Paul Robbins training and consultancy

Credit Management

Lesson 3 – Monitoring and Controlling Customer Accounts & Collecting Debts and Dealing with Insolvency

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The 80 / 20 Rule

- This states that, for many businesses, 80% of the total trade receivables balance is made up from only 20% of the customers of the business
- Therefore the credit control function of the business needs to focus most of its efforts on monitoring the accounts of the top 20% of its customers
- The other 80% of customers only represent 20% of the total trade receivables balance and, whilst it is important to ensure that all monies due to the business are collected, they are not as material as the top 20% of customers

Trade Receivables Analysis

- A trade receivables analysis summarises amounts of money owed by customers which is analysed into time periods showing the age of the debts
- This enables a business to see which of its customers are either slow in paying their invoices or not paying their invoices at all
- Whilst a trade receivables analysis can be produced manually, in most cases a business will run a report from its computerised accounting software which provides this information in a fraction of the time it would take to produce the information manually. The reports are sometimes called ‘aged debtors reports’
- The reports are usually produced just after the end of each month

Trade Receivables Analysis

- This should show the account name and account number for each credit customer
- It should also show the customer’s credit limit and balance outstanding which can be compared to ensure the customer has not exceeded their credit limit
- The amounts outstanding are normally analysed into the following columns; up to 30 days (current debts), 31 – 60 days, 61 – 90 days and 91 days & over
- The percentages of the total balance outstanding can also be analysed out between the different time periods to see whether the overall collection periods for debts are increasing or decreasing

Analysing Customers' Accounts

- When analysing individual customers' accounts the credit controller will look at the situation this month compared to last month, for instance seeing whether the invoices are taking longer to be paid or are not being paid at all and whether the customer still placing orders with our business

- There will probably be some customers who have a reputation for being slow, albeit reliable, payers. Whilst all customers should pay within the normal credit limits and this will need to be addressed with them at some point, as long as they continue to pay according to their previous payment pattern, this is not something for immediate concern

Analysing Customers' Accounts

- Credit controllers will often start by looking for customers with account balances which are significantly outstanding (91 days & over) as these will need to be investigated as a matter of priority

- It is essential that this is done with great tact and diplomacy, especially where the customer appears to be a regular customer who always pays promptly and there is just one significantly outstanding amount

- It could well be that a particular invoice is disputed and remains unpaid or we may have made an error, for instance not recording prompt payment discount taken on the customer's account. Speaking to colleagues and looking up notes on the customer's account is a good starting point in resolving this

Chasing Overdue Debts

- There are a variety of ways that credit controllers can chase overdue debts
- These should follow the credit control policy of the business and could include:
- **Reminder letters** – an informal ‘friendly’ reminder to start with, followed by more formal requests for payment and formal letters threatening legal action
- **Telephone calls** – a more direct way of contacting customers
- **Placing the customer’s account ‘on stop’** – withdrawing their trade credit
- **Taking legal action** – attempting to recover the money through the courts

Reminder Letters

- Almost all businesses will have standard reminder letters that will be sent out to customers with overdue account balances. It is essential that credit control staff use these standard (template) letters to put across the correct message that the business wants to use at each stage of the debt chasing process

- <u>Reminder letters should be issued to customers in the following order:</u>

- An initial ‘friendly’ reminder letter advising them that payment is overdue

- Formal letters chasing payment and advising their account will be put ‘on stop’

- A formal letter threatening legal action if the account is not settled immediately

Telephone Calls

- Telephone calls are useful because the credit controller gets to speak directly with someone from the customer’s business and this cannot be ignored in the same way that a letter can
- This also provides the credit controller with a range of useful information about the customer’s business. For instance, do they always find themselves speaking with different people in the accounts department and is there a high turnover of staff, do their accounts department appear to be organised and competent, having the relevant information to hand when they call
- The customer will often give a range of excuses as to why payment has not been made which the credit controller can address there and then

Excuses for Non Payment – Exercise

- <u>Working in pairs, discuss how you would reply to these excuses:</u>
- *“We have not received the invoice (or latest statement) from you”*
- *“We will need to look into this and get back to you”*
- *“There was a problem with the goods or services (or they were not received)”*
- *“The person who can authorise payment is not in the office at the moment”*
- *“A cheque has been sent to you in the post”*
- *“An electronic payment has been sent to your account”*
- *“Our computer systems are down at the moment”*

