
Institute of Credit Management

'Guide to a Credit Policy'

QICM Criteria White Paper



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Guide to a Credit Policy

The Credit Department should be judged not on how it controls credit, but on how successfully it manages credit for the company. The title 'Credit Management' sets the correct basis on which the department can develop as a vital team member within the organisation, working closely with Sales, Production, Marketing, Customer Services etc.

There must be a secure and reliable platform on which the business can place its trust. Part of this platform is the availability of reliable information and secure systems. The Credit Management Team has a leading role in building secure systems and one aspect is to ensure that an acknowledged Credit Policy and procedures are in place and clearly articulated and understood across the business.

The majority of misunderstandings between Credit and their internal stakeholders and customers are mainly due to a lack of communication between the parties where each is not fully convinced that the other has the best interests of the company's future at heart.

Purpose

The purpose of the Credit Policy is to define the Credit Management function and to outline its objectives, scope and responsibilities.

The policy needs to be clear and concise to ensure that the concept, the importance of efficient management of credit within the company and the reasons for it are understood by those inside and outside the credit function. The details below are aimed at covering the detail of the policy document but should be considered as a guide only as each company needs to understand their own requirements for a policy as one size does not fit all. For example during QICM Assessments we have seen some credit policies comprising of 120 pages and others comprising of 20 bullet points and all points in between. In reality for the document to be read we would recommend 20 pages maximum.

Function

The function of Credit Management is the protection of the investment in the debtors of the company as well as maintaining the lowest levels of receivables, balancing risks inherent in achieving sales objectives.

This is probably the most important statement within a credit policy document, as it clearly states why the Credit Department exists. It gives a very clear indication that it is not a negative news giver, is looking positively at the assets of the company and effectively

giving notice that it too can be a profit centre. Since 2008 and the economic downturn proactive Credit Management teams are assist sales and marketing in the development of strategies and business models which grow revenue and margins providing additional markets for the development of the business, additionally with the high cost of customer acquisition and the need to improve customer retention the Credit Management Team and Customer Services should work closely to assist customers to settle amounts before they become overdue. The scope of the Credit Management Team's activities is changing to meet the economic requirements of the business, and the Credit Policy document should reflect that especially in the opening statement or **Purpose** of the document.

A good Credit Policy should be subject to continual change, and such revisions and changes are usually the responsibility of the Credit Manager to issue revisions and individual department heads to ensure the use of the latest version. With organisations increasingly using internal company intranets or shared network drive folders, the need for printed copies is becoming less important and revising the documents becomes easier with one amendment being made and an emailed link to the new document circulated.

Objectives

The main objectives of credit management are to ensure that:

1. Credit terms are used to maximise sales with the minimum of risk
2. High risk or marginal accounts, especially those likely to get into financial difficulties, are identified and to take whatever action is necessary to safeguard sales to those customers.
3. All amounts due are collected according to the agreed payment terms.
4. Monthly cash collection targets are achieved
5. A high quality of Accounts Receivable is maintained
6. An accurate and responsible database of customers is operated and maintained

Responsibilities

The responsibilities and scope of each area within the company should be clearly defined and this is true of the Credit Management Team, but the boundaries of the 'traditional' Credit Control Manager are changing and adapting to meet the requirements of a modern business. Increasingly Credit Managers are now becoming more like 'Order to Cash' (O2C) extending their responsibilities and scope of their activities into customer set-up, order processing, billing and invoicing, credit and collections, cash allocation and banking. From our experience during the last 3 years of QICM Assessments the role of Credit Managers and the demands being placed on them is changing and becoming even more critical to the business.

As we have said 'one size doesn't fit all' but an example of the main responsibilities of a traditional credit management function could be as follows:

1. Credit Management are the responsibility of the Director of Finance
2. Credit Management is responsible for all recommendations and decisions made in accordance with Credit Management Procedures and the Policy
3. Any action falling outside the recommendations of the Credit Department must be endorsed by the Director of Sales after agreement with the Director of Finance. In cases of disagreement, the issue must be escalated to the next level of management to gain agreement. The final arbiter will be the Managing Director or CEO.

In many large organisations now, for example those in shared service centres either onshore or offshore, the levels of approval and escalation processes will differ and it may be unlikely that either the FD or CEO becomes involved in such decisions. In any event there must be a proper escalating 'manual of authority' for any escalation of issues but also doubling as approvals for key financial transactions for example, credit note and write off approval with the appropriate segregation of duties taken into consideration.

Contents of a Credit Policy

Your Credit Policy and procedures should be an accessible document, used as part of the induction process to the Credit Management Team. This does not have to be an extensive document that details every procedure in minute detail, in fact given that the policy needs to be circulated and read not only by the credit management team but also sales and customer services it is preferable that the policy summarises the key points and a separate document is produced providing the details and work instructions to key stroke levels on the major processes. So before you start with the development of the policy try to understand first the level to which the Credit Policy goes and which of the key processes will be summarised within it.

