

## PAPER DETAILS

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TECHNIQUE

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## ***ACCOUNTS RECEIVABLE MANAGEMENT: DESCROPTION AND SAMPLING TECHNIQUE***

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### **ABSTRACT**

The accounts receivable term represents the funds that a company had not yet collected for the services/products that were already provided purchasing party. Such kind of services are sold on credit and the fund collection is the task that should be properly realised, i.e. the management of accounts receivable should be accomplished. Usually companies negotiate all conditions of the payment processes and conduct them in the mutual contracts as per which the accounts receivable management is realised. However, the accounts receivable management itself may not be considered as a simple fund collection and it covers a much complex line of processes. Each company has to make a certain collection plan that depends on number of factors and considers various techniques that help the company make the correct decisions and actions for achievement of targets. Certain part of such decision-making falls on different company departments that are not directly connected to a counting, such as marketing and sales departments, which gives additional value to their performance as well.

**Keywords:** *Account receivable, management, sampling technique, credit sales*

### **ALACAK HESAPLARININ YÖNETİMİ: TASARIM VE ÖRNEKLEME TEKNİĞİ**

#### **ÖZ**

Alacak hesapları, satın alma gerçekleştiren taraftan sağlanan hizmetler / ürünler için bir şirket tarafından henüz toplanmadığı paraları temsil etmektedir. Bu tür hizmetler kredili satılmaktadır ve para toplama, doğru bir şekilde gerçekleştirilmesi gereken görevdir, yani alacak hesaplarının yönetimi gerçekleştirilmelidir. Genellikle şirketler, ödeme süreçlerinin tüm koşullarını müzakere eder ve alacak yönetiminin gerçekleştirdiği karşılıklı sözleşmelerde yürütürler. Bununla birlikte, alacak hesap yönetiminin kendisi basit bir fon koleksiyonu olarak kabul edilemez ve çok karmaşık bir süreç dizisini kapsar. Her şirket, faktörlerin sayısına bağlı olarak belirli bir toplama planı hazırlamalı ve şirkete hedeflerin

başarılması için doğru kararları ve eylemleri yapmasına yardımcı olan çeşitli teknikleri düşünmelidir. Bu tür karar alma sürecinin belirli bir kısmı, pazarlama ve satış departmanları gibi doğrudan bir sayımla bağlantılı olmayan farklı şirket bölümlerine de yansıtıyor ve bu da performanslarına ek bir değer katıyor.

**Anahtar Kelimeler:** *Alacak hesapları, yönetim, örnekleme tekniği, kredili satışlar*

## Introduction

The details and full plan of accounts receivable management is the matter of decision making for each company and totally depends on the type of activities and corporate management of the corresponding company. However, there are various commonly used techniques that are applied by the companies in order to have a well functioning accounts receivable processes.

This article would show the sampling technique that is commonly used among accountants as one of the methods for determining the accounts receivable plan. However, as part of accounting principles the companies are strongly urged to use and apply several accounts receivable technique at the same time for the better view of situation.

Below we may see the best know accounts receivable management techniques:

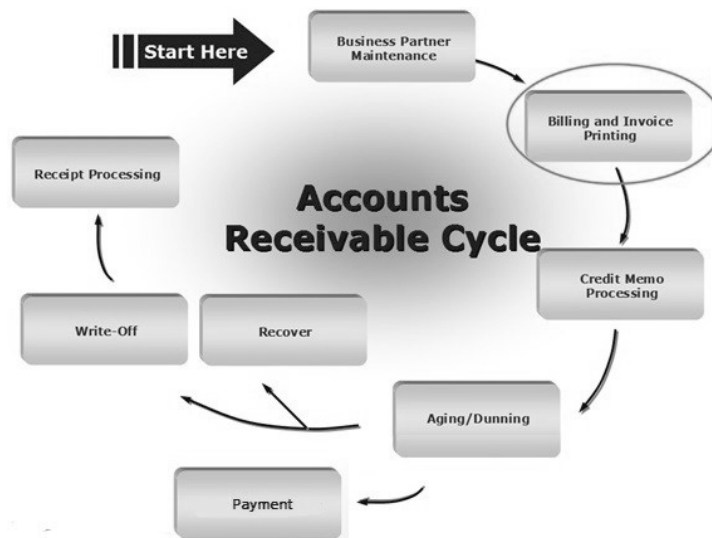
- Ratio analysis
  - Accounts Receivables Turnover Ratio
  - Days Receivables Ratio
- Budgeting
- Customer profiling
- Statistical types of analysis
  - Regression type analysis
  - ANOVA type analysis
  - Cluster type analysis
  - Correlation type analysis
  - Sampling
- Accounts Receivable Aging

