AccountsWeb

Accounts Receivable



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Accounts Receivable (AR) represents the credit sales of a business, which have not yet been collected from its customers. They are current asset account that keeps track of money that third parties owe to you. that is, it means that there is a transaction occurring where cash is not involved.

"Coming down to the layman. When you buy goods from a shop without payment and intention to pay later, to the seller the goods sold without receiving cash is accounts receivable".
Money owed to you by customers

WHY MAINTAIN ACCOUNT RECEIVALE RECORD

- Purchase of goods on credit allows for more sales as customers who can pay on a later date but unable to fund such purchase at the immediate will be encouraged to buy.
- Improve operational efficiency
- Since accounts receivable is a current asset, it measures a company's ability to manage short-term obligations
- Helps to improve customer relationships

RISKS OF ACCOUNTS RECEIVABLE

- Cash flow deficiencies – A business needs cash flow for its operations. Selling on credit may boost revenue and income, but it offers no actual cash inflow. Where cash is trapped on a long run it can cause the company to run short on cash and have to take on other liabilities to fund operations.
- Bad debt - High accounts receivable that goes uncollected for a long time is written off as bad debt. This situation occurs when customers who purchase on credit go bankrupt or otherwise do not pay the invoice and efforts to recover said sum proves abortive.

ACCOUNTS RECEIVABLE MANAGEMENT

Account receivable management plays a great role in smooth running of a business (cash is said to be the oxygen of every business). Where customers delay in making payment as at when due, it has a negative impact on the business. This calls for the need of effective management of accounts receivable to avert business disaster.

Accounts receivable management helps improve cash flow and sales but beyond that it plays a great role in attracting investors as they see how disposed the company is in managing its asset.

Proper management of accounts receivable include but not limited to:

- Invoice Creation - An invoice is the first stage in ensuring that a business generates income from its accounts receivable. It informs customers of all items they've purchased. The individual costs of each item and when payment is due. This means the client will be well informed about payments and deadlines, as well as potential late fees and penalties (in form of interest. Etc.,)
- Screen your customers – it's necessary to carry out a background check on your customers to determine if they are credit worthy. Where a doubt exists, you may refuse granting such request.
- Issue invoice promptly – the longer you delay in issuing your invoice, the longer your money gets tied in the business.
- Keep tab of payments may to be able to avoid any form of discrepancy or misunderstanding.
- Have limits to customers you allow credit purchase or services
- Know when to drop a customer from accessing the credit purchase of service convenience. Where you have stubborn customers you chase at every interval, you may be better of getting rid of them
- Take cognizant of unpaid invoices - Outstanding invoices usually indicate bad debts or missed payments. Regular monitoring ensures that accountants are also constantly aware of any unpaid debts.

RISK ASSESSMENT OF ACCOUNTS RECEIVABLE

- Assess the history of unpaid invoices – assessing the risk of bad debt over the period will help you draw a line or limit the people, group, industry or sectors that are not credit worthy. analyzing past bad debts can also help you assess the quality of your company's receivables management then proffer solutions.
- Sort your customers - Sorting your customers into groups will help you identify patterns and establish a risk profile. Customers who take longer time to pay their debt may present greater payment risk and this will help to analyze your solvency and customers concentration.
- Limit your exposure to bad debt by limiting the amount allowed as sales or services on credit

- Carry out a financial statement analysis and calculate your average collection period in days to determine if your company is on track in credit management.
- Carry out an aging report - An aging report is a table that records your accounts receivable according to how long each invoice is outstanding. An aging report will help you identify how long individual customers are taking to pay.
- Analyze your current in flow to and access the risk of allowing credit transactions. (Especially on a long run)
- Handle recalcitrant client – have a proper arrangement on ground to curb issues of non-payment especially on client that makes it a norm.
- Make Team Training a Priority - Make sure that your collections team is well trained in your collections process and the steps you intend to take when things go wrong.
- Reduce long collection cycles as they lead to cash constraints

JOURNAL ENTRIES

Two journal entries are required;

First when issuing your invoice to the customer or client:

Debit (Dr) Accounts Receivable

Credit (Cr) Revenue or Deferred Revenue

Second when your customer finally pays

Debit (Dr) Cash received

Credit (Cr) Accounts receivable.

This process is called the double entry principle.

DERIVATION/FORMULAS

1. **Accounts receivable =**
   Opening balance (b/f)
   + New unpaid invoices
   – Cash collected or received.

2. Average accounts receivable =
   Accounts receivable ÷ Credit Sales × Number of days.

This measures the number of days or length of time it takes the company to collect cash. the quicker you collect your cash, the less bad debt, and the more favorable your cash position will be.



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