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Keeping Credit and Collection Manageable

As an integral part of the overall accounts receivable program, credit and collections must be handled efficiently and promptly. Because the collection of open invoices is the primary source of cash that provides the necessary cash flow for a business, it is imperative that a business not lose control of this potentially unwieldy piece of the accounts receivable program. A successful accounts receivable program identifies and adopts strict credit and collection policies and uses set procedures to ensure the timely and accurate collection of any debt. The following outline establishes simple guidelines that can be implemented to keep your credit and collection efforts manageable.

Establishing Accounts for New Customers

1. **Get a credit application on file.** Ask specifically for two references whom the new customer has done regular business. Include a question of “Expected Monthly Purchases” on the credit application to help set credit limits. Use your professional contacts to verify credit references.
2. **Follow up on references.** Call them; don’t just read the application. Be wary of some references. The applicant will not list companies with which they have had payment difficulties in the past.
3. **Use credit status codes** (like “R” for risk) to track new accounts.
4. **Insist that the customer pay for their first order(s)** within credit terms to earn a higher credit limit.
5. **Ask for a credit card** to be used as a security only if the account is not paid within the terms you have established.
6. **Limit your liability** until the customer is established using credit limits. Start low, around \$300-\$500 or so, and increase the limit as the customer proves credit worthy. Your policy may be to eventually remove any credit limit, although this will vary from publisher to publisher.

Monthly Statements

1. **Monitor statements closely.** They are concise snapshots of customer problems.
2. **Write personal notes** and utilize stickers with various levels of seriousness when payments are overdue.
3. **Make two lists: *Hold and Call*,** as you review statements. Frequently, lack of payment is due to a misplaced invoice and can be taken care of by providing a copy of the invoice along with the statement.



- **Hold list.** For invoices two months overdue (i.e., on the March statement, invoice was dated in the previous January). Use the Hold list to determine which accounts to put on credit hold, so that future orders are approved before processing. Use these pending orders to further encourage customer to pay old invoices and thus get their new orders.

Type “On Hold 03/31/13” on the customer memo pad or record for future reference. This helps to separate those accounts that notoriously have trouble paying their invoices from those who simply lost an invoice once and were late for that reason. A credit hold status allows tracking and monitoring accounts even if the financial manager is not entering transactions. In some order fulfillment systems, customers with past due balances appear on a separate report if they pay. In general, using a Hold list as the basis of a system for orders to be approved and released eliminates the potential for these customers to be overlooked or forgotten.

- **Call list.** For invoices beyond three months overdue (i.e., on March statement, invoice dated prior to December 1st). Use this list to initiate correspondence or phone calls. If customers have reached this point of tardiness, they need a personal nudge or reminder.

Copy overdue statements and use as a tool to make phone calls during the upcoming month. Keep thorough notes of phone calls, letters, faxes, requests, comments, contact names, phone number, fax numbers, etc. on this copy for future reference. Keep the statement copy and any supporting materials until payment is resolved so you don't have to recreate the wheel each month.

Keep a brightly colored folder of all of these small account problems. You don't need a separate file for every account. Simply keep all copies in this folder alphabetically for reference and to track progress. Every seven to ten days, work your way through the credit hold folder. If payment has since arrived, remove all related materials. If not, call again. Continue contacting the customer until payment has been received.

Tracking and Resolving Discrepancies

1. **Make clear what credit will or won't be given** by establishing good procedures with warehouse personnel and returns entry operators. Make sure they understand what steps should be taken in each situation.



Create adjustment forms for the customer that clearly explain why full credit wasn't given. Mail the adjustment form along with the credit memo for the return to inform the customer immediately of the problem(s). If the customer makes an adjustment of the return credit now, it won't become a receivables problem later.

2. **Follow the company's procedures on denied returns.** Some customers want the returned products automatically returned to them, some customers don't ever want it back.
3. **Document the credit memo number** if the amount credited the customer account doesn't match their claim. Record the credit memo number, the credited amount, the difference, and the invoice on which the discrepancy is pending. Put this on a copy of the check stub for future reference. Use the check stub copy to track any and all details of this discrepancy and gather related materials and supporting documents behind the stub itself.

Keep good notes and document all steps taken to resolve the issue; this ensures nothing is lost or forgotten. Keep the notes in your file until the discrepancy is resolved. For smaller accounts that may have only one periodic discrepancy, write brief letters/faxes explaining the discrepancy in detail. Provide all supporting documentation to allow for quick repayment of the discrepancy.

