

# **ACCOUNTING AND FINANCE**

## **LEVEL - IV**

**BASED ON November 2023, curriculum V-II**



**Module Title: Managing overdue customer accounts**

**Module code: LSA ACF4 M02 1223**

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**Prepared by: Ministry of Labor and Skills**

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**Addis Ababa, Ethiopia**

## ACKNOWLEDGMENT

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## ACRONYMS

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QMS            Quality management system

DPO           Days payable outstanding

EPA            Enforceable Payment Agreement

## Introduction of the module

Accounting and finance filed; the Manage Overdue Customer Accounts”. in the work place helps to know the identify customers requiring collection activity, establish contact with customers and attempt to resolve outstanding payment matters, negotiate resolution and monitor agreements to ensure adherence. Accounting and finance filed.

This module is designed to meet the industry requirement under the Accounting and Finance occupational standard, particularly for the unit of competency manage overdue customer accounts

### This module covers the units:

- Manage Receivables Account.
- Establishment of contact with customer
- Resolution of outstanding payments
- Monitoring of agreement

## Learning Objective of the Module

- To Manage Receivables Account.
- To establish contact with customer
- Resolution of outstanding payments
- To monitor agreement

## Module instruction

For effective use these modules trainees are expected to follow the following module instruction:

1. Read the information written in each unit
2. Accomplish the self-checks at the end of each unit
3. Red the identified reference book for examples and exercise

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## UNIT ONE - MANAGE RECEIVABLES ACCOUNT.

This unit is to provide you the necessary information regarding the following content coverage and topics:

- Overdue account reporting system
- Customer information
- Reviewing overdue debtors

This unit will also assist you to attain the learning outcomes stated in the cover page.

Specifically, upon completion of this learning guide, you will be able to:

- Overdue account in reporting system
- Access customer information
- Review overdue debtors

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## 1.1. OVERDUE ACCOUNT REPORTING SYSTEM

As soon as you miss a payment, the account is considered past due or overdue. Even if you're only a few days late, this is technically considered an overdue payment. However, if your account is only a little bit past due, you're unlikely to face any intimidating collection efforts.

### EVALUATING ACCOUNTS RECEIVABLE

Business owners know that some customers who receive credit will never pay their account balances. These uncollectible accounts are also called bad debts.

Companies use two methods to account for bad debts:

- A. The **direct write-off method** and
- B. The **allowance method**.

- **Direct write-off method:**

- Bad debts charged directly to expense when debt is considered un-collectable
- It is only acceptable in those cases where bad debts are immaterial in amount.
- direct write-off method is simple
- also called direct charge off method

If a customer named Tola fails to pay a Br225 balance, for example, the company records the write-off by debiting bad debts expense and crediting accounts receivable from Tola. The appropriate entry for the direct write-off approach is as follows:

2-10-210	Uncollectible Accounts Expense	225	
	Accounts Receivable		225
	To record the write off of an uncollectible account from Jones		

**Notice** that the preceding entry reduces the receivables balance for the item that is deemed uncollectible. The offsetting debit is to an expense account: Uncollectible Accounts Expense.

- **Allowance Method:**

- Estimate of doubtful debts made at the end of the period
- An adjusting entry is made at the end of each accounting period.
- This method is consistent with the principles of accrual accounting, recognizing the expense in the same period as the related revenue
- Records an estimate of the expense in same period as the income to which it relates
- Creates an allowance that will be deducted from accounts receivable on the balance sheet
- Allowance also known as ‘provision’
- Since the specific customer accounts that will become uncollectible are not yet known when the adjusting entry is made, a contra-asset account named allowance for bad debts, which is sometimes called allowance for doubtful accounts, is subtracted from accounts receivable to show the net realizable value of accounts receivable on the balance sheet.

### **Estimating Bad Debts expense**

The allowance method of accounting for bad debts requires an estimate of bad debts expense to prepare the adjusting entry at the end of each accounting period. There are two approaches to estimate bad debts expense using the allowance method:

- Percentage of Total Receivables method
- Percentage of sales method

However, if you don’t pay the past due balance, you could experience any of the following:

- Phone calls from your creditor or service provider
- Past due letter in the mail
- Discontinued service (in the case of utilities)
- Negative impact on your credit score
- Legal action



## 1.2. RECORDING CUSTOMER INFORMATION

Information is a fact, thought or data conveyed or described through various types of communication, like written, oral, visual and audio communications.

Knowledge communicated or received concerning a particular fact or circumstance; news: information concerning a crime. Knowledge gained through study, communication, research, instruction, etc.; factual data: His wealth of general information is amazing.

Types of information

The information you collect from your customers might include:

- Personal contact details
- Personal residential details
- Government-issued identification
- Medical history
- Emergency contact and next of kin
- Buying habits and preferences
- Product or service preferences
- Financial statements and credit history.

