

Credit, Collections, and Small Business Contracts

Getting paid is fundamental to business survival, and having the right contracts in place is what makes that possible. This course covers the essentials of extending credit responsibly, navigating collections, and drafting or reviewing small business contracts that hold up. For CPAs and tax professionals who advise clients on operations and financial management, understanding these legal fundamentals helps you provide well-rounded guidance that goes beyond the numbers and addresses real business risk.

CREDIT HOURS 2 | FIELD OF STUDY BUSINESS | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify the characteristics of the various laws related to providing credit to customers.
- Identify the characteristics of legally binding contracts.

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Chapter 1: EXTENDING CREDIT AND GETTING PAID

Chapter Objective

After completing this chapter, you should be able to:

- Identify the characteristics of the various laws related to providing credit to customers.

In this chapter, you'll find out how to establish credit practices that help ensure that you get paid when you should. You'll also learn how to comply with federal and state credit laws and what to do if customers, clients, or patients don't pay when they're supposed to.

THE PRACTICAL SIDE OF EXTENDING CREDIT

Some businesses give customers 30 or 60 days to pay for goods and services. They might even let customers make installment payments over a longer period. For example, a small wholesaler of children's music products might require retail customers to pay at the time of sale but extend 30 days' credit to wholesale customers. Similarly, many professionals and other service providers extend short-term credit to clients and customers, who are expected to pay after receiving a monthly invoice.

If you extend credit, you need to set up a well-organized, accurate, easy-to-use system of accounts, send out bills periodically, and keep after those who pay slowly or not at all—all of which takes time, money, and effort.

Many small business people fantasize about avoiding the whole mess by requiring customers to pay cash. Unfortunately, this sort of daydreaming is normally just that; in many businesses and professional practices, it's almost impossible to operate if you don't extend credit.

Professional and Personal Service Businesses

In many professional or consulting practices, it used to be considered unusual to require a client or patient to complete a formal credit application. No longer. Today, credit applications are becoming routine, because businesses simply can't afford to provide services unless they get paid. But if you shy away from a formal application, you can still gather much pertinent information from your new client or patient intake sheet. Ask where the person works and banks. Ask for the name of the "nearest relative not living with you"—useful information if the client or patient skips out.

Health care professionals will, of course, want to inquire about insurance or Medicaid/Medicare coverage. Consider offering a modest discount (say, 5%) for payment at the time services are

rendered—it usually leads to prompt payment. Also, if you accept credit cards, there’s really no reason for the patient not to pay on the spot.

Lawyers, accountants, appraisers, engineers, dentists, and other professionals may appropriately ask for advance payment to be applied against the first batch of services, especially if a new client or patient needs extensive services. One way to do this is to present a fee letter to each new client. The letter might state that new clients are asked to pay a retainer and that future payments are due 10 days from billing. (See “Putting Professional Relationships on a Sound Financial Footing,” below.)

Another positive thing a professional or consultant can do is to routinely record bank account data about the client or patient as payment is received. Then, if you have to sue the client or patient, you have one more place to turn to try to satisfy your judgment.

If you’re worried that someone isn’t creditworthy—particularly if the bill is likely to mount rapidly—you can run a quick credit check with a credit reporting agency. Credit checks are so routine these days that this won’t drive away business. However, you should notify the client or patient beforehand. Also, before using credit reports, familiarize yourself with the federal Fair Credit Reporting Act and similar state laws. (See “Laws That Regulate Consumer Credit,” below.) For example, if you reject credit for a client or patient based on a credit report, you need to disclose this to the person, as well as the name, address, and phone number of the credit reporting agency that gave you the negative information.

Putting Professional Relationships on a Sound Financial Footing

If you have a professional practice or run a consulting or personal service business, consider giving each client or patient a written statement of your billing procedures, so that they know what to expect.

It is also businesslike and inoffensive to prepare a letter of retention spelling out the services you'll be performing, how much you'll be charging, when you'll be billing, and when payment is due. Such letters might even be legally required. In California, for example, lawyers and clients must sign a fee agreement if the expected fee is more than \$1,000 or the fee is contingent on the outcome of a lawsuit.

You could even take the retention letter one step further by providing payment envelopes for the patients to use in sending their monthly checks. This approach works for professionals where fairly predictable services are delivered over a defined time period.

