Accounts Receivable
Unsecured Loans by a Company

By
Daniel R. Siburg, CPA, CVA
And
Howard W. Fisher
Account Receivable Topics

• Defining accounts receivable - trade and other receivables
• Receivables classifications
• Managing accounts receivables
• Receivables collections and DSO
• Bad debt and allowances
• Other Receivables
What Are Accounts Receivable?

• Sales to customers on account - trade accounts receivable

• Employee advances

• Loans to officers
Other Receivables

- Advances to subsidiaries
- Dividends and interest receivable
- Deposits
- Tax refunds
- Promissory notes
- Credits for returned, lost or damaged goods
- Investments
Receivables Classifications

• Short term receivables - will be turned into cash within a year or the operating cycle (i.e. accounts receivable - trade and short term advances)

• Long term receivables – cannot be turned into cash quickly; instead cash will be received at some date in the future or over a period of time (i.e. other receivables)
How Does Your Company Manage Accounts Receivables?
Start With The Payer In Mind

• Customer contracts
  • Phone
  • Fax
  • E-mail address

• Customer terms

• Invoice form

• Packing slip with product shipments

• Proof of delivery for shipments
Beyond Just Billing The Customer

A Sale Is Only Complete When It Has Been Paid For!
Collecting Accounts Receivable

• Collection efforts are proactive vs. reactive
• Target collection efforts
• Call the customer
• Use new orders as leverage for payment
• Using collection agencies
Collecting Money Is Like Charming A Cobra Out Of A Basket Without Getting Bitten!
Proactive Collections

- Credit applications with accounts payable and bank references
- Manage customer credit limits
- Strict use of customer terms
- COD for new or problem customers
- Manage the customer base
Customer Base

- Have a diversified customer base
  - Avoid customer concentrations
- Sell to a diverse set of industry segments
  - Avoid industry segment concentrations
- Work with good customers
  - They pay their bills within established terms
- Fire bad customers
Accounts Receivable Collections

• Accounts receivable collections is a daily activity!

• Customers pay companies that call on a regular basis

• The company, as a whole, needs to support accounts receivable collection efforts
Customer Invoice

• Customer invoice should contain:
  – Customer bill to and ship to information
  – Customer purchase order number
  – Credit terms
  – Invoice date
  – Product, units purchased and price
  – Sales tax payable
  – Total amount due

• Packing slip with order shipment
Days Sales Outstanding (DSO)

- DSO is a metric that measures how well a company is collecting accounts receivable.
- A company’s DSO should track to the industry average or better.
- DSO is a mathematical equation that can be incorrectly interpreted, so you need to truly understand what affects the equation.
DSO Formula

A/R Turnover = \frac{\text{Net Sales}}{\text{Avg. Trade Receivables (net)}}

= \frac{$2,500,000}{\$475,000 + \$525,000} \div 2

= 5.00 \text{ (divide into 365 to get days)}

= 73.00 \text{ days}

Industry Average = 6.75 \text{ or 54.07 days}
DSO Formula Analysis

• DSO is a metric that shows how quickly a company’s invoice is turned into cash
• DSO is affected by sales cycles
  – Large sales months will push down DSO
  – Low sales months will push up DSO
• Quality of sales will have an impact on DSO
• Accounts receivable write-offs will affect DSO
Bad Debt

• Bad debt is an accounts receivable, trade or note, that is deemed to be uncollectable
• Bad debt can be the result of:
  – The accounts receivable age
  – Customer bankruptcy
  – Customer dispute
  – Economic conditions
• Bad debt needs to be reserved in the period the company determines the receivable uncollectable
How To Handle Bad Debt

• Bad debt due to a customer going bankrupt should be written off immediately
• Bad debt accounts should be turned over to a collection agency for continued collection effort on the account
• Bad debt accounts are not customers!
Returns and allowances are generally expressed as a percent of sales on account, for the current period.

Returns and allowances percent is based on:
- Previous sales experience
- Inventory with right of return
- Economic conditions
A Nice Idea, But Your Company Is Not A Bank!
Types Of Employee Advances

• Payroll advances

• Travel advances

• Company credit cards
Payroll Advances

- Payroll advances positively re-enforce negative behavior
- If your company gives payroll advances, make the employee sign a loan agreement with the repayment date and method of repayment stated
Travel Advances

• If an employee cannot afford to pay their out-of-pocket expenses, then the employee should not be traveling

• If your company gives travel advances, make the employee sign a loan agreement with the repayment date and method of repayment stated
Company Credit Cards

- The company policy should be that an employee will be reimbursed for one credit card annual service fee
- All credit card purchases made by an employee will be submitted for reimbursement through the expense report process
Other Types Of Receivables

• Other receivables such as officer loans, deposit, tax returns, advances to subsidiaries and promissory notes are generally of a long term nature and are limited in ability to be collected quickly

• Never count on other receivables to support current operating capital requirements
Questions and Comments?

Daniel R. Siburg, CPA, CVA
Managing Director
The Siburg Company, LLC

Phone: 480.502.2800
Fax: 480.502.2804
Email: Dan.Siburg@thesiburgcompany.com
Website: www.thesiburgcompany.com