Customer information is the behavioral, demographic and personal information about customers collected by businesses and marketing companies to understand communicate and engage with customers.

## 1.3. REVIEWING OVERDUE DEBTORS

A debt is overdue as soon as payment is late. A debt is overdue as soon as payment is late. It must be remembered that once payment is late, even by as little as a single day, the law considers the debt to be overdue. The debtor is in breach, because he failed to fulfill his obligation by the deadline.

A debt is a creditor's right to be paid by a debtor. A debt becomes an overdue debt once it is due and outstanding, provided that it is certain, liquidated, due and payable. Once a debt is overdue, the creditor can collect it, either personally or through an agent.

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To ensure timely payment to vendors, accounts payable departments often set up a schedule. An overdue invoice is an invoice a company has yet to pay and is past the invoice due date. Failure to pay the invoice by a due date makes an invoice overdue.

## ORGANIZATION POLICY AND PROCEDURES

Organizational policies and procedures provide guidelines for decision-making processes and the way that works in an organization should be carried out. The result of having clear, well-written policies and procedures are increased transparency, accountability, uniformity and stability.

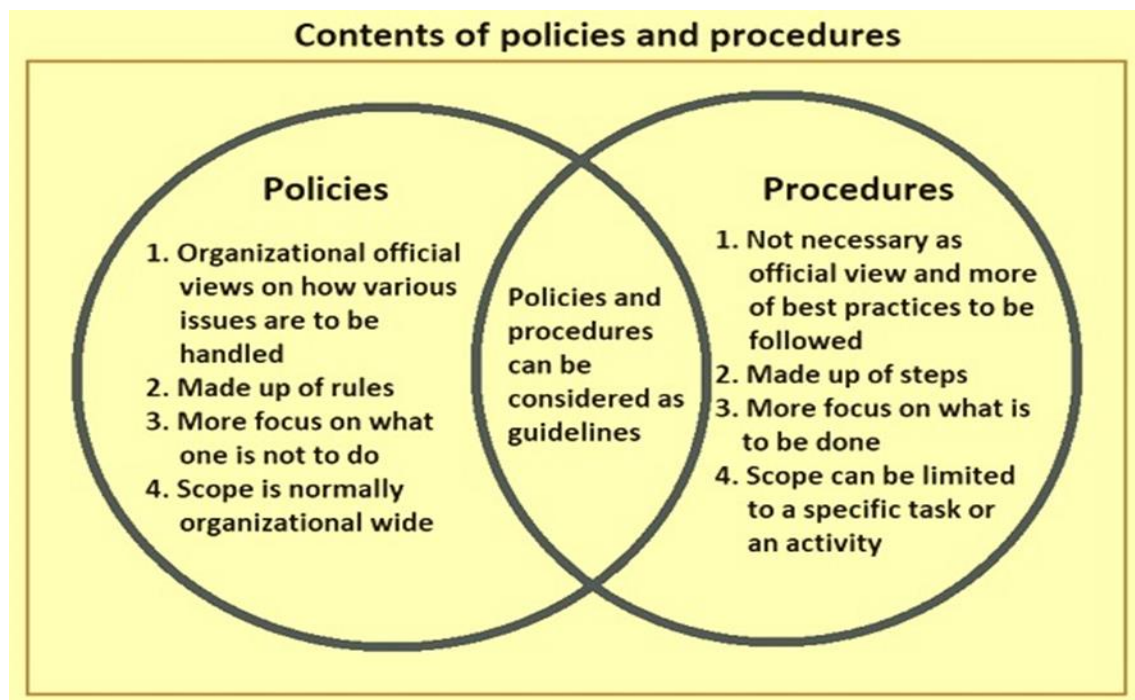


Figure1-1: content of policy and procedure

### Organization policy and procedures

May include but not limited to;-

- Consideration of customer circumstances
- Ongoing support and negotiation with customers
- Referral to external organizations for advice
- Settlement schedules recovery costs suspension of credit facilities

## LEGISLATION

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Legislation, the preparing and enacting of laws by local, state, or national legislatures. In other contexts it is sometimes used to apply to municipal ordinances and to the rules and regulations of administrative agencies passed in the exercise of delegated legislative functions.

Legislation is the process or result of enrolling, enacting, or promulgating laws by a legislature, parliament, or analogous governing body. Before an item of legislation becomes law it may be known as a bill, and may be broadly referred to as "legislation" while it remains under consideration to distinguish it from other business. Legislation can have many purposes: to regulate, to authorize, to outlaw, to provide (funds), to sanction, to grant, to declare, or to restrict. It may be contrasted with a non-legislative act by an executive or administrative body under the authority of a legislative act.

