Credit and Collection Measures

Collection Effectiveness Index (CEI)

Definition: This percentage expresses the effectiveness of collection efforts over time. The closer to 100 percent, the more effective the collection effort. It is a measure of the quality of collection of receivables, not of time.

Formula:

$$\frac{\text{Beginning Receivables} + (\text{Credit Sales/N*}) - \text{Ending Total Receivables}}{\text{Beginning Receivables} + (\text{Credit Sales/N*}) - \text{Ending Current Receivables}} \times 100$$

*N = Number of Months or Days

Days Sales Outstanding (DSO)

Definition: This figure expresses the (aggregate) average time, in days, that receivables are outstanding. It helps determine if a change in receivables is due to a change in sales, or to another factor such as a change in selling terms. An analyst might compare the days' sales outstanding with the company's credit terms as an indication of how efficiently the company manages its receivables.

Formula:

$$\frac{\text{Ending Total Receivables} \times \text{Number of Days in Period Analyzed}}{\text{Credit Sales for Period Analyzed}}$$

Best Possible Days Sales Outstanding or Average Terms Based on Customer Payment Patterns

Definition: This figure expresses the best possible level of receivables.

TIP *This measure should be used together with DSO. The closer the overall DSO is to the Average Terms Based on Customer Payment Patterns (Best Possible DSO), the closer the receivables are to the optimal level.*

Formula:

$$\frac{\text{Current Receivables} \times \text{Number of Days in Period Analyzed}}{\text{Credit Sales for Period Analyzed}}$$

Sales Weighted DSO

Definition: This figure expresses the (aggregate) average time, in days that receivables are outstanding. There are several formulas to calculate Sales Weighted DSO, other formulas should yield the same results.

Formula:

((Current Age Category / Credit Sales of Current Period) + (1 to 30 Day Age Category / Credit Sales of Prior Period)+(31 to 60 Day Age Category / Credit Sales of 2nd Prior Period) + (61 to 90 Day Age Category / Credit Sales of 3rd Prior Period) + (91 to 120 Day Age Category / Credit Sales of 4th Prior Period) + (etc.)) **x 30**

Bad Debt to Sales

Definition: This expresses the percentage of credit sales that were written off to bad debt. A lower percentage signifies that effective credit policies and procedures are employed.

Formula:

$$\frac{\text{Bad Debt Net of Recoveries}}{\text{Credit Sales}}$$

Active Customer Accounts per Credit and Collection Employee (Total Department)

Definition: This figure represents the total number of active accounts per department employee. Generally, the higher the number of accounts per employee, the more efficient the use of technology and people. (This is a departmental measure.)

Formula:

$$\frac{\text{Number of Active Customer Accounts}}{\text{Number of Total Department Employees}}$$

Active Customer Accounts per Credit Representative or Collector

Definition: This figure represents the total number of active accounts for an individual credit representative or collector. Generally the higher the number of accounts per employee, the more efficient the use of technology and people. (This is an individual measure.)

Formula:

$$\frac{\text{Number of Active Customer Accounts}}{\text{Number of Total Credit Representatives or Collectors}}$$

Operating Cost per Employee

Definition: This figure represents the total dollars spent per employee. The lower the cost, the more effective use of technology and people.

TIP — Operating Cost per Employee is listed here in the Credit and Collections section, but is just as valuable and applicable under Accounts Receivable. The formula is the same for each department.

Formula:

$$\frac{\text{Departmental Operating Costs}}{\text{Number of Department Employees}}$$

Cost per Sales Dollar

Definition: This calculation relates dollars spent in the credit and collection effort to credit sales generated, or how much it cost the company to process each dollar in credit sales. A higher percentage signifies that a more effective operation is employed:

True DSO

Definition: *The accurate and actual number of days credit sales are unpaid.*
Formula:

Number of days from invoice date to reporting date **x** (invoice amount / net credit sales for the month in which the sale occurred) = True DSO per invoice.

The sum of True DSO for all open invoices = True DSO per total accounts receivable.

