



How to Improve Collection of Accounts Receivable

by Elizabeth Graham Weber

bweber@dbllaw.com

Unless your company operates on a strictly cash basis, you have accounts receivable. What most companies do not understand is the extent to which they can affect the collectability of those accounts receivable, beginning with the first contact with a prospective customer.

If you extend credit to customers, the credit application process is critical to your later success in collecting delinquent accounts. The application itself need not be long, but it must require disclosure of specific information by the applicant. Firstly, it is important to know exactly to whom you are extending credit. Is it a sole proprietorship, a corporation or an LLC, or a partnership? If the customer is other than an individual, it is important to know the exact name of the company, the state of creation, and the names and addresses of the principals. This information is key because if a customer later defaults, it will be important to determine if the legal entity was in good standing at the time the debt was created. If it was not, it will likely be possible to hold the principals personally responsible for the debt.

Other critical information you will want to inquire about at the time credit is extended is banking information. Not only is it important to get the name and address of the customer's financial institution, but it is also important to get the exact name of the account holder and the account number. Oftentimes, small businesses will hold funds in an account titled in a name other than that under which they do business. Knowing how funds are held will later aid your legal counsel in knowing who to sue; it will give both you and legal counsel the ability to verify funds before extending additional credit; and, most importantly, it will aid in executing on a judgment and garnishing funds. As such, you should require a copy of a void check at the time of application and you should retain copies of all checks subsequently used to make payments on an account.

The best protection afforded companies that extend goods or services on credit is the personal guaranty. A personal guaranty allows you to hold a company's principals personally liable for a debt even if the company closes its doors or files bankruptcy. Moreover, when a customer begins to flounder and its owners are picking and choosing which of its creditors will get paid, those guaranteed will get the most attention and those that are not guaranteed become inconsequential once a company has made the decision to close operations. Companies are often reluctant to ask customers for personal guaranties, but it should be a requirement of extending credit unless you have determined that you can afford to forego payment on the account.

In both Ohio and Kentucky, guaranty contracts must be in writing and signed by the guarantor. Unfortunately, the vast majority of companies that utilize guaranty contracts in Kentucky use a form that is unenforceable in Kentucky. Generally in Kentucky, a guaranty on an open account either must be written on the credit application being guaranteed or must contain both a maturity date and a maximum principal indebtedness amount. The guaranty document can be very simple, but it must contain the necessary verbiage or it is void. These same requirements are not in place in Ohio and enforceability is not usually a problem there.

In sum, know your customer and ensure that your account application documents are legally enforceable. You can directly affect your bottom line.