Examples of legislation

- Bankruptcy law
- Bills of Sale and Other Instruments law
- Cheques and Payment Orders manuals
- Consumer credit directives
- Corporations law
- Criminal code
- Door to Door Sales Act or equivalent
- Evidence Reproduction procedures
- Fair Trading laws

## Self – check 1.1

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## Part two – True or False Statements

1. The direct write-off method involves recording uncollectible accounts by charging directly to expenses when they are deemed uncollectible.
2. Customer information collected by businesses might include personal contact details, financial statements, and government-issued identification.
3. Legislation related to Fair Trading laws can be an example of legal frameworks governing business practices and consumer rights.
4. The direct write-off method is the only acceptable method for accounting for bad debts in any situation.
5. Customer information collected by businesses does not involve any financial statements or credit history.

## Part Two - Matching

### Column A

1. Direct Write-Off Method
2. Allowance Method
3. Percentage of Total Receivables Method
4. Percentage of Sales Method
5. Organization Policy and Procedures

### Column B

- A. Bad debts are charged directly to expense when deemed uncollectible.
- B. Estimates bad debts expense at the end of each accounting period.
- C. Subtracts a contra-asset account from accounts receivable for net realizable value.
- D. Recognizes the expense in the same period as the related revenue.
- E. Provides guidelines for decision-making processes and operational conduct within a company.

## Part two - Short Answer

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6. How to collect from your customer information's

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7. What is legal action and their examples

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8. Define the difference between policy and procedures

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6. Explain the difference between debtor and creditor

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## UNIT TWO: ESTABLISHING CONTACT WITH CUSTOMER

This unit is to provide you the necessary information regarding the following content coverage and topics:

- Confirming proposed communication.
- Establishing and communicating rapport.
- Advising purpose of contact.

This unit will also assist you to attain the learning outcomes stated in the cover page. Specifically, upon completion of this learning guide, you will be able to:

- Determine and confirm proposed communication.
- Establish and communicate rapport.
- Advise purpose of contact.

## 2.1. CONFIRMING PROPOSE COMMUNICATION

Communication is neither transmission of message nor message itself. It is the mutual Exchange of understanding, originating with the receiver. Communication needs to be effective in business. Communication is essence of management. The basic functions of management (Planning, Organizing, Staffing, Directing and Controlling) cannot be performed well without effective communication. Business communication involves constant flow of information. Feedback is integral part of business communication. Organizations these days are very large. It involves number of people. There are various levels of hierarchy in an organization. Greater the number of levels, the more difficult is the jobs of managing the organization.

Confirming messages convey that parties in the relationship are valued. There are three main categories of confirming communication: showing recognition, acknowledging the other person's thoughts and feelings, and expressing agreement.

For example, if a friend enters your home and you smile, hug them, and say, “I’m so glad to see you” you are confirming their existence. If you say “good morning” to a colleague and they ignore you by walking out of the room without saying anything, then they are creating a disconfirming climate by not recognizing you.

The purpose of communication is to inquire, inform, persuade, entertain, request and investigate. A single message can have one or more of the following purposes: To convey information/opinion, for example, “I have headache” or “I am here to give you medication”.

Confirmation- Messages sent to another that communicate they are valued by the sender.

Disconfirmation- Messages sent to another that communicate they are not valued by the sender.

