

## Black Holes and Old Invoices

My article titled *Black holes and Credit Management* published in *To Your Credit's* fall 2007 edition began with this paragraph:

“Credit management is an integral and highly visible part of the cash-to-cash business cycle, in which cash invested by shareholders is used to produce and deliver goods and services that are sold for even more cash. As the last step in closing the cash-to-cash cycle, accounts receivable is a valuable company asset that is, at times, not given its due credit.”

Unfortunately, accounts receivable might not be given due credit by both high level management *and* in-the-trenches A/R clerks. This can lead to a “permanent” leak in cash flow, something few companies can afford – especially as we enter recessionary times.

One of the surest ways to create a “permanent” leak in cash flow is to apply customer payments to the oldest invoices just because they are the oldest. When we explore the reasons this procedure is applied we often find that old outstanding invoices raise red flags. These red flags can create stress between A/R clerks and their managers, which is something clerks want to avoid. Trying to avoid this stress leads to a disconnect between the value of an asset that is the “last step in closing the cash-to-cash cycle” and the effort one is willing to expend managing that asset.

In short, clearing the oldest invoices from the customer account instead of requiring the customer to state which invoices are being paid with which payments is a risky way to manage A/R. Below are a few reasons why:

### Customer already paid

- Inevitably, disputes with customers will arise when the invoice you are trying to collect is listed on the stub of a cheque the customer mailed to your company.

### Remove before paid

- Customers do not always accept all charges on invoices and withhold paying certain invoices until the invoices are corrected. If such an invoice is arbitrarily cleared from the A/R sub-ledger it is no longer on the A/R clerk's radar and the customer will not be pursued for payment. Therefore the company loses 100% of the cash value of the invoice.

### Lost opportunity to fix problems

- If an invoice the customer refuses to pay is cleared from the A/R sub-ledger then the reason for the refusal becomes lost, and an opportunity to discover where the company failed and how it can become a better company is also potentially lost.

### Trust system disintegrates

- Customer A/P personnel change, customers hire consultants to find errors, memories fade. This mix can lead to a significant breakdown in a procedure that was working

almost entirely on trust. Which A/R clerk and which management team will be “holding the bag” when that trust fails and the write-offs begin?

We are in an economic downturn that will likely get worse before it gets better. Can your organization afford to have a “permanent” cash flow leak? If not, communicate with your customers and clear the right invoices for A/R at the right time.

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