Out of above mentioned accounts receivable techniques this article will reflect the aspects of sampling technique, its application, strong and weak points, best usage advises.

### Accounts receivable management

Accounts receivable management considers all proper and necessary steps that the accounting department and a company in overall should take for the purpose of managing the fund collections, that would create a complex balance between covering the needs of the company and keeping the clients motivated and satisfied. Respectively, the bigger a company is, the harder accounts receivable management process becomes to them, however, this matter is important for any kind of the companies that provides any kind of services/gods on credit sale conditions.

Below we may see the core cycle of accounts receivable management processes:



**Table 1.** Chekijian, J. Accounts Receivable Factoring Guide

#### Step 1: Business Partner Maintenance.

This step considers the collection and coordination of all necessary information regarding each client to which the services/gods are provided on credit sales. On the background of this process lies the performance of marketing and sales departments as well.

#### Step 2: Billing and Invoice printing

This step considers the data input regarding each invoice issued for each client as per the services/goods provided to the corresponding client. Also, this step represents the physical issuing of the invoices and billing to the clients on timely basis. The conditions of invoice billing and delivering has to be reflected in contract terms.

### Step 3: Credit Memo Processing

This step considers all communication steps between the client and service/goods provider in order to obtain the most optimal way of accounts receivable realisation and solution. By realising this step, the accounting department consider communicating with the client side and notifying about the payment due and conditions. The methods of credit memo processing includes such documents as credit memo document, IOU notes, follow-up emails, official letters and others. Respectively all conditions and dues dates are mentioned in the contacts and should be reflected in the invoices correspondingly.

### Step 4: Aging/ Dunning

At this step the company takes all reasonable and needed action for the analysing the information that they have which includes main below units:

1. Amount received
2. Total amount awaited
3. Amount promised to be covered
4. Minimum needed amount as per the planning

Once the company has a clear view of the situation, i.e. all amount that they actually received till that point of time and what should be collected it takes further steps with purpose to collect the rest needed funds. As shown in previous unit, the company would be using all needed communication actions in order to collect the needed funds.

### Step 5: Payment

At this stage the company account department takes care of the payments that the client companies realise and allocates them as per personal accounts of each client and covers the outstanding invoices, confirming the realisation of accounts receivable in refer to the corresponding case. This step also considers the correct management and collection of the bank information as the proof of the paid funds. The correct allocation is a very sensitive process and should be committed with high accuracy, so that the actually paid invoices and still outstanding invoices are divided and not mixed among each other. This step is very critical for further fund collection and may not undervalued.

### Step 6: Recover or Write-off

Once the company finalises its allocation process it has the clear view of all invoices that still are counted as outstanding ones, i.e. the ones that are still needed to be followed and collected. After the analysis of all paid invoice, i.e. covered funds the company has to make another analysis of the data and decide

whether invoice is up to further evaluation and follow up or it does not have any chance for covering.

In other words, the company would have to decide to which below category the invoice is applicable:

- a. Recovery
- b. Write-off

The recovery category stands for the invoices that need to be further worked on and have a chance for recovering, i.e. collection by the company from the clients. While writer-off category stands for the invoices that are count to be a bad debt, i.e. would not be collected under any circumstances, which is counted as pure loss for the company.

Respectively, the company target is to avoid the write-off category as much as possible and to have invoices paid fully and in time.

