Covering Credit Bulletin

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Myths and Misconceptions About Computer Viruses

By: Michael C. Dennis, MBA, CBF

Why do credit professionals care about computer viruses? For two reasons: First, because most credit departments are heavily dependent on computers, and a virus can bring down the systems the credit department relies on. Second, ignorance is *not* bliss. If a virus infects your system, or worse infects your computer and spreads to others, because you don't know enough to exercise caution, this will damage your reputation as a careful and conscientious risk manager.

A computer virus is a program designed to enter a computer without the user's knowledge and then to replicate itself throughout the system, and in doing so alter the way in which the system operates. Unfortunately, there is no way to guarantee that any system will not be infected by a computer virus. Common sense is the best defense. For example, set your anti-virus program to automatically start when the computer starts and run at all times. Scan every attachment using your anti-virus software even if you trust the sender. Only download files from well-known and trusted websites. Be wary of links or attachments that come with instant messaging programs. Also, back up computer files regularly.

Here are some common myths and misconceptions about computer viruses:

Myth. A computer can be infected simply by accessing a website on the Internet. Reality. Only an executable program can infect a computer. Viruses do not exist by floating around the Internet.

Myth. Anti virus programs prevent computer viruses. Reality. Anti virus programs installed correctly and updated regularly will clean systems of viruses that they have

been designed to detect and defeat. They do not prevent the spread of *every* virus because new computer viruses are created daily.

Myth. Anti virus programs should be updated once a year. Reality. Anti virus programs should be updated as often as the manufacturer recommends. Often, the purchaser buys the anti virus software and receives the right to download upgrades as soon as they are released.

Myth. Viruses can be spread by email or by accessing a group bulletin board. Reality. Viruses cannot be spread by reading an email text message, but they can be spread if an email comes with an executable file as an attachment, but only if the attachment is opened. For this reason, computers should never be permitted to automatically open any email attachment.

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Creative Ways to Accelerate Cash Inflows
By: Michael C. Dennis

Most of us are concerned about accelerating cash inflows, especially in an economy in which many sectors seem to be struggling. Here are a number of creative ideas for accelerating cash inflows:

- **use a lockbox**
- **if you already have a lockbox, consider using more than one lockbox located appropriately based on a bank lockbox study in order to reduce mail float**
- **if you have one or more lockboxes, make certain that all of your customers are using them - otherwise your customers are taking advantage of mail float by mailing payments to your office rather than to the appropriate lockbox**
- **offer a cash discount**
- **offer a larger cash discount**
- **encourage all customers to take advantage of your cash discount by reminding the buyer's controller or the CFO that are not taking the discount about the discount for early payment**
- **shorten grace periods before charging back unearned cash discounts**
- **eliminate grace periods before charging back unearned cash discounts as a way to encourage faster payment**
- **discourage customers from paying late by adding late payment penalties**
- **use credit holds as a way to *encourage* customers to pay delinquent balances sooner rather than later**
- **if you already use credit holds, use them more frequently**
- **eliminate grace periods before calling customers about past due invoices**
- **if you are trying to avoid having your collection calls screened, call before or after normal business hours and you will have a better chance of avoiding the call screeners and still reaching the decision maker(s)**

- **don't negotiate for payment with clerks or intermediaries; instead deal directly with the business decision maker at the debtor company**
- **ask delinquent customers to remit payment by overnight delivery**
- **require delinquent customers to remit payment by overnight delivery**
- **pay the costs associated with arranging for delinquent customers to remit payment by overnight delivery**
- **ask your salesperson to arrange to pick up payment from a delinquent customer and forward payment to you by overnight delivery**
- **arrange for a third party, such as a courier service, to pick up a payment from a delinquent customer and forward it to you by overnight delivery**
- **confirm payment commitments from seriously delinquent debtors in writing**
- **confirm payment commitments from all customers in writing**
- **require delinquent customers to confirm their commitments to you in writing whenever possible, and if this is not possible confirm their commitments back to them in writing**

