Covering Credit Bulletin

August 2006

This Month's Topics:

- **Credit Fraud**
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Credit Fraud

A simple definition or description of credit fraud is that credit fraud involves any business activity that uses deceitful practices to deprive creditors of their property, or other rights [such as the right to receive payment for goods sold in good faith on open account terms]. Credit fraud results in economic injury.

One of the most troubling aspects of business credit fraud is that no one can be certain how much money business creditors lose to business credit fraud. Some companies are reluctant to report even when they are convinced they were the victims of credit fraud. Other companies are unsure that they are a victim of this type of fraud.

Contrary to popular misconception, some of the most successful frauds are the simplest. For example, using a stolen credit card number to purchase goods does not require a high degree of expertise. Paying for merchandise with a check drawn on a closed account also requires little or no imagination. Generating a forged Letter of Credit or a forged Cashier's Check or a forged Money Order probably requires little more than access to a computer equipped with a scanner and attached to a color printer.

The only real requirement to commit credit fraud is a desire for money, a willingness to break the law, and a willingness to face criminal charges if one is caught and convicted.

Q. The version of this Bulletin I received is different from the one my co-worker received. Why?

A. I usually modify the Bulletin during the month as I receive input from recipients. I think you are the first person that has ever commented on this.

GET ON TRACK

Be there when the starting gun goes off for the 19th Annual NACM Western Region Credit Conference, October 4-6 in Las Vegas. The "Get On Track" Conference is designed for anyone who performs the business credit function at your company. Our educational tracks support entry level to executive experience. From the Credit Analyst to the CFO, you can all benefit by attending the "Get On Track" Conference. Visit the website for more information: http://www.wrcc.biz

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Questions and Answers

Question: What interest rate can we charge on past due accounts?

Answer: You did not mention what State you were selling to. This link provides usury rates State by State. It is a free site: http://law.enotes.com/everyday-law-encyclopedia/interest-rates

Q. Can a business file a Chapter 13 bankruptcy?

A. Yes, a Chapter 13 filing is intended to be used by individuals and by small businesses. There are specific requirements the debtor must meet to qualify to file as a business under Chapter 13 rather than under Chapter 11.

Q. What makes credit scoring software better than people making credit decisions based on all the available information?

A. I hope that I did not say that credit scoring software is better than human intervention. Credit scoring software is clearly different to the extent that the decision rules ensure consistency. The best credit scoring software programs mimic human decision making. There are relatively unsophisticated programs available that are inexpensive and/or easy to use but the quality of the decisions they recommend suffers from the software's lack of sophistication.

Q. How do you develop an appropriate bad debt reserve?

A. I recommend a three step process. The first step involves developing a general reserve based on historical bad debt write offs. The second step involves creating a specific reserve for accounts in bankruptcy, placed for collection, in receivership, etc. The third step is to create a high risk reserve for accounts that the credit department is currently concerned about.

Q. My customers often tell me they can only pay us when their customers pay them. How can I address this problem?

A. I refer to this as "pay when paid" terms… meaning that it is not unlike consignment sales. The problem is that when your customer has 'your' money and 'your' merchandise they are in the dominant position. I think the best way to address this problem is to tell the customer that the agreed terms are whatever terms appeared on their PO and your invoice – and that if they wanted to negotiate for consignment terms that it should have been done before the order was shipped. I would then ask for immediate payment of the past due balance.

Q. Our terms are Net 30. The customer's Purchase Order showed net 60 when I pulled it. Is the invoice due in 30 days or in 60 days?

A. Probably 60. Even if your invoice *and* your credit application indicate that the terms are net 30 days, when the customer modifies this arrangement by presenting a PO with net 60 day terms and that PO goes unchallenged there is little that you can do after the fact to correct this problem and accelerate the customer's payment plans.

The key is the proverbial ounce of prevention. Someone must be responsible for and accountable for reviewing customer purchase orders and rejecting those with unacceptable terms and conditions.

Q. Our shipping terms are FOB Origin, Prepaid and Charged. One customer has several invoices for which they refuse to pay freight indicating they were told by our manufacturer's representative that freight was prepaid. Who is right?

A. Under "Prepaid and Charged" terms, your company as the seller pays the freight charges and then invoices your customer for the freight cost. In this scenario, the term prepaid seems to be confusing your customer. The key is not whether freight is prepaid since it almost always is prepaid; the question is who pays the freight. The terms "prepaid and allowed" means the buyer will not be

required to pay freight. The term "prepaid and charged" means that the customer is invoiced for the cost of the freight.

Q. With the uncertainty in Mexico following the Presidential elections, do you have any concern or any recommendations about whether or not it is safe to do business on open account terms with customers located in Mexico?

A. I don't have a strong opinion one way or the other. I believe that financially sound customers will continue to pay their creditors while weaker customers may actually be adversely affected or may use political unrest associated with these elections as a reason to delay payment.

I am sorry I cannot be more specific.

Q. We have a customer with a deficit net worth that is also losing money. The account is and over its credit limit and my manager and his manager just told me to release another $100,000. The company President and the customer have a long standing relationship, both personal and professional dating back more than twenty years to when our company President was a salesperson. I think this is a serious mistake. What would you do?

A. I would ship the order and carefully document the file. I would also try to find out why executive management thinks this is a good idea.

FYI, I had one similar experience and I eventually learned that my employer was planning to acquire the customer…which they did.

Q. I inherited a past due invoice from my predecessor that is more than two years past due, is valued at about $2900 and is owed by the United States Navy. I cannot seem to get the customer to take the time to investigate and resolve this. Is it still collectable, and if so how should I proceed?

A. If your question is whether there is a limitation of some kind on your ability to collect, the answer is that there may be but at two years past due you have almost certainly not reached that deadline. Assuming the invoice is legitimately due, this means you should be able to collect the balance due. I suggest a brief letter to the Commanding Officer of the base - along these lines:

"According to our records, the attached invoice remains open and unpaid and is now over two years past due. May I respectfully request that you arrange for someone to review this invoice and contact me to discuss payment status? Thank you."

Q. What is the Prompt Pay rule and what are its implications for creditors?

A. The Prompt Payment rule ensures that federal agencies pay vendors in a timely manner. Under the Prompt Pay rule, federal agencies can be assesses late interest penalties when invoices are paid after the due date. For more information, you may want to follow this link: http://www.fms.treas.gov/prompt/ or the following link and type *prompt pay act* in the search field shown at the top of the web page: http://www.encyclopediaofcredit.com/FlashHelp/Encyclopedia.htm

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FOB Terms

Credit professionals need to know the FOB point because the FOB point determines whether the buyer or the seller bears the risk of loss or damage in transit. For example, if your freight terms are FOB Destination, title passes to the buyer at the delivery point specified by the buyer. This means that the seller bears the risk of loss or damage in transit and must file claims when goods are lost or damaged in transit.

Under FOB Origin terms, title passes at the seller's shipping point. The buyer owns the goods while they are in transit. The buyer bears the risk of loss or damage in transit.

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Free White Papers

Essays on the following topics will be emailed to readers on request. Please send your request to me at mcdennis@coveringcredit.com

- **How to Evaluate the Credit Department's Performance**
- **Rules of Escheatment**
- **Spotting Credit Fraud**
- **Disputing Bankruptcy Preferences**
- **Bankruptcy Reclamation**
- **Financial Ratios for the credit department**

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