Placing Accounts ‘On Stop’

- If a customer has received a second reminder letter and possibly a reminder telephone call, but has still not paid their outstanding account balance, the next step will be to put their account ‘on stop’
- This means that their trade credit is ‘frozen’ and no further credit sales should be made to the customer until their account is paid in full
- If the customer’s account is placed on stop, this should be communicated to the Sales department in a timely manner, to prevent more sales being made
- It is important that there is good, prompt communication at all times between the Sales, Accounts and Credit Control departments of a business

Doubtful Debts & Irrecoverable Debts

- Doubtful debts are where the business is doubtful about whether the customer will pay, although it is possible that they will
- Irrecoverable debts are where the business is absolutely certain that the customer will not pay and these will need to be written off in the accounts
- It is normal practice for a business to make a provision for doubtful debts
- This is usually a percentage of the overall trade receivables balance, but in some cases businesses prefer to go through each customer’s account to highlight the debts that are doubtful and record these as a provision for doubtful debts

Collecting Outstanding Debts

- Before a doubtful debt is written off as an irrecoverable debt, the business has the option to try and recover the money from the customer through the use of debt collection agencies, sending solicitors letters and taking legal action
- Before going down this route, it is important to make sure that it is worthwhile doing this, rather than just writing off the amount as an irrecoverable debt
- If the customer is unlikely to have the money or other assets which could be sold to pay the debt, then even if the matter is taken to court, the business is unlikely to receive any money and will be further out of pocket
- Credit controllers will need to recommend that some debts be written off

Collecting Outstanding Debts

- It may not be worthwhile taking a customer to court to collect a debt if:
- The debt is a small amount particularly when compared with the cost of trying to recover the debt
- The customer appears to be insolvent and would be unable to pay the debt, even if the matter was taken to court
- The customer is insolvent (bankruptcy for individuals and liquidation for limited companies)

Irrecoverable Debts

- Whilst an irrecoverable debt is something that should be avoided, some of the loss can be mitigated as VAT paid can be recovered on irrecoverable debts and irrecoverable debts can be charged as an expense in the SoPoL, which will reduce the tax liability of the business. VAT paid can be reclaimed where:
- The VAT has already been accounted for and paid over to HMRC
- The debt must have written off in the accounts as an irrecoverable debt
- The debt is more than six months overdue
- The VAT must be reclaimed within four years & six months of the payment date

Using Debt Collection Agencies

- Debt collection agencies are businesses which specialise in collecting debts on behalf of their clients
- They earn money by taking a percentage of the amount of money collected
- They are usually very effective at collecting debts as they are tenacious and quickly escalate the debt collection process through reminder letters, telephone calls, legal letters and court proceedings
- Often customers take more notice when an external debt collection agency gets involved and are more likely to pay the money owed

Using Solicitors

- As a last resort, a solicitor's letter to a customer with a significantly overdue debt can be a good option, as the customer can see that the business is not going to give up on the money owed and is more likely to pay up

- It is important to choose a firm of solicitors that specialises in debt collection and the business needs to provide the solicitor with detailed and accurate information about the customer and the money owed

- Solicitors letters should only be sent if the debt is not too small and there is a good chance of receiving money from the customer. Using solicitors is not cheap and the Small Claims Track System (Small Claims Court) will not award reimbursement of solicitors' costs

Taking a Customer to Court

- The business taking a customer to court will need to hire a **licensed insolvency practitioner**, who will be able to advise the business and, if necessary, represent the business in court

- There are two ways in which a customer can be taken to court:

- **To enforce repayment of the debt from the customer**

- **To bring about the bankruptcy (individuals) or liquidation (limited companies) of the customer**

Taking a Customer to Court

- Legal cases relating to recovery of unpaid debts are normally heard in the **County Court** in the first instance and may then be referred to the **High Court**
- The County Court and High Court are both examples of the **Civil Courts**
- It is essential that paperwork submitted to the court is correct; for instance the name and address of the debtor, the amount owed and the date of the debt
- When the paperwork has been submitted to the court, the court will issue a 'default summons' to the customer (the debtor), who can agree to the claim, ignore the claim (in which case judgement will go against the customer) or alternatively go ahead with the court proceedings