#### Step 7: Receipt processing

At this stage the company accounting department makes another analysis of overall funds received for the certain period and applies the accounts receivable management techniques in order to have a full view of what was collected with what age, what rate of the issued invoices and to find out the weak and strong points of the company. This analysis also shows the payment attitude of the clients, so that company would be able to decide on how it should treat its clients and what kind of actions should applied for covering the gaps within the company.

### **Accounts receivable management principles**

As a main part of accounts receivable management the company has to determine certain principles and act per those principles that would make the company ensure the correct management of collection processes.

Below we may see the principles of Accounts Receivable Management:

1. Client determination
2. Establishment of a payment period
3. Monitoring the collections
4. Evaluation of the receivables balance
5. Acceleration of cash receipts from receivables. (Collins, B. and McKeith, J. (2009). Financial Accounting and Reporting: 2nd edition. Pearson Education, London, UK. (pg.40-75)

Client determination stand for the choosing of the clients that the service/goods providing company wishes to see as client with credit sales option. In other words, besides the client that chooses the service/goods providing company there is always a choice on the side of the contractor if it agrees to provide certain service or goods on credit sales. As we know the credit sales always considers certain risk of losing funds if the accounting team fails to collect those funds. Respectively, it is very important to have a certain client research actions beforehand and determine if the particular client is reliable enough to provide the services/goods that that party on credit sales.

Establishment of a payment period is also very sensitive process for the company as the payment due allowance period plays one of the main roles in such matter as payment aging ( the age of invoices at their payment point). As we know each company has to make its own decision what kind of payment allowance frame it want to set for the clients and such kind of decision depends on certain criteria.

Below we may see the criteria that influence the decision making of payment allowance that is settled by the service/goods providing side:

1. The potential receivable revenue for the client
2. The reputation of the client
3. The mutual history with the client company
4. The financial situation of the company (contractor)

The payment allowance period is a matter that should be communicated and agreed by both the client and contractor sides, respectively mentioned with details in contract and reflected in each issued invoice to the corresponding client.

In below table, we may see the applicable algorithm of the proper steps for establishment and realisation of main credit terms:

Establishing credit terms:

- Once a firm decides what its credit terms is, it has to establish below units as well:
  - The payment allowance period (net days mentioned as period)
  - If the discount should be applied
    - If the discount is decided, the rate should be determined
  - If the company is quite small, it would probably settle softer credit payment terms

*(Chekijian, J. Accounts Receivable Factoring Guide)*

Monitoring of the collections is the principle that urges the companies make all necessary steps to build up a strong and stable system that would monitor the data that company has and be able to come up with certain outcomes. In other words as per the principle the company has to mine any information it gets from working process with purpose to realise and develop the proper accounts receivable management.

The monitoring principle also urges the companies to determine a well structured communication attitude with the client companies that would provide them the needed information for usage.

Besides that this principle states that the company should be able to make proper analysis and use it for its own benefit without abusing the ethics and the accounting principles which are very important for both the company and the market in general.

Evaluation of the receivables balance is the principle that represents the analysis of the information as per issued invoices and determining the need of what should be collected, for what period, when and how much. As per the principal each company needs to make below two arrangement for each corresponding period and a financial year correspondingly at the end of each period.

Below we may see these two arrangements:

- Amount to be received
- Amount under the risk to be not received (dubious)

“Amount to be received” arrangement respectfully divides on two kinds as per below:

- The one which is done for each next period/month
- The one which is done for each next financial year

In the calculations, the accountant responsible for collection of accounts receivable would not need to determine the probability percentage for each and every invoice, the employee would only mention the details of invoices that planned to be paid as per the objective analysis.