Again the contents will be based on the scope of the function which for the purposes of this document we will assume to be:

- Credit Assessment and the granting of credit limits
- Collections processes
- Authority Levels (credit limit, transactions and bad/doubtful debt)
- Payment collection, allocation and application

Whilst the policy summarises the key points it is becoming more common for a secondary document to detail the complete end to end process from credit application through to bad debt recovery and wrote-off.

Define Your Procedures

- Credit Application and Credit Limits**

Regular financial monitoring is worth the time and effort and you need to be prepared to respond to the results of the checks. Consider the frequency of credit assessments once a credit account is open.

- Reporting Structure**

Otherwise known as a 'Escalating Authority' or 'Delegation of Authority' this ensures process compliance and controls in the granting of credit, approvals of credit limits and transactions and write-offs. All credit policies should have this written down. An example of such a schedule is below:

	Other Direct Reports to Executive Director - HR and OHSE - Manager	Group Estates Manager, OHSE Director, Direct Reports to CFO Northern Europe and UK, UK Finance Director and Group Financial Controller	Group Financial Controller	Executive Director - HR and OHSE, CIO	CFO Northern Europe and UK, CFO UK	Joint Authority (see note) in absence of CEO	Chief Executive Officer	Notes
Sales								
Contracted work	n/a	n/a	n/a	n/a	n/a	n/a	6,000,000.00 €	Annual turnover
Credit Notes	n/a	n/a	£50,000 net amount	n/a	£150,000 net amount	£300,000 net amount	Not specified	Per Occurrence
Purchasing								
For PO's, invoices without PO and cheque	£5,000	£25,000	£50,000	£100,000	£200,000	£2,000,000	6,000,000.00 €	Per Order
Personal Expenses	£1,200	£1,200	£2,000	£2,000	£2,000	£5,000	> £2,000	Per Claim
Capex								
Budgeted	nil	£5,000	£25,000	£50,000	£150,000	£3,000,000	6,000,000.00 €	Per Project
Excess over Budget	nil	nil	nil	nil	Excess < £15,000	n/a	n/a	Per Project
Unbudgeted	nil	£2,500	£5,000	£5,000	£100,000	£500,000	6,000,000.00 €	Per Project
Excess re Unbudget	nil	nil	nil	nil	Excess < £10,000	n/a	n/a	Per Project
NOTES								
For the above, direct reports does not include executive or personal assistants								

(Figure 1 – Authority Matrix Extract)

This example is from a QICM Accredited Company and is very detailed, another simpler example is shown below:

- Up to £1,000 – Credit Controller
- Up to £3,000 – Credit Team Leader
- Up to £5,000 – Credit Manager
- Up to £10,000 – Finance Director
- Over £10,000 – CEO / Managing Director

- **Payment Terms**

All payment terms should be documented and approved by senior management and detailed on the Credit Policy. There should be no unofficial terms granted to customers outside these terms.

- **Terms and Conditional of Sale**

All customers should be provided with the Standard Terms and Conditions (T&Cs) which form a part of the credit application process and subsequent 'welcome' pack of company information. A signed copy of the T&Cs should be returned by the customer. This information should form part of the Credit Policy.

T&Cs form an integral part of the contract between your company and the customer and should be a statement of what you will provide the customer and what you expect in return. It should also outline what happens in the event that the customer fails to meet their obligations. For example consider adding to the policy a late payment clause including interest on late payments, for example highlighting the EU Late Payment Directive (2000/35/EU) which provides companies with the statutory right to interest and reasonable costs to recover a debt 30 days after the due date, except where other payment terms have been agreed.

- **Order Acceptance and Release of Suspended Orders**

This should detail an agreed process for the approval and release of orders, once again this would be in line with the delegation of Authority, which may be across functional boundaries in the event of out-of-hours working.

- **Collections Performance and Targets**

This should detail the Key Performance Indicators (KPIs) and targets to monitor the effectiveness and performance of the credit team at company, team and individual level. The structure of the KPIs is wholly dependent on the structure of the business and the KPIs used should suit the objectives and requirements of the business. Some examples of KPIs follow:

1. *Days Sales Outstanding (DSO)* = average time it takes from invoicing to payment
2. *Delinquent Days Sales Outstanding* = average time it takes from invoicing to payment less payment terms (overdue DSO)
3. *Cash Targets* = measurement of cash receipts over a given period
4. *Aged Debt Analysis* = usually measured in 30 day 'buckets' from due date to >365 days (e.g. 0-30, 30-60, 60-90, 90-120, 120-180, 180-365, 365+)
5. *Percentage Overdue* = percentage overdue, or overdue by a specific amount (e.g. % >90days)

6. *Bad Debt* = usually measured as a percentage of revenue in a given period
7. *Debt in Dispute* = value of debt in dispute or query which is being delayed for payment by customers
8. *Billing Accuracy %* = by number and value (e.g. number of invoices vs. number of credit notes raised in the same period)

This is by no means an exhaustive list, ask 10 credit managers their top 5 measures and you will receive 10 different answers, but we would recommend no more than 5 measures whatever they may be, but whatever these measures are these should be listed in the Credit Policy with a definition and an example. The frequency of reporting and to whom the reports are to be sent should be listed in the credit policy.