‘Tracks’ in the County Court

- **Small Claims Track** – this is used if the amount claimed is £10,000 or less and the business can bring the case itself without needing to employ a solicitor or barrister. This is sometimes known as the ‘Small Claims Court’
- **Fast Track** – this is used if the amount claimed is between £10,000 and £25,000 and applies to more detailed and complex cases which will normally only take one day in court to resolve
- **Multi-Track** – this is used if the amount claimed is more than £25,000 (or if it is a particularly complex case less than £25,000) and applies to detailed and complex cases which will normally take more than one day in court to resolve. Some very complex cases may be held in the High Court in the first instance

How Courts Enforce Judgements Made

- If the judgement of the court is in favour of the business bringing the claim, a **County Court Judgement (CCJ)** will be issued against the customer (debtor) requiring them to pay the business the money that they owe to them
- If the customer pays the money that they owe this is the end of the process
- However, if the customer either refuses to pay the money that they owe or is unable to pay the money that they owe, then further action needs to be taken
- The court may order that the customer has to have an **oral examination**. This is where the customer is required to come to court to be questioned about their income, capital and savings

How Courts Enforce Judgements Made

- **Garnishee Order** – this is a court order which is sent to a bank or building society where the customer has an account, ordering the bank or building society to pay the business directly from the customer’s account on a certain day. However, it relies on there being money in the account on that day

- **Warrant of Execution** – this allows bailiffs to enter the customer’s home or business premises and obtain money or assets to the value of the debt, apart from essential living items and the customer’s ‘tools of their trade’

- **Warrant of Delivery** – if the customer has goods which belong to the business, for instance if there is a retention of title clause in place, the court can issues a Warrant of Delivery to allow bailiffs to retrieve the goods

How Courts Enforce Judgements Made

- **Attachment of Earnings** – this requires that the customer's employer deducts a set amount of money from their salary on a regular basis until the debt is repaid. The judge will decide how much money will be deducted, taking into account the money the customer needs for living expenses

- **Charging Order** – if the customer owns a property, the business can ask the court to 'register a charge' against the property which will show that the business has the right to receive part of the money received from the sale of the property when it is sold

Insolvency

- Insolvency is defined as **not being able to meet your financial obligations (pay your debts) when they fall due**
- A business can take a customer to court to prove that the customer is insolvent. If this is the case, the court will arrange for the customer's assets to be sold off and the money received from the sale will be distributed to the customer's creditors, although trade payables are one of the last groups to be paid and may receive little or no money
- An **individual** found to be insolvent is declared **bankrupt** whereas a **limited company** found to be insolvent is said to be **'in liquidation'** (sometimes called winding-up or dissolution) which may be compulsory or voluntary

Insolvency Legislation

- Insolvency Act 1986
- Enterprise Act 2002
- Deregulation Act 2015
- Small Business, Enterprise and Employment Act 2015

Stages of the Insolvency Process

- The business firstly needs to ensure that the debt is £5,000 or more. This is the minimum amount that the courts will allow for the bankruptcy process
- If the debt is £5,000 or more, the business needs to make a ‘statutory demand’ to the customer for the amount owed, using an official form
- If the customer does not pay the debt in three weeks, the business needs to send in a ‘creditors petition’ to the court. The court may decide to call a meeting of all creditors, who will be asked to submit evidence (‘proof’) of amounts owed by the customer

Order of Payment Priority for Insolvency

- Liquidator fees and expenses
- Secured creditors with a fixed charge
- Preferential creditors
- Secured creditors with a floating charge
- Unsecured creditors
- Shareholders (limited companies only)

Administration and Receivership

- If a business becomes insolvent, an insolvency practitioner is appointed by the courts as the administrator. The administrator will take control of all of the assets of the business and its business operations with the aim of turning the business around and saving it. During the period of administration, usually lasting around eight weeks, the organisation is protected from any legal action relating to bankruptcy or liquidation

- Receivership is where one of the creditors with a legal charge against one or more of the assets of the business appoints an administrative receiver. They are responsible for selling off the relevant assets and obtaining the money for the creditor