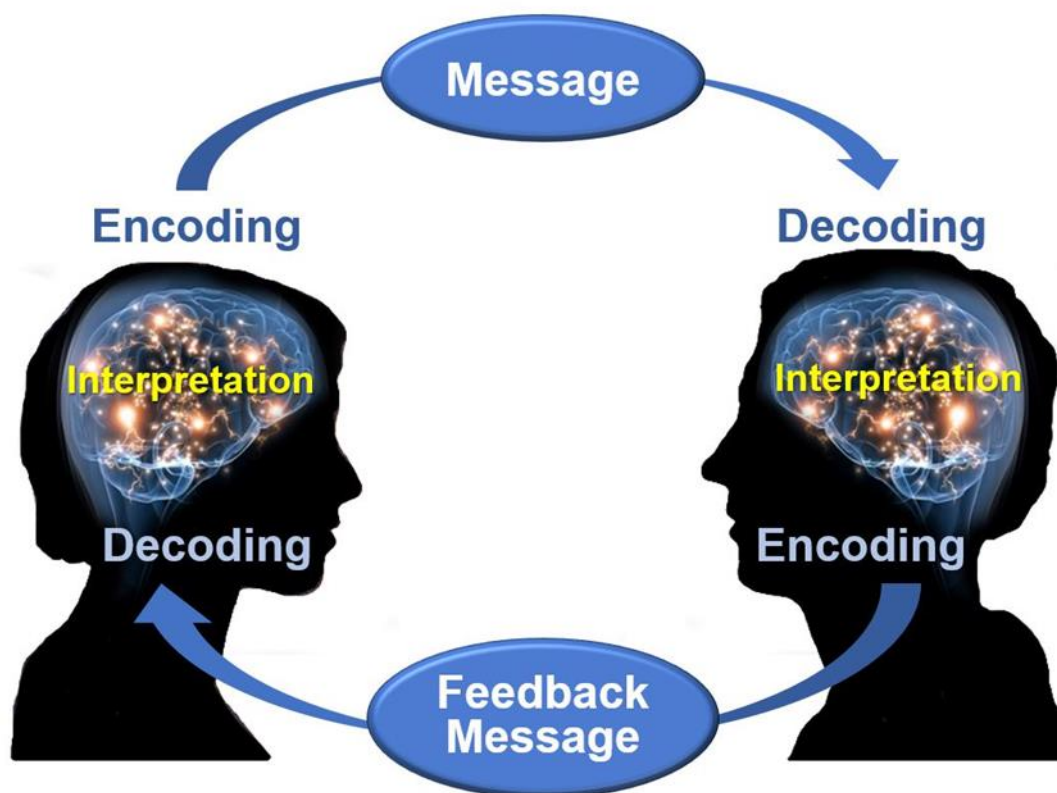


Figure 2-1: Model of communication

## 2.2. ESTABLISHING AND COMMUNICATING RAPPORT

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Building rapport involves establishing a connection or bond with someone, creating mutual understanding, and fostering a positive relationship. Here are some tips to effectively communicate and establish rapport:

**Active listening:** Pay attention to the person speaking, maintain eye contact, nod occasionally, and show genuine interest in what they're saying. Reflecting back or summarizing their words helps demonstrate your understanding.

**Empathy and understanding:** Try to see things from the other person's perspective. Show empathy by acknowledging their feelings and emotions, even if you don't necessarily agree with their point of view.

**Open body language:** Your body language can convey a lot. Maintain an open posture, smile, and use gestures to express yourself. Avoid crossing your arms, as it might signal defensiveness.

**Find common ground:** Look for shared interests, experiences, or values. Highlighting similarities helps create a sense of connection and understanding between you and the other person.

**Be authentic and genuine:** People appreciate sincerity. Be yourself and show authenticity in your interactions. Avoid pretending or being insincere, as it can harm trust and rapport.

**Use mirroring and matching:** Subtly mirroring the other person's body language, tone of voice, or pace of speech can create a subconscious sense of rapport. Be cautious not to mimic excessively or in an obvious way.

**Ask open-ended questions:** Encourage the other person to elaborate on their thoughts and feelings. Open-ended questions promote deeper conversations and show your interest in understanding them better.

**Show appreciation and respect:** Express gratitude, acknowledge their contributions or thoughts, and be respectful in your communication. Valuing their opinions can strengthen the rapport.

**Maintain positivity and warmth:** A positive attitude and friendly demeanor can go a long way in establishing rapport. Maintain a warm and welcoming tone during conversations.

**Practice patience:** Building rapport takes time.



Figure 2-2: build rapport

Building rapport with colleagues, managers and customers is a critical stage of creating trust and building relationships. Without trust you limit what you can achieve at work, whatever your position. Everything becomes a lot harder and takes a lot longer.

### **Establishing rapport**

It's the sense of connection that you get when you meet someone you like and trust, and whose point of view you understand. It's the bond that forms when you discover that you share one another's values and priorities in life.

One of the most important communication skills for building rapport and trust is listening actively. This means paying attention to what the other person is saying, showing interest and empathy, and asking relevant questions.

#### **Five ways of Building Rapport and Connecting with Work Colleagues**

- Be the Real You
- Turn Up Prepared
- Practice Positive Body Language
- Make the Conversation About Them

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### 2.3. ADVISING PURPOSE OF CONTACT

It means plays a key role in your education—whether you’re an undergraduate or a graduate student. Advisors not only know program requirements, but they also get to know you. They take time to learn about your interests and goals.