Below we may see the main targets of the objective analysis:

1. Promised arrangement of payment by client (with approximate payment date) which was notified either orally or in written



2. The attitude of the client which is counted to be a systematic behaviour as per precedent. Example: some client companies notify their contractors that their company makes payment on certain dates of the months and the contractor already knows when to await the payments. This does not mean that the invoice would be surely paid, but once the companies have good communication skills, they may have arrangements that gives a big chance for the payment in promised time.
3. Technical issues that may delay the payment. Sometime the wire transfers of paid debts may last up till 1 week, if the transfer is international (depending on the countries of transferring sides). In such cases the payer (client company) may have already made the payment for debt, but the payee (provider company) would receive it in the time that would fall on the next period. It may also include cheque payments, that is sent via postage and would be delivered in certain time

Acceleration of cash receipts from receivables principal states that making all reasonably needed actions with purpose of gaining the collections in soonest time after the invoice is issued, is the contractor's i.e. service/goods provider company's top target and task. Below we can view two main reasons that represent the above-mentioned principal:

1. Each day of waiting bring up to the decrease of money time value with respectively makes the company dare to collect the funds in the soonest future.
2. Companies consider that is risky to wait for the payment of certain invoice and it should make all actions in order to get them now, and even if they have to make a certain discount for it, it is acceptable and considered as benefitting the company, correspondingly considering the reasonable amount to be discounted.<sup>1</sup>

Reasonably, there are various kinds of actions that the company can apply in order to fulfil the principal.

Below we may see the two types of the mentioned actions that may be taken for realisation of this principal:

1. Discounting
2. Accounts receivable financing

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<sup>1</sup> Salek, J.G. *Accounts Receivable Management Best Practices*.

Discounting is the method that then contractor companies use referring the their clients in order to obtain the speed up in collection processes. On other words, the company makes certain discount to the clients for the payment that is done within certain period of time, which is shorter than the payment allowance period. This method is widely used among the companies and such s=condition should be clearly reflected in the issues invoices.<sup>2</sup>

Accounts receivable financing is a more complex method that is used by companies toward their clients in more risky situations, when the service/goods providing company cannot succeed in receiving the payment. In such situations some of the companies ask for the assistance of some legal assistance companies and sell them the debt of the client company for less amount that the debt itself is. As result of it the contractor company gets the funds saved from bad debt at least partially and the legal company deals directly with the client company. Usually, the legal companies take all legal actions in order to get the funds. From the other side the contractor company would definitely terminate the contract with the corresponding client. Respectively, all needed documents and authorisations are exchanged between the contractor and legal companies. The main purpose of Accounts Receivable Management principles is to provide correct core instructions of how the company should manage its collections as this task is considered as one of the most tricky and risky processes in the company that is the responsibility of accounting department. The principles of Accounts Receivable Management consider the benefits of the service/goods providing side, however it does not exclude all other accounting standards and the ethics in general, which should always be applied and followed by all type of companies.

### **Sampling technique**

Sampling technique is a statistical method of data analysis that estimates the attitude of whole group of units (clients in our case) as per the sample results of only several of such units. This technique is widely used by the accounts receivable controller while they try to determine an overall situation in the company. Such kind of method is more applicable in big companies that in smaller ones, due to the big load of information, where a company has a great number of clients, respectively with greater number of invoices issues to them and it is inapplicable to analyse each single invoice and the information about it manually. Due to this the accounts receivable controller uses the sampling technique, that may not show him/her the exact information about each client, but it would definitely let the employee know if there is a signal for warning and if the clients are mistreating their contractor and the contract condition and terms. Sampling technique is mainly

<sup>2</sup> Abbasov Q. (2010). *Accounting principles: 3rd edition*. Sherq-Qerb Publications, Baku, Azerbaijan. (p.13-29)

used with the aging information for each invoice that the company issued and tried to collect. This technique may be used with unpaid invoices either, however, as per the world practice it is less recommended. The sampling technique may be easily applied in excel program as well, which makes it easy for usage.

On below sample we would be able to overview the efficiency of the sampling technique in the account receivable management processes:

The contract terms for all below invoice state that the invoices have to be covered within 30 days since the delivery of invoice. While the real payment of invoices happened as per below information.

| Invoice No. | Age (payment day) |
|-------------|-------------------|
| Invoice 1   | 131               |
| Invoice 2   | 29                |
| Invoice 3   | 68                |
| Invoice 4   | 21                |
| Invoice 5   | 36                |
| Invoice 6   | 57                |
| Invoice 7   | 27                |
| Invoice 8   | 74                |
| Invoice 9   | 55                |
| Invoice 10  | 57                |
| Invoice 11  | 26                |
| Invoice 12  | 51                |
| Invoice 13  | 90                |
| Invoice 14  | 114               |
| Invoice 15  | 75                |
| Invoice 16  | 81                |
| Invoice 17  | 16                |
| Invoice 18  | 37                |
| Invoice 19  | 88                |
| Invoice 20  | 91                |
| Invoice 21  | 27                |