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<u>Collection Tools and Techniques</u>

1. Even if the collection call you are making is the most important call of the day, the week or even the month, try to make it sound routine. If you suggest to the customer that it is critical to your company to get a commitment or a quick payment, you are weakening your bargaining position.
2. Even short-term debt repayment extensions should be linked to specific and documented on debt payment dates.
3. Every credit department should have a specific timetable for following up on past due balances. A simple example would be: Every delinquent account will be called within five working days of going past due.
4. Explain a decision not to offer open account terms to an applicant based on a poor payment history but do not feel that you are obligated to try to *convince* the applicant company that your decision was correct.
5. Make your voice mail message a higher priority by ending the message by asking for an immediate call back and by stating that your message is urgent.
6. Follow the 80/20 rule when planning your collection calls. This rule states that 80 percent of the money owed to your company is typically owed by just 20 percent your customers.
7. For larger invoices, send a reminder letter after the order is invoiced and before the invoice is due. This letter should state that your company shipped the order and sent the invoice. This letter should ask the customer's accounts payable department to be sure they have everything they need to schedule the invoice is scheduled for payment, and to call you of they do not. The goal of this letter is to reduce the number of "disputes" discovered only after the invoice becomes past due.
8. Formally demanding payment [generating a formal demand letter to be sent to the customer's company President or business owner as well as anyone that has signed a personal guaranty before placing an account with a third party for collection is a good strategy. Doing so sometimes convinces customers that you are

serious, and that they need to pay the past due balance immediately to avoid litigation and long-term damage to their company's credit reputation.

9. **Generally, short e-mail messages that ask the customer to take specific action are more effective than longer a message that hint at what the creditor wants and expects the customer to do.**

10. **Give the debtor and your department every opportunity to resolve a dispute or payment problem amicably before resorting to more drastic measures to collect such as threatening to place the account for collection.**

Excerpted from "1001 Collection Tools, Tips and Techniques" written by Michael Dennis

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<u>DSO and DDSO</u>

Many companies use DSO to measure the credit department's ability to manage risk, to control delinquencies and to resolve customer deductions quickly. Unfortunately, DSO is a relatively blunt instrument and is usually regarded as a relatively poor measurement of the credit department's abilities. DSO is influenced by actions or decisions made outside of the credit manager's control. For example, if the sales department offers customers extended dating, DSO will increase through no fault of the credit department. Similarly, if the number of errors made in order entry increase, so will the number of disputed invoices and deductions, and as a result DSO will also increase. Also, if senior management requires the credit department to accept more risk [for example, in an effort to increase sales] then DSO is likely to increase as the amount of credit risk increases.

Better ways to measure the efficiency and productivity of the credit department include:

- **Calculating days delinquent sales outstanding.**
- **Measure DSO after deduction of large dollar deductions caused by operational problems and errors made by your company, the seller.**
- **Calculating the average cost per invoice to maintain the credit function.**
- **Measuring the average amount of time required to open a new account.**
- **Determining the average number of days an invoice is past due before a customer is called about payment.**
- **Calculating the frequency of follow up on past due balances.**
- **Determining the average length of time orders are in the credit queue before they are reviewed [but not necessarily approved and released].**

DDSO differs from the DSO calculations in that it measures delinquencies rather than evaluating the entire accounts receivable portfolio. Delinquent DSO also known as the Average Days Delinquent, calculates the average time from the invoice due date to the paid date. It provides information necessary to evaluate individuals, subgroups or overall collection performance.

The advantage of using DDSO to measure the effectiveness of the credit department is that, at least in theory, the credit department has direct control over the amount of delinquencies outstanding at any given time. The same cannot always be said of DSO.

The DDSO formula is: DSO – Best Possible DSO.

The DSO formula is: (Ending Total Receivables Divided by Total Credit Sales) x Number of Days in the Period.

The Best Possible DSO formula is: (Current Receivables / Total Credit Sales) x The Number of Days in the Period.