The advisor/advisee relationship is essentially educational in nature, and is thus broad and multi-faceted. For the student new to an academic community, advisors can help the student engage with and learn to thrive in their new environment. Advisors who take the time to introduce themselves to their new advisees with something as simple as an introductory exchange of emails, office visit, or telephone conversation do the following:

- Demonstrate an interest in the student’s well-being
- Communicate to the student that he/she, as an individual, matters
- Provide a friendly and supportive connection to university life
- Can serve as a campus expert by referring them to campus and community resources
- Confirm that faculty on campus are approachable and helpful

#### Advisor and advisee responsibility

##### Advisor Responsibilities:

- Communicate university policies and procedures
- Help students define and develop realistic goals
- Match student needs with available resources; make appropriate referrals
- Assist students with planning programs consistent with their abilities and interests
- Discuss linkage between academic preparation and careers

##### Advisee Responsibilities:

- Gather all relevant decision-making information
- Clarify personal values and goals
- Become knowledgeable about college programs, policies, and procedures
- Be an active learner by participating fully in the advising experience

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- Ask questions if you do not understand an issue or have a concern
- Accept responsibility for decisions

### **Purpose of advising**

The advisor's role is to help the student evaluate and realize educational and career options. This requires the advisor to: approve the student's academic program of study. Provide accurate and consistent information.

### **SELF – CHECK 2.1.**

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## Part one - Choice

- What one of the primary purposes of communication is as mentioned in the text?  
A) Entertainment B) Persuasion C) Trust-building D) Recognition
- Which of the following is NOT listed as a way to build rapport with work colleagues?  
A) Being authentic B) Arriving unprepared C) Using positive body language D) Focusing the conversation on them
- What are some responsibilities of an advisor as outlined in the text?  
A) Helping students define goals and match needs with resources B) Encouraging students to avoid asking questions C) Avoiding discussions about academic preparation and careers D) Referring students to campus resources
- What does disconfirming communication convey to the recipient?  
A) Valued by the sender B) Ignored or not valued by the sender C) Mutual understanding D) Confirmation of the sender's opinions
- What does effective communication represent in the context of management, according to the text?  
A) An obstacle to the basic functions of management B) Essential for the proper execution of managerial functions C) Unnecessary in large organizations D) Only necessary for organizational hierarchy

## Part Two – Short Answer

- Explain communicating rapport

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## UNIT THREE: RESOLUTION OF OUTSTANDING PAYMENTS

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2. Discuss the purpose of relevant customer information

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3. Write the difference between advisee and advisor

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4. What is rapport?

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7. List and explain model of communication

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This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Advising debtors
- Using appropriate techniques
- Undertaking further action

This unit will also assist you to attain the learning outcomes stated in the cover page. Specifically, upon completion of this learning guide, you will be able to:

- Advising debtors
- Using negotiation techniques
- Undertaking further action

### 3.1. ADVISING DEBTORS

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The act of using a lawyer or a court to help settle a disagreement, etc. that you have with a person or an organization. Legal Action means, with respect to any Person, any and all litigation or legal or other actions, arbitrations, counterclaims, investigations, proceedings, requests for material information by or pursuant to the order of any Authority or suits, at law or in arbitration, equity or admiralty, whether or not purported to be brought on behalf of such Person, affecting such Person or any of such Person's business, property or assets.

Examples of legal action

May include but not limited to

Court action:

- Statement of claim (summons)
- Statement of liquidated claim letter of demand

If the debtor does not pay the debt, there are five options:

- Offering the debtor an Enforceable Payment Agreement
- Further negotiation
- Mediation
- Commencing legal action
- Writing the debt off

➤ **Offering the debtor an Enforceable Payment Agreement (EPA)**

Instead of taking legal action, or at any stage after you have started legal action, you can offer an Enforceable Payment Agreement to the debtor. An EPA is an agreement for the debtor to pay the debt in installments, and that the creditor will not commence a legal action or report the debt to credit referencing agencies.

If the debtor defaults on the EPA, the creditor can rely on the EPA to issue proceedings (if that has not happened already) and obtain summary judgment.

➤ **Further negotiation**

Further negotiation may be an attractive option, especially if the debtor indicates they may be able to pay the debt in the future. Use the same techniques described in ‘Negotiation with the debtor’ above. Consider suggesting an EPA as part of your negotiations.

➤ **Mediation**

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Mediation is a process where both parties agree to sit down in the same room with a mediator to resolve their dispute. A mediator is a neutral third party who may help with discussions, but it is up to the parties themselves to arrive at a solution. Mediation has a number of benefits:

- It is informal compared to court proceedings, with less stress on the parties
- The mediator will not decide on how to settle the matter – this is for the parties to decide
- The parties have more control over the process and outcome
- Free mediation services are available, whereas legal action involves court fees
- Mediation generally gives a quicker resolution than going to court
- The privacy and confidentiality of the mediation process is assured (parties sign a confidentiality agreement before the first mediation session and, if both parties are in agreement, the outcome can remain confidential)
- The Magistrates Court offers a mediation service.

➤ **Commencing legal action**

There are several factors to consider before taking legal action.

✓ **Proof**

Can you prove that you are owed money by the debtor? Do you have documentation of the debt such as an invoice, or witnesses who will confirm your version of events? Do you have text messages, letters or emails from the debtor that confirms the debt?

