

Credit Control

Recap:

1. A system of securing payment from customers.
2. Dependent on an efficient & timely system of recording transactions.
3. A good system:
 - 1) Secures prompt payment.
 - 2) Minimizes bad debts.
 - 3) Avoids disputes.
4. Requires reliable documentation flow over each stage of a sales transition:

	STAGE	DOCUMENT USED
1.	Initiation of the sales order	Use of <i>Official Order Form</i> that sets out each product item and the quantities ordered by the customer.
2.	Authorization	Orders of unusual size are referred to the credit controller <i>who initials the order form</i> before releasing goods.
3.	Execution	Issue of <i>Despatch Note</i> in duplicate when goods have been released from the warehouse and loaded on distribution vehicle.
4.	Custody	<i>Despatch Note signed by customer</i> and original retained by delivery agent.
5.	Recording in the accounting records	Despatch Note passed to accounts as evidence of delivery and <i>Sales Invoice</i> raised promptly and mailed to customer.
6.	Periodic Statement of Account sent to all customers.	At the end of each month, a <i>Statement of Account</i> is sent to each customer that sets out all unpaid invoices that makes up the outstanding balance.
6.	Allocation of payment received	When payment has been received, the payment should be <i>promptly entered in the Sales Ledger</i> account for the customer to reduce the outstanding balance.

5. Evaluation of Credit Control using key ratios:

- 1) From the management accounts prepared, there should be regular review of:

Debtors Days:	$\frac{\text{Debtors}}{\text{Sales}} \times 365 =$	average number of days credit allowed to customers.
Bad Debts %:	$\frac{\text{Bad Debts}}{\text{Sales}} \times 100 =$	% of sales that were bad debts (normal is 1 to 1½% per annum)

- 2) From Reports:
Review of age- listing of Customer Balances to identify at an early stage those customers who consistently fail to adhere to agreed credit terms (particularly where significant element of the balance drifts into the “3 months +” column of the report).

REVIEW OF CREDIT CONTROL FROM EXAMINATION OF ACCOUNTS:

J.B Ltd

The following figures were extracted from the accounts of J.B Ltd:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Sales	1,500,000	1,400,000	1,200,000
Gross Profit	860,000	840,000	720,000
Bad Debts	28,000	19,000	18,000
Debtors	226,000	172,000	148,000

A) Compute for each year:

- Gross Margin
- Bad debts %
- Debtors Days

B) From a review of your computations at a), what concerns would you have about the effectiveness of credit control procedures in J.B Ltd.

Solution – J.B Ltd

	<u>2019</u>	<u>2018</u>	<u>2007</u>
Gross Margin:			
= $\frac{\text{Gross Profit}}{\text{Sales}} \times 100$	$\frac{860,000}{1,500,000} \times 100$	$\frac{840,000}{1,400,000} \times 100$	$\frac{720,000}{1,200,000} \times 100$
	= 57%	= 60%	= 60%
Bad Debts %	$\frac{28,000}{1,500,000} \times 100$	$\frac{19,000}{1,400,000} \times 100$	$\frac{18,000}{1,200,000} \times 100$
	= 1.9%	= 1.4%	= 1.5%
Debtors Days	$\frac{226,000}{1,500,000} \times 365$	$\frac{172,000}{1,400,000} \times 365$	$\frac{148,000}{1,200,000} \times 365$
	= 55 days	= 45 days	= 45 days

PART B:

- Fall in gross margin may indicate that the company is operating in a more competitive environment and that, in order to maintain or grow sales, it is selling its goods at a tighter margin in conjunction with offering customers improved credit terms (see Debtors Days below)..
- Increase in Bad Debt %: indicates greater existence of bad debts. The company should determine how these bad debts arose and over how long a period i.e. why was non-payment not identified earlier & stops put on subsequent orders. More importantly, it should be determined if the balance written off because its was disputed by a customer & there was no documentary evidence (i.e a signed Delivery Note) to support the claim for payment (see earlier).
- Increase in Debtors Days (45 days to 55 days)
 - Indicates rate of payment from customers has slowed down.
 - Prompts a general review of credit control procedures to ensure no breakdowns.
 - Age list of debtors should be reviewed to identify slow payers.
 - Age list reviewed for the existence of balances that should be written off as bad debt.
 - Check for any change in credit controlling policy e.g. increasing credit term to some customers to generate more sales.