Price Bailey
CHARTERED ACCOUNTANTS

Avoiding the write-off trap

# A new approach to dealing with late payments and 'bad' debts

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The right advice for your business life

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Research undertaken by Xero last year found that SMEs had £131 billion tied up in late payments and bad debts. This is an eye watering amount - and that was before the economic impact of COVID-19. Does anyone truly believe this annual figure is going to reduce? I think we know the answer...

But are these so-called bad debts really bad debts? Have they been properly qualified by a finance team - or has it just been assumed that they are bad debts because the debtor has failed to pay after a certain period of time? Surely a bad debt only occurs when someone 'can't pay' rather than when they simply 'won't pay'?

Our experience is that, in most cases, a debtor will be left to age, maybe with some chasing by the credit control team, until the year end. At this point, the SME's accountant will ask whether management wants to make a provision for it or write it off. Most will just write it off on the basis they have neither the time, inclination nor money to pursue the debt.

The trouble is that this behaviour, mindset and recovery process create the multi-billion-pound blockage to SME cashflow that we mentioned earlier. And with the amount of cash that is stuck in the system likely to increase as a result of the impact of COVID-19, now is the time to rethink and restructure the approach. In response, we have set out below our simple step-by-step guidance to help you break the status quo and improve your cash flow position. We particularly encourage SMEs that have their year-end approaching to consider carefully what immediate steps they can take, before they default to the write-off trap.

## Follow our step-by-step guidance

**Step 1**
Get your house in order

**Step 2**
The first 30 days: Contract and deliver

**Step 3**
30-90 days: Credit control in control

**Step 4**
Post 90 days: Bad debt qualification

## Step 1 – Get your house in order

Strengthen your terms and conditions. If you have not had a chance to review them for a while, then now is the time to put that right. It could be the best investment you make over the next 12 months as it will give you a solid foundation to maximise recoveries from any late payments or perceived bad debts.

## Step 2 – The first 30 days: Contract and deliver

- Issue your invoice promptly. Remember that you are working to your trading terms, unless otherwise agreed, and should not look for payment beyond 30 days.

- Await payment of your invoice. Great clients appreciate what you do and usually pay up on time. But very few SMEs have a perfect customer base, so late or non-payment are to be expected...and should be managed into Step 3.

## Step 3 – 30-90 days: Credit control in control

Payment has not been made in line with the contractual terms. Whether you call it a late payment or a contract breach, the fact is that you do not have the money that you are entitled to. You need to recover your funds:

- If you do not yet have a formal credit control process, then adopt one quickly! There are plenty of good examples online – the best ones provide a clear step-by step framework for delivery

- If you have adopted a credit control process, make sure you use it. Do not make exceptions. A credit control process need not be aggressive or confrontational but it does need to be firm and achieve it's purpose: a recovery of the monies you are owed or a clear understanding of when and how you will make a recovery.

- If after 90 days you have neither received payment nor agreed a satisfactory payment plan, it is time to move onto Step 4.

## Step 4 – Post 90 days: Qualification

Be Pragmatic. With your payment at least 60 days overdue, it is time to accept the fact one of the following difficult scenarios may be playing out:

1. It is possible that your client is struggling to pay you (and, probably, other suppliers too). You need to move quickly to protect your position – in our experience, the first to move usually makes the best recovery.

2. Alternatively, it may be the case that your client does not value you at the same level you may value them - they are paying others at your expense. Ask yourself if they are important enough to you to be allowed to breach your trading terms without any justification. A successful and sustainable business does not carry clients like this for too long. Do not fear the loss of a potential future sale from a business that behaves like this. In many cases taking immediate strong action to recover from these sorts of situations can actually help rebalance the commercial relationship for future trading rather than close down future sales. Regardless, you need to immediately deal with prompt payment or recovery action.

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Do not waste any more time on repeating the credit control process once 90 days has passed. The goal now is to either take formal action to gain a recovery or qualify it as a genuine bad debt. We suggest the following steps:

- Write to the client requesting full and final payment in seven days, otherwise you will have no alternative but to instruct your legal representatives to start a recovery process. If the client wishes to discuss or dispute the payment, they should do so in writing within the 7 days. Then await the response:
    - If the client wants to agree a payment plan that you think is acceptable, then by all means accept it – but make sure you lock it into a formal written agreement that can be relied upon should a further breach occur. Do not be afraid to seek improved terms or extra comfort in return for granting any further indulgence that the client may request.
    - If the client disputes payment (is not happy with the service, quality etc) then provide a formal response. Be clear to highlight that they did not raise any of these issues for the previous three months and request an immediate full payment. It is important to remember that if there had been genuine issues in relation to the service or product you provided, these would have been identified by your credit control process (in Stage 2 above) - it is most likely a deflect and delay tactic by the client.
- If you are unable to secure a payment or agree a payment plan, it is time to begin the recovery process. Threats without action are responsible for many of the behaviours of the market to date and make a significant contribution to the late payment lock up. You must follow through with action. Use a service like Escalate (www.escalatedisputes.co.uk) that removes all your financial risk in pursuing a recovery and reduces management input, so you can remain focused on the rest of your business. Escalate will be able to quickly determine if you have a recoverable debt or whether you need to accept it is a bad debt.
- If the debtor is able to pay, then you can take confidence from Escalate that the payment will be made and you can make a sensible provision in your accounts. Remember something back is always better than a write-off.
- If a recovery is not deemed possible then you can write-off the debt, deal with the tax implications and move on. Importantly, you will be doing all of this alongside a real-time process rather than a stockpile of debtors for annual clean up. This is the basis of efficient and strong cash flow management – and it also means that you, as a director, are taking the necessary steps to protect the assets of the business.

Too many businesses go from a missed 30-day payment into a loose credit control process that drifts for 12 months before the payment is finally written-off. That might be manageable for the occasional invoice – but the cash flow impact on your business longer term can become significant. The importance of having a strong process for your business to manage late payments and commercial disputes has never been greater. Do not fall into the write off trap.

## For more information about tackling late payments and bad debts, please contact

Matt Howard
Partner
matt.howard@pricebailey.co.uk
07595 244 866

Chris Clay
Partner
chris.clay@escalatedisputes.co.uk
07875 403 543

Nick Harvey
Partner
nick.harvey@escalatedisputes.co.uk
07977 995 620