

## **Business Services Common: Too many bad debts/lack of a credit policy**

The business is experiencing a large number of bad debts and/or it is taking a long period of time to collect a substantial number of trade debtors.

### **Indicators**

- The debtors figure is increasing in value.
- The average age of debtors is increasing.
- Cash is decreasing.
- The business's overdraft is increasing.
- High level of bad debt expense in the profit and loss accounts.
- There is a substantial provision for doubtful debts.
- The business has an aggressive sales force who do not want to 'play by accountants rules'.

### **Causes of the problem**

- No credit policy; or inadequately monitored credit policy.
- Invoicing system is not working efficiently.
- Debtors ledger is not kept current and is never reconciled.
- Customers are not pressured into meeting payments.
- Lack of substantial long term customers.
- Insufficient reinforcement by upper management to stress the importance of adhering to a tight credit policy.

### **Short term solutions**

- An age analysis of debtors should be conducted, eg by dividing them into periods of 30, 60, 90 and over 90 days.
- All overdue customers/debtors should be contacted by phone and followed up by letter with a view to receiving payment as soon as possible.
- The debtors ledger should be updated and reconciled to ensure that all debts are recoverable.
- A short term credit policy should be implemented so overdue customers do not receive any further orders until outstanding invoices have been satisfied or cash is received on delivery (COD).
- Offer troubled customers the option of paying by instalments.
- Institute penalties for late payment as a form of early warning for when customers are in trouble.
- Offer early settlement discounts.



- Offer incentives for those employees responsible for incurring credit if they decrease their bad debts.

#### **Long term solutions**

- A credit policy should be created which analyses the credit worthiness of each client and attaches a credit maximum based on this analysis.
- The debtors ledger should always be kept up to date and correct (eg establish a system that the ledger must be current at monthly rollover date).
- Encourage and accommodate large reliable customers whenever possible.
- In conjunction with the 'target collections' policy encourage minimal bad debts by offering responsible employees incentives.
- Link the sales force's commission to bad debts (only pay commission on cash receipts)

Bentleys is an association of independent accounting firms in Australia that specialises in developing long term strategic partnerships with clients. Bentleys offers a broad range of services including business advisory, taxation, corporate recovery and audit.

Please [contact us](#) today to discuss your business needs.