Your letter should state when you expect to be paid—usually within 10 days of the statement date. Also, list the amount of any interest or finance charges you'll assess (as permitted by state law) if payment is late, and reserve your right to stop rendering services. (In a few professions, rules of professional ethics might affect how and when you can terminate the relationship.) Have the client or patient acknowledge in writing receipt of your letter and agreement to its terms.

Wholesale and Manufacturing Businesses

If you're a wholesale or service business—a shoe wholesaler, software company, or clothing manufacturer, for example—you should have a credit policy and you should insist that customers complete a formal application for credit. The details of your credit policy will depend on the kind of business you're in and the type of customers you serve. Here are some issues to think about:

- How many days after billing is payment due?
- Is there a discount for early payment?
- Do you require prepayment or “COD” (“cash on delivery”) terms for certain classes of customers?
- Do you add interest or finance charges? If so, how much?
- When are credit checks required? (For example, you obviously wouldn't require a credit check if the customer is the government and probably wouldn't for a major, well-established company. On the other hand, you likely would want to check on the credit of a new small business or an individual making a large purchase.)
- How are credit limits determined?
- When and how often do you send past-due notices and follow up with phone calls?

- Do you keep selling to a customer whose account is overdue?
- At what point will you begin aggressive credit efforts?

When you approve credit for new trade accounts, let them know the maximum credit you're allowing and when they're expected to pay—as well as other relevant features of your credit policy.

A sample credit application form designed for trade accounts is shown on the following pages.

Should You Charge Interest?

Most businesses don't charge interest or impose finance charges in exchange for granting credit. More typically, interest is charged when bills aren't paid within the agreed time, often between 10 and 30 days. If you decide to impose these charges, you must inform the customer how the charges will be computed. **The Truth in Lending Act**, which applies primarily to sales to consumers, prescribes the disclosures you must make—but not the rates you can charge. That's done by state law.

One reason to consider adding interest or finance charges after a certain date is that customers who are short of cash tend to pay first the bills that carry such charges. Other incentives for early payment include:

- Discounts for prompt payment—for example, 5% off if the customer pays the bill on the spot or within 10 days
- Free shipping and handling (a big item these days) for customers who prepay, and
- Making the customer responsible for paying for court costs and reasonable attorneys' fees required to enforce collection if the customer doesn't pay as agreed. The customer must agree to this, either in a credit application or in a separate contract.

Sample Credit Application

Credit Application

The undersigned company is applying for credit with ABC ELECTRICAL, INC., and agrees to abide by the standard terms and conditions of ABC ELECTRICAL, INC., as printed on the reverse side.

Company name _____

DBA (if different) _____

Contact person _____

Address _____

Phone (____) _____ Fax (____) _____ Email (____) _____

Federal Tax ID or Social Security no. _____

Type of business _____

No. of employees _____ Date business established _____

Types of products you will purchase _____

_____ Amount of credit requested \$ _____

Are You a:

☐ Corporation

State of incorporation _____

Names, titles, and addresses of your three chief corporate officers _____

Name and address of your resident agent _____

☐ Limited Liability Company (LLC)

State where formed _____

Names, titles, and addresses of your three chief managers or members _____

Name and address of your resident agent _____

☐ Partnership

Names and addresses of the partners _____

☐ Sole Proprietorship

Are you sales tax exempt? ☐ Yes ☐ No

Have you ever had credit with us before? ☐ Yes ☐ No

If yes, under what name? _____

Authorized purchasers _____

Purchase order required? ☐ Yes ☐ No

Trade References

Reference #1 Name _____

Address _____

Email _____ Phone (____) _____

Reference #2 Name _____

Address _____

Email _____ Phone (____) _____

Reference #3 Name _____

Address _____

Email _____ Phone (____) _____

Bank References

Bank #1 Account # _____ Phone (____) _____

Contact person _____

Name of bank _____

Address _____

Bank #2 Account # _____ Phone (____) _____

Contact person _____

Name of bank _____

Address _____

I represent that the above information is true and is given to induce ABC ELECTRICAL, INC., to extend credit to the applicant. My company and I authorize ABC ELECTRICAL, INC., to make such credit investigation as ABC ELECTRICAL, INC., sees fit, including contacting the above trade references and banks and obtaining credit reports. My company and I authorize all trade references, banks, and credit reporting agencies to disclose to ABC ELECTRICAL, INC., any and all information concerning the financial and credit history of my company.

I have read the terms and conditions stated below and agree to all of those terms and conditions.

Authorized signature: _____

Printed name: _____

Title: _____

Date: _____