✓ **Time**

A Minor Civil Claim in the Magistrates Court can be settled at any time. However, it will be some months before a trial occurs if the debtor does not agree to pay the debt. Enforcing the judgment will take some time after this and the debt may not be paid in full straight away but in installments.

If you are representing yourself, you would need to be available in court at the time set for your directions hearing and trial.

✓ **Costs**

Fees need to be paid when:

- You give notice of intention to sue using the prescribed Final Notice

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- You file a Minor Civil Claim
- If you need to enforce the judgment

➤ **Writing the debt off**

If negotiation and mediation are not successful or possible, and if any of the above factors mean that you do not wish to take legal action, then you can choose not to recover the debt, that is, you can ‘write the debt off’. In some cases, a business debt may be tax deductible.

### 3.2. USING NEGOTIATION TECHNIQUES

**Negotiation Techniques for Successful Accounts Receivable Collection** Understanding the Debtor’s Situation Understanding the debtor’s situation is a critical first step in the accounts receivable collection process. Before initiating negotiations, it’s essential to gather relevant information about the debtor’s financial health and the challenges they may be facing. This includes reviewing their payment history, creditworthiness, and any past communication related to the outstanding debt. By doing so, businesses can gain insights into the debtor’s ability to make payments and the factors that may be influencing their current financial circumstances

The increased sensitivity gained from this drill helps a practitioner attack and counter an opponent’s movements precisely, quickly, and with appropriate techniques.

A technique is a method of doing some task or performing something. Your technique for opening drinks might be to twist the top off with your teeth. If so, your dentist better have a good tooth-repair technique. The noun technique can also refer to someone’s skillfulness with the fundamentals of a particular task.

To help visitors develop an understanding of the relevance and significance of resources, interpretation involves linking a tangible resource at your site to the intangible meanings it represents. Appropriate interpretive techniques create those links. Simply declaring that a resource is relevant doesn’t provide an opportunity for visitors to form their own connection to what the resource means or why it is significant. Using techniques like storytelling or comparisons can provide opportunities for connections to the resource. This may motivate visitors to care about, and perhaps even care for, the resource

### 3.3. UNDERTAKING FURTHER ACTION

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Furthermore, demonstrating an understanding of the debtor's position can lead to more productive communication, improved customer relations, and, ultimately, a higher likelihood of successfully collecting outstanding debts

### **Building a Collaborative Approach**

Building a collaborative approach is essential in the accounts receivable collection process to foster a positive and cooperative atmosphere during negotiations. Instead of adopting a confrontational stance, a collaborative approach emphasizes working together with the debtor to find mutually beneficial solutions to resolve outstanding debts. Here's how to implement a collaborative approach effectively:

**Open Communication:** Establish open lines of communication with the debtor from the outset. Encourage them to share their concerns and challenges openly, and actively listen to their perspective without judgment.

This creates a sense of partnership and demonstrates that you value their input.

- Pay their suppliers promptly and on-time (within 30 days)
- Cooperate with suppliers

### **Establishing Clear Terms and Agreements**

Is a crucial step in the accounts receivable collection process to ensure both parties have a mutual understanding of the resolution reached during negotiations? When negotiating with debtors, it's essential to document all agreed-upon terms in writing to avoid misunderstandings or disputes in the future. Here's how to effectively establish clear terms and agreements

**Written Agreements:** Record all negotiated terms and agreements in a written format, such as an email, letter, or formal contract.

**Specific Payment Terms:** Clearly outline the payment terms, including the amount owed, due dates, payment method, and any other relevant details.

## **SELF – CHECK 3.1.**

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## Part One: True or False Questions

1. Is an Enforceable Payment Agreement (EPA) solely for the debtor's benefit and doesn't offer any advantage to the creditor
3. Mediation involves a decision-making process by the mediator to resolve the dispute between the parties.
4. Writing off a debt means the creditor can never pursue legal action in the future if circumstances change.
5. Does legal action involve considering factors such as proof of debt, time, and costs before commencing proceedings
6. Is interpretation at a site about creating connections between tangible resources and intangible meanings using appropriate techniques like storytelling or comparisons

## Part two - Short Answer

1. Define and explain legal action

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2. List examples of legal action

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3. What is an negotiation technique?

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## UNIT FOUR: MONITORING AGREEMENT

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Reviewing account.
- Breaches of agreement.
- Payment matters.

This unit will also assist you to attain the learning outcomes stated in the cover page.

Specifically, upon completion of this learning guide, you will be able to:

- Review account.
- Adders breaches of agreement.
- Identify Payment matters.