Excerpted from "Credit and Collection Handbook"

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<u>Questions and Answers</u>

Question: Can I deposit a COD check we just received from the carrier issued by a customer that is now in bankruptcy?

Answer: Chances are that the bank account is already closed and that the check will not clear, but you have nothing to lose by depositing the customer's payment.

Q. If a new customer is publicly traded, would you still get them sign a company credit application?

A. In my opinion, the only reason any applicant company would not sign a credit application is because they do not want to be bound by the creditor company's terms and conditions. Instead, the purchaser wants their Purchase Order terms and conditions to control the sale.

Q. My company offers long seasonal dating terms. Our DSO ranges from 40 days to 150 days depending on the season. Why do we bother to calculate DSO?

A. Even *if* DSO is not a relevant measure of your collection efforts, management will almost certainly want and need to calculate DSO for accounting reasons.

Q. A customer has requested an explanation for our decision not to extend an account terms. What do I say?

A. I recommend you create a standard form letter that list various reasons for denial and simply check the applicable reason or reasons. The most common reason is this: Your business does not meet our company's criteria for an open account terms.

Q. We recently had a layoff. A collector who was laid off asked me for a letter of recommendation. Obviously he was terminated because he was a weakest link. What should I do?

A. Speak to your human resources department. Many companies have policies relating to letters of reference based on a concern that the former employee will find in the recommendation some basis for a lawsuit.

Q. One of our customers faxed a Purchase Order. It stated in part: "Subject to all of the terms and conditions that appear on the reverse of this purchase order." The customer had not sent the reverse side of the PO and I refused to release the order without it which created quite a controversy. Was I wrong?

A. If your company is going to accept the customer's terms of sale, you need to know what they are. When faced with this problem in the past, I have pointed out that the terms and conditions on the reverse could say anything, such as: "*Buyer will receive a 20 percent prompt payment discount if the invoice for this shipment is paid in less than 90 days*." The point is that you don't know until you read the document.

Q. Why is it so hard to collect deductions taken by customers?

A. One reason is that the credit and collection department is the only entity with a vested interest in getting deductions taken in error repaid. Clearly, customers would prefer not to repay deductions. Your sales department's goal is to focus on future sales, not past problems. Therefore, the credit and collection department is the only entity that considers deductions to be a problem.

Q. Why would my employer continue to sell on open account terms to a customer that breaks payment commitments and appears to have serious cash flow problems?

A. Most companies do not have the luxury of refusing to sell on open account terms to marginal accounts if they intend to meet their sales volume targets. Most accounts receivable portfolios will include a number of marginal accounts which the credit department is expected to manage.

Q. Is there a website where I can get information about Canadian customers?

A. If your Canadian customer is a publicly traded company, please visit the SEDAR [System for Electronic Document Analysis and Retrieval] website found at www.sedar.com. Access is free, and this site has detailed information about public company filings in Canada similar to the U.S. Securities and Exchange Commission's EDGAR website.

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<u>Some Limitations of Financial Statement Analysis</u>

Financial statement analysis is a tool many credit managers use in evaluating credit risk. Credit risk generally comes in two forms (1) The risk that a customer's business will fail resulting in bad debt write offs for its creditors, and (2) the risk that the customer will pay slowly.

However, many credit managers perform customer financial statement analysis without understanding its limitations. These are some of the limiting factors credit managers must keep in mind:

- **Past financial performance, good or bad, is not necessarily a good predictor of what will happen with a customer in the future.**
- **The more out-of-date a customer's financial statements are, the less value they are to the credit department.**
- **Without the notes to the financial statements, credit managers cannot get a clear picture of the scope of the credit risk they are considering.**
- **Unless the customer financial statements are audited, there is no assurance they conform to generally accepted accounting principles. As a result, the statements may be misleading or even completely fraudulent.**
- **To see the big picture, it is necessary to have at least two years of financial statements for comparison. Trends will only become apparent through comparative analysis.**

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