Financial Risk of Credit Extension

One of the fundamental business risks, particularly regarding credit management, is non-payments. When a business extends credit to a customer, it typically involves issuing an invoice with payment terms ranging from 30 to 90 days - assuming the customer will settle the invoice within the agreed period.

The issue arises when the payment is delayed or, in the worst-case scenario, *not made at all*.

Any delayed payments lead businesses to face outstanding debt. Over time, that debt goes old, becomes aged debt, and most likely becomes a provision on the balance sheet, meaning it's money that your business isn't recouping.

This will ultimately affect your business's cash flow. Businesses that don't see this as a top priority in risk management run the risk of limiting their growth and placing significant strain on their financial obligations.

Managing Risks in Diverse Jurisdictions

Managing financial risk becomes even more complex for multinational businesses due to the varying regulatory environments across different countries.

Millions of payments are made across borders daily, and each jurisdiction has unique invoicing requirements, tax mandates, and compliance standards that businesses must meet to be financially compliant.

Globally, there is no set framework, with each country or region having its own system to comply with tax laws and government standards. For example, some countries have mandatory e-invoicing requirements, whereas others do not.

Latvia, for instance, plans to make e-invoicing mandatory for all business-to-business (B2B) and business-to-government (B2G) transactions by 2025.

This is in stark contrast to Hungary, which does not mandate e-invoicing for B2B and B2G transactions, instead opting for a real-time invoice reporting system for native companies and foreign companies with branch offices within the country.

Additionally, compliance with regulatory requirements such as the US's Sarbanes-Oxley Act (SOX) is crucial for financial reporting and risk management. However, complying with SOX presents significant financial risk challenges to organizations, primarily due to its stringent requirements for internal controls and financial reporting.

Public companies view SOX compliance as a routine checklist of tasks to be completed. They may skip the part where their business should carefully consider the specific risks that could impact the accuracy and integrity of their financial reporting.

In simpler terms, this means that the organization does not thoroughly analyze potential risks and does not establish control measures to address those risks effectively. Without a risk-based approach to SOX, organizations may find it challenging to identify and monitor emerging risks most effectively, leaving them vulnerable to compliance breaches and financial misstatements.

Strengthening Controls Through Automation

Fortunately, we live in an era where businesses can mitigate risk by leveraging automation to strengthen controls over their financial processes.

Modern technology is playing an increasingly important role in alleviating challenges for F&A and credit management teams, giving them tighter control over a range of activities and simple risk flags like changes to the bank account a payment is made into.

Adding an automation element to risk management arms businesses with the tools to process data in real-time. Traditional methods, mainly from the invoicing side, rely on periodic data analysis, often leaving businesses to react to overdue payments rather than anticipate them.

Modern, automated systems can flag potential risks as soon as they emerge, allowing businesses to react more efficiently to them.

An example would be if a customer has a County Court Judgement (CCJ) issued against them in the UK or a Civil Judgement in the US. Rather than waiting for them to miss the payment or the invoice due date, automated systems allow businesses to take corrective actions – such as contacting the customer or adjusting credit terms –before any payment issues escalate.

Navigating the role of human error is another aspect to consider when considering risk management strategies. Any time humans are involved in practices such as data entry or evaluation, simple mistakes can creep in whereby a one becomes a two or a nine becomes a zero and suddenly you run the risk of misrepresenting figures.

Modern automation reduces this risk, eliminating the need for manual spreadsheet entries, enhancing both the accuracy of data and reducing the risk of non-compliance.

The human element is particularly important when considering compliance with regulations such as SOX in the US. These regulations require stringent controls to ensure accurate financial reporting and automated systems help facilitate adherence to these regulations by ensuring consistent and accurate data processing throughout.

Automation streamlines and strengthens the compliance process and provides clear documentation of financial transactions, which is essential for audits and regulatory reviews.

What About AI?

Naturally, Artificial Intelligence (AI) is starting to creep into conversations around financial risk management. BlackLine's research of over 1,300 global C-Suite and F&A leaders revealed that they see generative AI (78%) and new kinds of AI (76%) as essential for improving business resiliency in the face of future disruption.

Businesses are looking for solutions with embedded AI algorithms to evaluate customers' payment behavior over time and flag deviations from expected patterns to enhance their proactivity.

By continuously learning from new data, AI systems can refine their predictions and improve risk management strategies, providing businesses with a dynamic tool for navigating financial uncertainties into the future and beyond.

Generative AI also has potential in this area. The beauty of generative AI is that you don't need to be an expert coder to use it - it gives users the ability to query data in natural language – making it more straightforward and intuitive for F&A teams to find the answers they need at a greater speed.

AI functionality will continue to develop as we move through the remainder of 2024 and beyond, but businesses should also consider the technology's dual potential. While it can enable more proactive risk mitigation strategies, organizations need to ensure the technology does not create risks of its own.

It must be implemented and used within existing compliance frameworks and have its own set of checks and balances.

Ultimately, robust controls are critical for businesses in the current, complex risk landscape. However, this landscape is also set to evolve rapidly going forward, and controls and compliance must keep pace if businesses are to remain resilient in testing times.

About the Author

Andy Lilley, Managing Director, Global Invoice-to-Cash at BlackLine is responsible for the growth and strategic development of BlackLines' Invoice to Cash business in the markets we serve. Delivering on our winning aspiration to Inspire, Power and Guide Digital Finance Transformation. Andy joined Blackline in 2020 through the acquisition of Rimilia where he was Chief Product Officer and part of the leadership team. Since joining, he retained that leadership position in the P&T organization until taking ownership more broadly of the Invoice to Cash business.