#### 4.1. REVIEWING ACCOUNT

An account review is a regularly scheduled meeting between a supplier and client to review performance and further develop the relationship. On the client side, participants include the decision maker, the purchaser and the user of the product or service. On the supplier side, the sales rep attends and may bring the sales manager, president and/or technical expert. Frequency is less important than consistency. For some industries, annual reviews are enough, while for others, quarterly works best.

Increasing revenue is among the top three goals of company owners, and while converting new prospects is an easy way to measure the return on investment for a sales implementation, there is also often a larger untapped pocket of potential in the clients the company already serves. The first step to accessing this potential is an account review.

The accounting review consists of control processes and clearance of the balance sheet accounts before the closing of a financial year or period. It enables the financial statements of a company to be analyzed with a view to verifying their sincerity, regularity and conformity.

#### 4.2. BREACHES OF AGREEMENT

One way companies can ensure compliance with Contracts of Adherence is by implementing a quality management system (QMS). A QMS can help companies to track and improve their performance against the standards set out in the contract. It can also help companies to identify and address any areas of non-compliance.

A contract of adherence is an agreement between two parties that outlines the rules and regulations each must abide by. In a business context, it's used to ensure compliance with any laws or regulations that may be imposed on the business or its customers.

A contract of adherence is an agreement between two parties in which one party agrees to adhere to the terms and conditions of the other party. The terms and conditions may include, but are not limited to, the payment of a fee or the performance of a service.

In order for a company to ensure compliance with a Contract of Adherence, they must first understand what the contract entails. A Contract of Adherence is an agreement between two or more parties that

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outlines the terms and conditions under which they will do business with one another. This type of contract is often used in situations where one party is providing a service to another party, and both parties want to ensure that the quality of the service meets their expectations.

The key elements of a Contract of Adherence include:

- A description of the services to be provided
- The expectations of both parties regarding the quality of those services
- The consequences that will occur if either party fails to meet their obligations under the contract

One way companies can ensure compliance with Contracts of Adherence is by implementing a quality management system (QMS). A QMS can help companies to track and improve their performance against the standards set out in the contract. It can also help companies to identify and address any areas of non-compliance.

Another way companies can ensure compliance with Contracts of Adherence is by appointing a compliance officer. The compliance officer is responsible for ensuring that the company complies with all aspects of the contract. They will liaise with different departments within the company to ensure that everyone is aware of their obligations under the contract.

### 4.3. OUTSTANDING PAYMENT MATTERS

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Outstanding payment refers to a payment that has not yet been made or received. It may refer to a bill or invoice that has not been paid, or to money that is owed to someone but has not yet been received. This term is commonly used in financial contexts, such as in businesses or personal finance.

It means the payment has been billed 'out' but not received. That distinguishes it from accumulated but unbilled accounts receivable. These are distinctions that make up the discipline of accounting.

Days payable outstanding (DPO) is a financial ratio that indicates the average time (in days) that a company takes to pay its bills and invoices to its trade creditors, which may include suppliers, vendors, or financiers. The ratio is typically calculated on a quarterly or annual basis, and it indicates how well the company's cash outflows are being managed.