- **Payment Collection**

The credit policy should outline the steps that will be taken to collect outstanding debt and include any proactive measures (e.g. welcome calls or proactive calls prior to due date) taken by the credit team.

The credit policy must include all methods of payment accepted by the company and the which one is preferred usually Direct Debit.

The sequence in which payments will be allocated to the customers accounts and invoices should be detailed in the event of a lack of remittance advice from the customer.

- **Query/Dispute Control**

Each query or dispute type should have an owner and or resolver to make it clear who is responsible for the resolution and the agreed service levels for the resolution of the disputes.

- **Debt Recovery and Bad Debt Write Off**

Once again the steps that are taken to recover debt and the approvals required in line with the Delegated Level of Authority to write-off debts.

- **Refusal/Withdrawal of Credit**

This is the most emotive area of a credit managers role and the one most likely to cause the disagreement between the credit and sales teams, it is therefore extremely important to ensure that the process for the refusal or withdrawal of credit is very clear, approved and understood by all.

Conclusion

The information in a Credit Policy should be clearly understood by all customer facing staff not least sales who need to understand the boundaries within which they must work to generate sales, revenue and margin for the company. Credit Policies differ from company to company from 125 pages of documented policies and procedures to a single page of 20 bullet points, so one size doesn't fit every company and neither does a single set of contents. Below are the Credit Policy contents pages from 2 QICM Accredited Companies.

Table of Contents	
Section	Page
1. Introduction and Scope	1
2. Objective of the Credit Risk Policy	1
3. Responsibility for the policy	1
4. Credit Risk and Risk Appetite	1
5. Granting of credit	1
6. Credit terms	2
7. Acceptance of Risk	3
8. Exposure levels and limits	3
9. Premium charging and documentation	3
10. Methods of payment	3
11. Payment by instalments	4
12. Account collection and control	4
13. Processing queries	5
14. Writing off balances due	5
15. Bad debts	6
16. Bad debt provision	6
17. Bankruptcies, Receiverships and Liquidations	6
18. Loans	7
19. Performance measurements and management reporting	7
20. Monitoring the Credit Risk	7
21. Record keeping	7

(Figure 2 – Contents Page - EIO Credit Risk Policy Nov 2010)

Client	
Global Shares Services UK Credit Policy 2012	
Table of Contents:	
1. Summary Overview of Credit Policy.....	Page 4
2. Operational Structure and Location of the Credit Function.....	Page 5
3. Credit Structure in relation to Credit Limits.....	Page 5
4. Granting of Credit Limits.....	Page 6
5. Authorisation Protocol.....	Page 7
6. Client Credit Warehouse (SCW).....	Page 7
7. Terms and Conditions of Trade.....	Page 8
8. Credit Limit Management and Monitoring.....	Page 8
9. Blocking / Unblocking Customer Accounts.....	Page 9
10. Legal Action, Provisions & Write – Offs.....	Page 9
11. Reporting.....	Page 9
12. Existing Customers of a Client Acquisition.....	Page 9
13. Credit Control / Customer Interfacing.....	Page 10
14. Dispute Resolution and Debtor Review Process.....	Page 10
15. Closing Summary.....	Page 10
16. Signature Sign Off.....	Page 10
17. Appendix A – Cluster Credit & Risk Management.....	Page 11
18. Appendix B – Min. Standard Credit Management Matrix.....	Pages 11-15

(Figure 3 – Credit Policy Contents Page)

The Credit Policy should be signed by the Senior Management, Board of Directors including the Directors of Sales, Finance and Customer Services and circulated to all customer facing management and their teams.

QICM Requirement

The QICM Assessor will check the following

The Credit Manager's Responsibility

- That the Credit Policy is owned by the credit manager
- That the credit Policy has a revision timetable with regular reviews of the policy to ensure it is up to date and meets the business needs
- That the Credit Policy is communicated to the business and stakeholders
- That the latest version of the Credit Policy is signed and approved by the appropriate Senior Managers/Directors of the company.

Senior Management

- Understand the key areas of the policy and are able to locate the policy either in hard copy or on the company intranet

Credit Staff

- Have a clear understanding of all elements of the policy and are able to locate this in hard copy or on the company intranet
- Are trained in the credit policy during induction and also receive regular refresher training

For more information and to discuss how the ICM can assist you in developing and implementing a Credit Policy for your business please contact qicm@icm.org.uk

Document Ends

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This document was originally published in 2005 in an ICM Credit Management supplement written by Paul Stevenson FICM.
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