

## CREDIT CONTROL

The credit controller should set target figures for the credit control department that reflect the agreed credit policy. These target figures are generally:

- bad debts as a percentage of sales (generally 1% to 1½%), or
- the average period of Credit Allowed or Debtors days (we have seen this ratio before and is based on industry norms and past trends).

Both of these ratios serve as a yardstick against which the effectiveness of the credit control department may be measured when accounts are prepared and the key ratios calculated.

The first stage in creditor control is assessing potential customers for credit worthiness. In other words, determine that you really want to transact with this customer on a credit basis. Typical procedures for assessing include:

- a. A formal application is made by the customer for an account facility by completing a standard application form which will include full details of the company (trading name, business address, directors etc). The following may also be sought:
  - 1) Two known trade references (reference from other suppliers who have traded with the applicant on credit terms).
  - 2) A banker's guarantee for a specified amount (applies to overseas customers where the foreign bank guarantees any balance owed – known as a Letter of Credit).
  - 3) Reports by company representatives and salesmen.
  - 4) A credit rating agency's report (there are many providers of these in this era of databases and data analytics).
  - 5) Analysis of the customer's latest report and accounts (review of last accounts filed with Companies Registrations Office to determine the solvency and profitability of the company).

The credit limit and the credit term should be related to the degree of risk associated with the customer. Throughout, the purpose should not be to avoid all risks: some sales will fall into this classification and should be approved as long as the price compensates for this risk and the credit period being offered.

- b. The second aspect of Credit Control is to have good documentation flow over each stage of a sales transaction. The purpose of this is to avoid disputes over amounts owed. So official order forms and signed delivery notes (or “Proof of Delivery”) should be used so that there is no dispute with customers that goods delivered were actually ordered and that the delivery was signed for and accepted by the customer.
- c. The third aspect is monitoring compliance by customers with the credit terms by regular review of the sale ledger. Should an order cause a customer’s balance to exceed the agreed credit limit (the amount of sales agreed to be supplied in any one month), then this order should be referred to the credit controller for consideration and approval.

If not approved and a customer's order causes an account balance to exceed the agreed limit, the credit controller:

- a. Should place a stop on the order OR
  - b. Request the customer to reduce the current outstanding balance before releasing the ordered goods, OR
  - c. Contact the customer for first hand assessment AND
  - d. Give approval if satisfied
- d. The accounts department should update the sales ledger continuously. This is the most important aspect of credit control and you should review the “Debtors module” slide in the “Accounting System ZIP” file.
- e. Every month, the outstanding invoices should be "aged" to find out which customers have failed to observe the agreed credit terms. A sample age listing is set out at the end of this note.
- f. Over time, and depending on customer performance, the credit controller should revise the credit limit upwards for reliable customers and downwards for poor payers and possibly put stops on further deliveries.
- g. In the case of core outstanding balances, the course of action should be:
- 1) A statement of the account should be sent THEN
  - 2) A second statement and a letter THEN
  - 3) Telephone calls to specific personnel THEN
  - 4) Personal visits THEN
  - 5) Legal action to recover the debt.
- h. The analysis of the accounts will indicate the credit department’s performance. The computations of the 2 ratios from the accounts (viz Bad Debts as % of sales and Period of Credit Allowed / Debtors Days) can be compared with the target standards. Next, any deviations should be reviewed and remedial action taken either to control performance to plan or to revise the standards to more realistic levels (for example, setting a target for debtors days of 45 days that should really be put out to 55 days).

Sample of age analysis report:

Balances drifting into this column should be followed up

A/C No	CUSTOMER	BALANCE	CURRENT	1MONTH	2MONTH	3MONTH
A101	Abacus	10,200	4,100	4,500	0	1,600
C212	Cornel	17,200	3,100	10,200	3,900	
D111	Dekor Ltd	400	0	0	0	400
E100	Elevator Ltd	3,800	3,800	0	0	0
↓	↓	↓	↓	↓	↓	↓
↓	↓	↓	↓	↓	↓	↓
↓	↓	↓	↓	↓	↓	↓
Z120	ZZ Top	14,200	0	14,200	0	0
		-----	-----	-----	-----	-----
TOTAL		187,400	62,400	102,700	12,100	10,200
		=====	=====	=====	=====	=====
		100%	33%	55%	7%	5%