Large Accounts

On large accounts, make it a habit to generate a discrepancy packet every one month and send directly to their A/P department. Include a letter with a clear outline of each discrepancy, providing all supporting documentation to allow for quick payment.

Follow up after two to three weeks to see if there are questions on any of the discrepancies or if additional information is required. Continue to hound them (nicely!) until resolved.

Determine which method of communication (i.e. fax, e-mail, phone, mail) works best with each customer and stick with it, but always follow up a phone conversation with a fax or a letter so that any statements or promises that were made by either side will be documented.

Keep a separate folder for each major customer in order to better track and manage discrepancies and correspondence. On the folder flap keep track of contact names, phone/fax numbers, e-mail addresses, etc. and update as necessary.



Manners and Attitude

Two phrases to keep in mind when managing credit and collections are:

- ***“The squeaky wheel gets the grease.”*** Continuous contact with the customer regarding the problem will all but guarantee a resolution.
- ***“You’ll get a lot farther with honey than with vinegar.”*** If you treat a customer with respect and calmly offer to provide information to help them, they will pay you first and delay paying the vendor who is unhelpful and demanding.

When dealing with overdue accounts, remember that they are customers first and foremost. We depend upon them to exist and sell our product. Always be polite, direct, and to the point, yet understanding. Be firm but courteous. Always offer to provide your customer with copies of paperwork needed to resolve the discrepancy. Don’t depend on them to find the time to dig through the files. Do it for them. Make it easy for your customer to pay. Finally, be professional. Treat people as you would want to be treated, professionally and with respect. It sounds obvious, but it usually works

More Tips for Good Credit and Collections

1. **Set solid procedures** to ensure that any action you take results in prompting for appropriate future action. For example, putting a customer on credit hold not only prevents them from charging more orders, but the account then appears on various reports for greater visibility and monitoring.
2. **Coordinate with Marketing.** Maintain a good working rapport with the marketing department. Even though marketing staff is not responsible for collecting overdue invoices, they can play a key role in solving account problems, especially when trying to resolve complex payment or returns issues.
3. **Use your system tools**, such as credit status, credit limits, memo pads, and reporting to the fullest extent possible. Make these tools work for you. Accounts on hold will not allow orders to be processed or released. In most order fulfillment systems, accounts that have been placed on credit hold, alert the order

entry operator to a problem. These accounts should be immediately routed to the financial manager’s attention for decision. In addition, when payment for an account on hold is applied, it may appear on a report that is designed to track payments against delinquent accounts. Use these reports to analyze future handling of a particular account. If a one-time problem, or the customer misplaced the invoice, simply remove the hold status from the account and allow purchases on credit in the future. If the customer took six months or longer to pay, consider placing the account at a significantly lower credit limit. This allows for better monitoring of activity before



cautiously increasing their credit limit. Even if some invoices were paid, if overdue items still show on the account, leave them on hold until current. In summary, system tools are an opportunity to give the customer a warning about possible credit hold in the future.

4. **Review the monthly aged balance** of accounts receivable and calculate the days' sales outstanding. Pay close attention to trends on the report and any changes in those trends. Assist the CFO in determining an adequate reserve for doubtful accounts on the balance sheet so no surprises occur at year-end. Quick action on discrepancies will greatly increase the chance of recouping any losses. Old items are harder to prove and documentation is harder to find.

Collection Agents and Bad Debts

1. **Send the account to collection** based on established time limits in your credit and collection policy. Provide your collection contact with all pertinent data on the account and an overview of the collection efforts you have made up to that point.
2. **Write off the bad debt** according to established time limits. When all collection avenues have been exhausted, remove the past due amount from accounts receivable and write it off according to the accounting procedures established at your organization.
3. **Prevent future orders** by marking the "Bill-to" customer account in as many ways as you can to ensure that credit will not be extended in the future. Use a credit status code, such as "S" for "Sent to Collection" and "W" for "Write Off" to keep written-off accounts from receiving future credit. Mark the contact line of the account with a notation such as "*****WRITE-OFF 04/13*****" to catch the attention of the order entry operator, sales representative, credit manager, or any other person scanning the database for information. If payment on accounts that have been previously written off is eventually received, record it as recovery of bad debt and count yourself lucky to reduce the expense.

To learn more about setting up a credit policy or to update your current policy, call us today at (661) 810-2446 or visit us on-line at www.azarandassociates.com