**Table 3.** Litneva, N.A. and Malyavkina, L.I. (2006). Accounting: Principles and theory: 2nd edition. Sherq-Qerb Publications, Baku, Azerbaijan. (p.10-27)

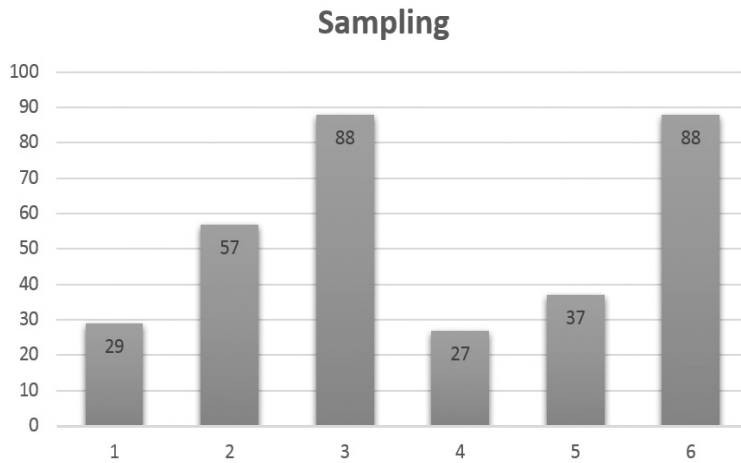
If we apply the sampling analysis to the above information consisting of 21 invoices and chose only 6 samples we would get below information (done with excel)

|    |
|----|
| 29 |
| 57 |
| 88 |
| 27 |
| 37 |
| 88 |

**Table 4.** Litneva, N.A. and Malyavkina, L.I. Accounting: Principles and theory: 2nd edition.

As we see in the analysis the randomly chosen 6 units roughly show that 4 out of 6 payments made by the client companies had been delayed. Such kind of information shows how there is quite a serious issue within accounts receivable management and certain steps should be taken. The delay of funds collection in overall means the fund loss for the company from the time value perspective which may not be acceptable for the company.

For better view of the situation the accounts receivable controllers mostly use charts as per below:



**Table 5.** Litneva, N.A. and Malyavkina, L.I. Accounting: Principles and theory: 2nd edition.

In the above chart we may clearly see how the most of sampled cases overlapped the 30 days allowance which is critical for the company. Sampling statistical technique has a big advantage above other techniques with its quick and easy usage and its overall information give a user a general forecast of situation and warns if something is wrong. Respectively, if there are many invoices, the accounts receivable controller should extract bigger number of samples for more detailed analysis. Sampling technique also is very appreciated by the accountants due to its acceptance and opportunity to use for several times for comparison, which most of the times gives the same of very close results which proofs its truthfulness once more.

## Conclusion

Despite the fact that accounts receivable management is quite a complex time consuming and difficult task, its proper management has its own ways of solutions which gives positive results to the company overall. The realisation of solutions on the way to the accounts receivable management is considered as one the main priorities of the company and its mistreatment would bring up to the failure of financial tasks. Each company has must make its own decision on what kind of accounts receivable management system they want to apply and how the company should treat the clients on the way to reaching the targets. Meanwhile, the companies should also remember that they cannot target collecting all funds at once and from everyone and due to this should be able to build up a plan of actions for each period and determine what their prior targets are, which would make it easier for the team to concentrate and manage the collection process. As per the review shown above we could observe how the accounts receivable management works and what kind of technique is one of the most commonly used among accounts receivable controller, their reasons and the main advantages of such approach. However, despite the technique choosing, the accounts receivable controller should always keep in mind the principals of accounts receivable management, what their true meaning is and how they instruct the accountants to manage the fund collection.

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