



Accounts Receivable Collections

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Collecting for work performed is viewed as an uncomfortable responsibility for many professionals. It involves discussion of dollars and services performed. Many professionals avoid the collections process as long as possible.

Planning and communicating your method of collecting will result in stronger client relationships and fewer problems. A pre-determined process that is communicated to clients will prevent surprises and result in faster payment.

Specific collection procedures and action must be addressed throughout the life of projects and include:

- GO/NO GO Decisions
- Contracting
- Project Set-up
- Project Initiation
- Project Implementation and Execution

GO-NO/GO Decisions

Research the client's ability to pay and previous payment history. Utilize outside sources such as Dun & Bradstreet. Obtain copies of the firm's financial statements, have discussions with suppliers, review Internet sites, understand banking, legal and accounting firm relationships, etc. These and any other information you can obtain are valuable in assessing the firm's credit worthiness and past reputation.

Contracting

Collecting issues must be considered in the contracting process.

- Obtain deposits and/or retainers from clients. Deduct deposits from the last invoice. Standard contracts should include one of these clauses. (However, if required the individual negotiating the contract can insert \$-0-.)
 - **“Deposit** - Upon Execution of this Agreement \$_____ shall be paid by “CLIENT” to “ENGINEER” as a deposit on work performed. This deposit will be deducted from the final invoice.”
 - **“Retainer** – “CLIENT” agrees to pay “ENGINEER” a monthly retainer of \$_____. A monthly accounting will be provided to “CLIENT” disclosing the difference between retainer and cost of services performed”.
- Include proper payment term clauses in your contract. Examples are as follows:
 - **“Billing and Payment** (from “ASFE Contract Reference Guide – Third Edition” – Page 28 & 29) CLIENT recognizes that timely payment of CONSULTANT’s invoices is a material part of the consideration CONSULTANT requires to perform the services indicated in this AGREEMENT.”

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- CLIENT shall pay CONSULTANT for services rendered in U.S. funds drawn upon U.S. banks, in accordance with the rates and charges set forth herein. Routine invoices will be submitted by CONSULTANT from time to time, but no more frequently than (every two (2) weeks, and shall be due and payable within (thirty (30)) calendar days of invoice date. If CLIENT objects to any portion of an invoice, CLIENT shall so notify CONSULTANT within (fourteen (14)) calendar days of the invoice date, identify the cause of the objection, and pay when due that portion of the invoice not in dispute.
 - CLIENT shall pay an additional charge of (one-and-one-half (1.5) percent (or the maximum percentage allowed by law, whichever is lower)) of the invoiced amount per month for any payment received by CONSULTANT more than (thirty (30)) calendar days from the date of the invoice, excepting any portion of the invoiced amount in dispute and resolved in favor of CLIENT. Payment there after shall first be applied to accrued interest and then to the principal unpaid amount.
 - Payment of invoices is in no case subject to unilateral discounting or set-offs by CLIENT.
 - Application of the percentage rate indicated above as a consequence of CLIENT's late payment does not constitute any willingness on CONSULTANT's part to finance CLIENT's operation, and no such willingness should be inferred. If CLIENT fails to pay undisputed invoiced amounts within (thirty (30)) calendar days of the date of the invoice, as set forth hereinabove, CONSULTANT may at any time thereafter, without waiving any other claim against CLIENT and without thereby incurring any liability to CLIENT, suspend this AGREEMENT (as provided for in Section ____, SUSPENSION) or terminate this AGREEMENT (as provided for in Section ____, TERMINATION.)"
- Include a sample invoice (and supporting documentation, if applicable) agreed to by your client as an attachment or exhibit to the contract. This will avoid confusion about the format needed to facilitate timely payment. Do not wait until the client calls stating "this format does not meet our needs".
 - Avoid "Pay When Paid" clauses. If the clause cannot be avoided establish a threshold that decreases your exposure. The "ASFE Contract Reference Guide – Third Edition" discusses this on page 116 as follows:
 - "CONSULTANT's invoice will be approved and presented by CLIENT to OWNER. CLIENT will pay CONSULTANT amounts due promptly after Owner pays CLIENT. Notwithstanding any action or inaction by Owner, CLIENT warrants that all of CONSULTANT's undisputed invoiced amounts will be paid within (sixty (60)) calendar days of the invoice date."

