

CREDIT POLICY AND PROCEDURES BEST PRACTICES

The BIG Small Business Event

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CASH FLOW IS CRITICAL

- What do banks place the most emphasis on when evaluating a company: Income Statement, Balance Sheet or Statement of Cash Flows?
- True or False:
 - An increase in AR is shows a company is growing.
 - A company can have a positive net income but a negative cash flow.
 - As long as the total cash and cash equivalents on the Statement of Cash Flows increases, my business is doing good.
- Three parts to Cash Flow Statement: Operations, Investing and Financing.

CREDIT POLICY AND PROCEDURES

BEST PRACTICES

- What is the impact of Accounts Receivable on your business?
 - How much revenue is required to operate the business?
 - When is that revenue needed to meet the obligations?
What % of sales can you afford to be on credit?
 - How reliable is your AR?
 - Do you have resources to cover short term cash deficits (LOC)?
 - Have you done a cash flow analysis for the year? A special project to determine if you will need financing?

ACCOUNTS RECEIVABLE

- How much have you written off to bad debt in the past year?
 - <\$1,000
 - >\$1,000 - <\$10,000
 - > \$10,000
 - If >\$10k, do you need a person assigned to collections?
- If response was less than \$5,000, what is the amount of AR currently over 90 days?
 - That amount should be added to your total bad debt!

ACCOUNTS RECEIVABLE

- If bad debt is greater than \$5k or 1% of sales, what are you doing to get it under control?
 - Who in your organization responsible for follow-up?
AR clerk → manager → sales → president.
 - How often does the president of the company review an Aged Accounts Receivable report?
 - Who approves write-offs of bad debt?
 - If your sales team is on a commission plan, do they get an adjustment when an account exceeds 60 days?

CREDIT POLICY

- Do you have a formal Credit Application?
- Who follows up with credit references?
- Who approves the credit limits for new customers?
- How are the credit limits determined?
- Are payment terms in line with what your vendors provide you?
- Know your customers. Assess credit files on a regular basis.
- Setting terms. Discount for prompt pay, credit cards accepted (and when!)

CREDIT APPLICATION

- COMPANY NAME _____
- BILLING ADDRESS _____
- CITY _____ STATE _____ ZIP CODE _____
- PHYSICAL ADDRESS _____
- CITY _____ STATE _____ ZIP CODE _____
- SHIPPING ADDRESS _____
- CITY _____ STATE _____ ZIP CODE _____
- PERSON TO CONTACT _____ PHONE (____) _____ FAX (____) _____
- E-MAIL ADDRESS _____
- PROPRIETORSHIP _____ PARTNERSHIP _____ CORPORATION _____ (TYPE _____) MUNICIPALITY _____
- FEDERAL ID NUMBER OR SOCIAL SECURITY NUMBER _____
- YEARS IN BUSINESS _____ TYPE OF BUSINESS _____
- PRINCIPALS NAME _____ TITLE _____ SOCIAL SECURITY NUMBER _____
- _____
- _____
- TRADE REFERENCES
- NAME ADDRESS PHONE & FAX NUMBER
- 1. _____
- 2. _____
- 3. _____
- BANK REFERENCES NAME ADDRESS PHONE NUMBER
- _____
- CREDIT AMOUNT REQUESTED \$ _____ DO YOU REQUIRE THE USE OF PURCHASE ORDERS? _____
- D & B RATING _____ DUNS NUMBER _____

CREDIT POLICY

- Confirm, verify and research all customers using information provided. Need to include resources independent from the customer (banks, credit reporting agencies, trade groups). For larger accounts, may consider on-site visits to their operations.
- Develop and implement a consistent method of credit risk evaluation.
- Remember – the potential customer is only going to list their best references.
- Credit limits need to be reviewed systematically to evaluate current risk levels.
- A strict credit policy can lead to missed sales. A lenient credit policy can lead to high bad debt. Need to strike a balance.
- Can you afford not to have a staff person dedicated to credit collections (what was your bad debt the past 3 years?)

CREDIT POLICY

- You do the follow-up review and the vendor tells you they are paying on average 58 days. Do you grant credit?
- Potential customer is wanting a credit limit of \$10,000 but the review of their credit references only shows a maximum of \$5,000. What would you do?
- Can you absorb the loss if your new customer can't pay?
- Know the risks of accepting credit card payments for on line orders.
- What is the average DSO for your industry and how do you compare?
 - $\text{DSO ratio} = \text{accounts receivable} / \text{average sales per day}$

COLLECTIONS

- If you are making that first call after 90 days, you are probably already too late.
- With first time customers, make a “friendly” reminder call 5 days before due date.
 - Have you received our invoice?
 - Did you receive everything as expected?
 - Do you have any questions regarding the invoice?
 - When and how often do you normally cut checks?
 - Can you tell me when we can expect payment?

COLLECTIONS

- Calls need to be made shortly after due date is past. If told payment has been made, request date of check and the check number. Record the information and compare mailing date when received (is business 'holding' checks).
- Need to compile a list of problem accounts (slow paying, short paying, etc). Have AR make a call 5 - 7 days before due date to inquire if they have received the invoice (fax to person speaking with if not) and if there are issues with the invoice. Also ask when you can expect a check to be cut. It's the squeaky wheel that gets the grease.
- If all efforts fail, consider an attorney or collection agency. Use collection agencies that work on a percentage basis and only get paid if they collect. Collection agencies want to take on past due accounts when there is a likely chance of them collecting so don't wait until account is over 180 days.

OVERVIEW

- Proper management and oversight are critical functions of credit risk, collections and accounts receivable. Proper management of these areas will not only help you to grow but also help protect you in down times. You can have fantastic sales but if you not collecting on those sales, you will soon be looking for other opportunities. An account written off to bad debt affects Net Income AND Cash Flow.

CREDIT POLICY AND PROCEDURES BEST PRACTICES

QUESTIONS?