Delinquent DSO or Average Days Delinquent

Definition: *This figure expresses, in days, the average time from the invoice due date to the paid date, or the average days invoices are past due.*
Formula:

DSO minus Average Terms Based on Customer Payment Patterns (Best Possible DSO)

Days Average Collection Rate

Definition: *This figure expresses, in days, the average time from the invoice date to the date paid.*
Formula:

$$\frac{\text{Total Flow of Funds}}{\text{Total Funds Applied}}$$

Prior Month's Past Due Collected

Definition: *This percentage expresses the amount that has been collected in the current month of the prior month's past due amount.*
Formula:

$$1 - \frac{\text{Current Months Past Due Age Categories}}{\text{Beginning Receivables of Prior Month}}$$

Percent Over 61 Days—or Percent of Any Age Category

Definition: *This figure expresses the percentage of Total Receivables that is 61 Days or more past due.*
Formula:

$$\frac{\text{Sum of the 61 Days and Older Categories}}{\text{Total Receivables}}$$

Formula:

$$\frac{\text{Departmental Operating Costs}}{\text{Credit Sales}}$$

Is your cost per credit sales dollar good? This question is relative. It could be answered by benchmarking with other organizations or measuring yourself against your own past performance.

Cost of Collections

Definition: This percentage represents the cost of collecting the collectable amount of Bad Debt. The lower the percentage, the more effective the attorney(s) or agency(s) employed.

Formula:

$$\frac{\text{Amount Paid to Attorneys and Agencies}}{\text{Collected Amount}}$$

High-Funds Accounts

Definition: This measure identifies accounts where significant funds could be collected in a relative short time.

You must set the criteria for your business of what defines a High-Fund Account. Example: by identifying accounts that have at least $2,000 over 60 Days and a total due of $5,000 or more that are not paying according to terms because of improper billing or processing problems. The closer to zero the more effective the collection effort, the better the working relationship with the customer and the more credit, collections, and accounts receivable policies and procedures are being followed.

Formula:

The Number of High-Funds Generating Accounts

High-Risk Accounts

Definition: This measure identifies significant potential bad debt accounts so they can be collected, thereby maximizing profits by minimizing losses.

You must set the criteria for your business of what defines a High-Risk Account. Example: these accounts have at least $2,000 over 60 Days and a total due of $5,000 and the customer is not paying because of its lack of ability to pay or some unknown reason for not paying according to terms. The closer to zero the more effective the collection effort, the better the working relationship with the customer and the more credit, collections, and accounts receivable policies and procedures are being followed.

Formula:

Number of High-Risk Accounts

Accounts Receivable Measures

Check Turnover per Cash Applicator

Definition: *This figure indicates the number of checks processed per person responsible for actually applying checks. A higher turnover rate implies that an efficient system is employed.*

This measure could include automated remittance processing "auto-cash". (Whether automated processing is included or not is a matter of choice, or in benchmarking comparability, sense consistency is the key.) Once the parameters are set, they should not change in like comparisons.

Formula:

$$\frac{\text{Number of Checks Processed}}{\text{Number of Cash Applicators}}$$

Transaction Turnover per Cash Applicator

Definition: *This figure indicates the number of transactions processed per cash applicator. A transaction includes all invoices, credits, deductions, and payments. A higher turnover rate implies that a more efficient system is employed.*

This measure could include automated remittance processing "auto-cash". (Whether automated processing is included or not is a matter of choice, or in benchmarking comparability, sense consistency is the key.) Once the parameters are set, they should not change in like comparisons.

Formula:

$$\frac{\text{Number of Transactions Processed}}{\text{Number of Cash Applicators}}$$

Transaction Turnover per Accounts Receivable Employee

Definition: *This figure indicates the number of transactions processed per individual employee. All employees involved in accounts receivable are included because their combined duties are directed in some fashion to processing transactions of all types. This includes secretaries, administrators, supervisors, and managers. A transaction includes all invoices, credits, deductions, and payments. A higher turnover rate implies that a more efficient system is employed.*

This measure could include automated remittance processing "auto-cash". (Whether automated processing is included or not is a matter of choice, or in benchmarking comparability, sense consistency is the key.) Once the parameters are set, they should not change in like comparisons.

Formula:

$$\frac{\text{Number of Transactions Processed}}{\text{Number of Accounts Receivable Employees}}$$

Deduction Turnover per Cash Applicator and A/R Deduction Specialist

Definition: *This figure indicates the total number of deductions processed by cash application and deduction specialists. The higher the turnover, the greater the efficiency per employee. (However, the lower the number of deductions, the more efficient the organization's billing process.)*

Formula:

$$\frac{\text{Deductions Processed}}{\text{Cash Applicators \& Deductions Specialist}}$$

Operating Cost per Transaction

Definition: *This figure indicates the cost of an individual transaction. The lower cost per transaction implies a more efficient use of technology and people.*

Formula:

$$\frac{\text{Departmental Operating Costs}}{\text{Number of Transactions Processed}}$$