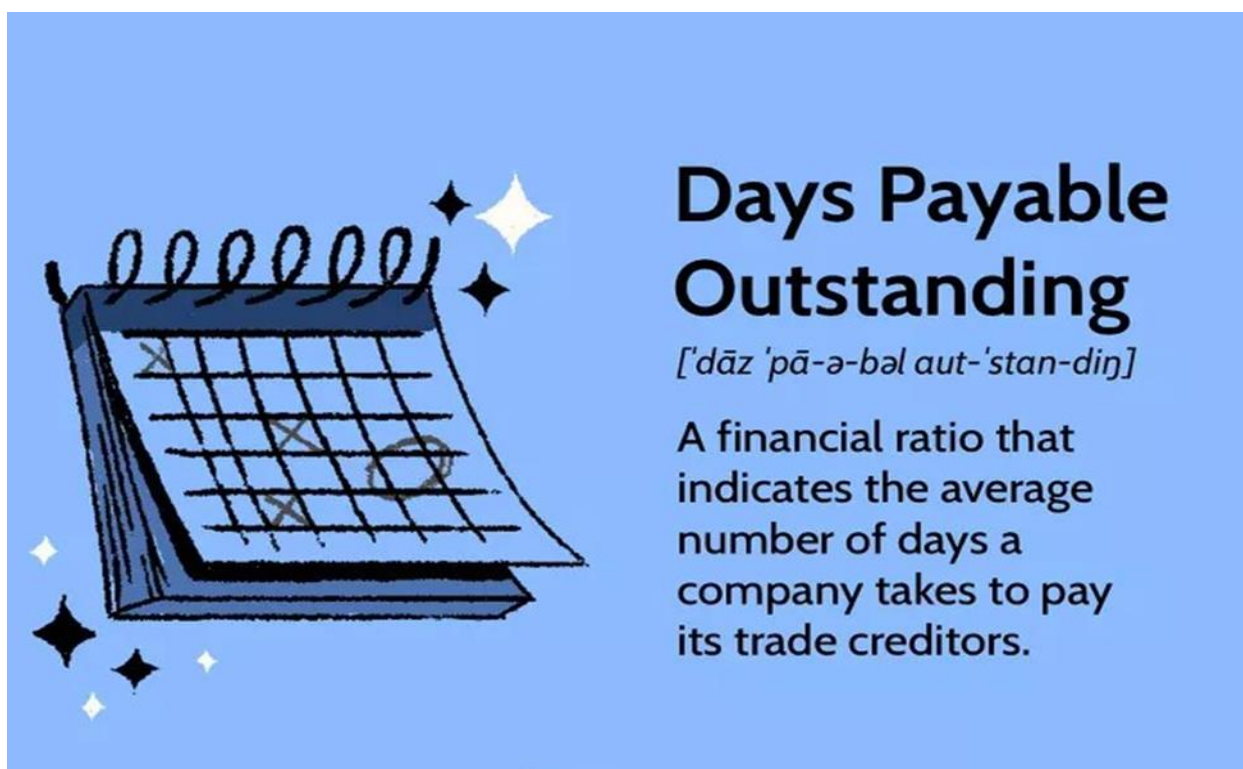


Figure 4-1: Day payable outstanding

A company with a higher value of DPO takes longer to pay its bills, which means that it can retain available funds for a longer duration, allowing the company an opportunity to use those funds in a

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better way to maximize the benefits. A high DPO, however, may also be a red flag indicating an inability to pay its bills on time.

Formula for Days Payable Outstanding (DPO)

$$\text{DPO} = (\text{Accounts Payable} \times \text{Number of Days}) / \text{COGS}$$

Where: COGS = Cost of Goods Sold

$$= \text{Beginning Inventory} + \text{P} - \text{Ending Inventory}$$

P = Purchases

Example of Days Payable Outstanding

Item	Beginning Balance	Ending Balance	Average
Inventory	\$ 2,300,000.00	\$ 3,500,000.00	\$ 2,900,000.00
Accounts Receivable	\$ 1,750,000.00	\$ 2,300,000.00	\$ 2,025,000.00
Accounts Payable	\$ 700,000.00	\$ 900,000.00	\$ 800,000.00
Net Sales	\$ 13,000,000.00		
Cost of Goods Sold	\$ 8,500,000.00		

Calculating the DPO with the beginning and end of year balances provided above:

Average accounts payable: \$800,000

Cost of goods sold: \$8,500,000

Number of days: 365

Solution

$$\text{DPO} = (\$800,000 / \$8,500,000) \times 365 = \mathbf{34.35}.$$

Therefore, this company takes an average of 34 days to pay back its accounts payable.

## SELF CHECK 4

### Part one - Matching Questions

Match the following terms to their corresponding

#### Column A

1. Quality Management System
2. Outstanding Payment
3. Account Review
4. Contract of Adherence
5. Days Payable Outstanding

#### Column B

- A) Agreement between parties outlining business terms
- B) Financial ratio indicating payment duration
- C) Tool for tracking performance against standards
- D) Unpaid bills or invoices
- E) Scheduled meeting to assess performance

### Part Two - Multiple Choice Questions

1. Regarding Account Reviews, what is the primary goal for companies in conducting these meetings?
  - A) Introducing new prospects
  - B) Establishing quarterly consistency
  - C) Enhancing client relationships and performance
  - D) Analyzing financial statements
2. Which of the following is NOT a key element of a Contract of Adherence?
  - A) Description of services provided
  - B) Expectations regarding service quality
  - C) Consequences of non-compliance
  - D) Payment of a fee for services
3. What is the primary purpose of a Quality Management System (QMS) in relation to Contracts of Adherence?
  - A) Enforcing legal regulations
  - B) Identifying non-compliance areas
  - C) Establishing payment structures
  - D) Tracking annual sales data

4. Days Payable Outstanding (DPO) is a financial ratio indicating what aspect of a company's financial behavior?

- A) Average time taken to receive payments
- B) Average time taken to pay bills
- C) Duration of cash retention
- D) Annual revenue generation

5. In the context of outstanding payments, what does a higher value of Days Payable Outstanding (DPO) typically imply?

- A) Efficient bill payments
- B) Inability to pay bills on time
- C) Increased revenue generation
- D) Effective cash flow management

### Part three - Short Answer

1. What is review account?

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2. Define and explain quality management system

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3. List the elements of a Contract of Adherence

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4. Explain outstanding payment

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