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- Avoid Retainage provisions. Retainage refers to clients holding a fixed percentage of your progress payments until completion of services. This is reasonable for construction contracts. Such provision is not reasonable for consulting services contracts. The provisions should be deleted from a consulting service contract. If this is not possible, establish reasonable thresholds to obtain reimbursement of retained funds based upon time periods, milestones or other factors that promise payment is received as soon as possible after the threshold trigger is met. Page 128 of the “ASFE Contract Reference Guide - Third Edition further discusses this.
- Obtain agreement on how to handle changes. Present the client with a process including sample change documentation and include as a contract attachment or exhibit. (See ASFE Practice Alert No. 8 for more discussion about Change Order Management).

Project Set-Up

During this stage of a project, appropriate information must be recorded to make sure invoicing is accurate and timely. Revenue must be recognized and billed in accordance with the contract.

- The invoicing format must be noted so the client is not surprised and receives the format required.
- Disclose the date your client needs to receive the invoice. (This is especially important when working as a subcontractor) Some clients will not pay you until they are paid. If they mail their invoice to their client on the 25th of the month, be sure you get your invoice to them in time for them to include your invoice with their billing.
- Note who and where the invoice should be mailed.
- Include telephone contact numbers regarding payment questions.

Project Initiation

Begin every project with a kick-off meeting. Included in this meeting, whether face-to-face or telephone, the discussion of billing and collection. Items you need to clarify at this meeting are:

- Invoice format
- Supporting documentation format
- When to invoice
- Who and where to send the invoice
- Who to call with any questions that may arise about payment

Project Implementation and Execution

Once the project work begins and throughout the project, the schedule and budget must be regularly reviewed and managed. Make changes and corrections as soon as possible and do not wait until invoicing. Communicate and document changes as soon as possible—preferably before any work is completed on the change.

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Billing Process

Do billing as soon as possible and not later than monthly. Promote an attitude of “How do we bill for the work we do?” instead of “How do we avoid billing?” The ultimate responsibility for billing and collection should be assigned to Project Management. However, if possible, assign someone separate from the Project Management to review and report the status of responsible for billing and timeliness of collections. Monitor days sales in accounts receivable and work to reduce days to less than 75.

The overall attitude promoted should be “How do we bill for the work we have accomplished” and to accomplish this as soon as possible – the only way to get paid is to get the invoice to the client.

The following procedures promote prompt billing and collecting:

- Accounting should provide Project Managers with billing sheets 2-3 days after end of the established billing period.
- The Project Manager or their designee should review, change, approve and return the billing sheets to accounting within 2 days after receipt.
- Accounting should finalize and mail the invoice within 2 days of return from the Project Manager.
- Large invoices should be sent by over-night mail to the client.
- The Project Manager/Accountant or other designee should call the client 5-7 days after mailing to confirm receipt of large invoices and first time mailed invoices.
- Aged unbilled and billed account receivable listings should be distributed biweekly to Project Managers. Someone separate from Project Management should be assigned the responsibility of monitoring accounts to assure timely collection.
- The Project Manager or their designee should call clients who have not paid within 5 days after the contract payment terms.
- Accounts over 60 days past due and over a pre-established dollar amount should be listed on an exception report and issued to upper management.
- Depending upon the contract terms and conditions and reasons for delinquent payments, specific actions should be taken as accounts become past due. As invoices age, actions should strengthen. Examples are management calls, formal letters, liens, withholding deliverables, use of outside collection people, stopping work, mediation, arbitration, lawsuit, etc.

Your company should monitor your days revenue in accounts receivable. The following formula computes this:

$$\frac{\text{Average Accounts Receivable}}{\text{Total Revenue}/365 \text{ days}}$$

The Average Accounts Receivable should include both unbilled and billed amounts. Days experienced by companies working with the following type clients are:

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<u>Type of Work</u>	<u>Typical Days Experienced</u>
Government – As Prime	60
Private Industry as Prime	60 – 80
Subcontractor to Prime	80 – 100

This experience can vary significantly from company to company. Factors can positively impact results and maximize cash. Many are discussed above. Others also include:

- Alternative pricing methods (i.e. for services performed ___% complete)
- Progress reporting
- Improving comfort level of Project Managers discussing dollars
- Rewarding and holding Project Managers accountable for collections
- Bonuses
- Performance review documentation
- Upper management's proactive attitude and communication of need/reasons for turning Accounts Receivable into cash.

Other

As e-commerce becomes more widely used, electronic billing and payment should be implemented. Customers are requesting this more frequently and more companies are changing to accommodate these requests. The overall speed and impact of this change is unknown. However, the principles discussed above should not change, even though the way that they are performed and the timing of events will probably change.

Summary

Days revenue in accounts receivable is largely controllable by every company. It is a choice that management makes at the very start of the business process. If you want to improve your cash cycle, you can. Companies vary from 40 days to 100+ days in accounts receivable turnover. It is your choice. Through implementing these or similar procedures, your cash cycle can improve.