

How to collect your accounts receivable

The basic message is simple: The longer an account goes unpaid, the more difficult it becomes to collect.

By **Janine M. Iacobelli, CPA**

In these uncertain economic times, many small businesses are finding their accounts receivable aging growing. Accounts receivable can be viewed as interest-free loans to your customers. Customers love to use your money if you let them. While customers live on your capital, you as a small business owner may be forced to limit your growth or take on more debt of your own. Lack of working capital is a principal reason many small businesses fail.

Accounts receivable management is key to survival and growth. The No. 1 strategy is to develop a system to limit the number of accounts that go past due. The basic message is simple: The longer an account goes unpaid, the more difficult it becomes to collect. When developing your collection policy, consider the following:

- When will you invoice your customer (prior to beginning the work, at the completion of the job, progress billing)?
- How often will you generate invoices (daily, weekly, monthly)? Will you send a monthly statement?
- Will you require a credit application? Will you check references? Will you set a credit limit?
- What will be the terms of payment (upon receipt, net 30)?
- Will you offer a discount for early payment? How much and by when must they pay?
- Will you assess a finance charge if payment is late? When and how much?
- What will your collection efforts be (letter, phone call, payment plans, collections agencies, small claims court)?
- When will a customer be put on hold?



Commit your policy to writing and share with your internal collection and sales staff. Likewise, publish your policy for your customers so they know the terms of your agreement and what to expect.

Often a measured approach to debt collection is difficult because of a lack of appropriate personnel. However, it is important to allocate time and staff to the collection process. Select the right person to spearhead your efforts — someone who is positive yet tough enough to hold his or her ground and, most importantly, organized with good follow-through. Because of conflicting interests, the sales person is typically not the best person to collect the debt. Consider the following collection tips:

- Contact the customer as soon as the payment is late.
- Don't give your delinquent customer an excuse for not paying.
- Get a commitment as to when the invoice will be paid.
- Document a verbal payment plan in writing.
- State the consequences of further delays in payment, such as interest charges, collection efforts or an effect on their credit rating.
- Follow through consistently until the account is paid in full.

As you cannot manage what you cannot measure, develop your performance benchmarks. Determine the health of your receivables by reviewing an accounts receivable aging monthly.

Calculate your accounts receivable turnover.

$$\frac{\text{Net credit sales}}{\text{Average accounts receivable}}$$

Calculate your collection period.

$$\frac{365 \text{ days}}{\text{Accounts receivable turnover}}$$

Observe trends. Compare your results to industry averages provided by your industry association. Set goals to improve these numbers. Create a plan to improve these numbers and meet your goals.

While we often hear from our clients that their business is different and they can't implement such policies without losing customers, I say, "Try it!" One client who did increased its accounts receivable turnover by 1.6 and decreased its average days to collect by 10. Not only did the client improve its cash flow, but the one and only customer who left soon returned noting he couldn't find comparable quality or service.

Remember, the goal is to collect the receivable on the invoice for the product or service that you have provided and that the customer has received and benefited from. Set a clear policy and stand by it. Limiting sales to customers who are willing to pay you will reduce collection costs and bad debt losses. In the end, cash is king!



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