International Credit Policy

Example and highlights to accompany Seminar

Produced on behalf of FCIB Europe

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INTRODUCTION

As companies operate in a dynamic environment, pro-active credit management is essential to cope with constant change and the ability to adapt to international market and global economic conditions. Some argue that to have a written credit policy in place creates too many rules to operate competitively. A well constructed credit policy should address those concerns and include scope for change and room for flexibility and adaptability.
Credit policy presented as an investment tool, can provide a clear outline of credit management's vision for the present and future adding both department credibility and corporate value.

This document provides a practical template or an example Credit Policy for an international environment, along with the methods and means it will use to support both department and corporate objectives. It is intended to provide a framework, including 'best practice' in credit management, to ensure that a written credit policy is operationally successful.

WHY HAVE A CREDIT POLICY - 7 GOOD REASONS

The policy is a key document supporting the credit departments' function and plays a fundamental part in ensuring that the company maintains standards in protecting the major asset on the balance sheet i.e. debtor.

Listed below are some of the key benefits:

1. Recognition at top level of the role of credit management in the company.
2. Demonstrates positive business attitude towards customers.
3. Clarification of the rules regarding credit for everyone having contact with customers.
4. Operational guide for credit staff.
5. Elimination of 'Special' credit deals by unauthorised staff.
6. Assists new entrants to the company in becoming effective.
7. Simplifies the work of auditors and other external factors.

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Example Policy

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(1) Introduction

[An introduction to the policy and reason for existence] The Company's policy is to protect its sales revenues against bad debts arising from commercial default by customers and political (country) risk.

This policy statement deals with the terms of trade under which the Company is prepared to conduct its businesses with its customers, enabling *[name the areas of business within your company e.g. Business Units, Commercial Services and Financial Departments*] within the Company to recognise the limits of their authority.

1.1 Objective

[Example set of objectives] The objective of this policy is to ensure that cost effective and value-adding credit processes are in place at a minimum standard level throughout the business. In order to maintain cost efficiency a risk based approach is taken when applying more restrictive rules to higher risk areas.

- Sales on credit terms are made to maximise sales with the minimum of risk.
- 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.
- All amounts due are collected according to the agreed payment terms.
- Monthly cash collection targets are achieved.
- A high quality of Accounts Receivable is maintained.
- An accurate and responsible database of customers is operated and maintained.

1.2 Scope

This Credit Control Policy will apply to all customers transacting any business with the Company operating in the *[country of operation].* Such application will be in accordance with the terms and conditions laid down in the policy, to include all products and services.

1.3 Responsibilities

Administrative arrangements supporting the policy are the responsibility of the *Credit Manager [or appropriate title].*

(2) Credit Assessment Process

The Company's policy is to protect its sales revenues against bad debts arising from commercial default by customers.

2.1 Customer Risk Assessment

The Credit Department will carry out a risk assessment for each new customer. A *Credit Application Form* must be completed by all new customers and will form the basis of the assessment. All customers must have their credit worthiness assessed and

approved prior to commencement of trading. Credit Department will credit check the customer using a Credit Reference Agency and undertake additional assessment if necessary.
(A customer represented by one legal entity dealing with multiple businesses within one country must have one single credit limit to cover all credit needs).

2.2 Information to Analyse

A statement regarding the minimum checks involved in assessment e.g. Minimum Checks must be applied for all Customers as follows:

- Internal local system check for prior defaults/payment performance
- Fraud prevention checks where necessary (taking a risk based approach):
  - verify that the contact person is an employee of the company and that the applicant is that person
  - verify that the collected minimum master data is from a source other than the applicant (e.g. public register of companies)

Credit Risk Assessment for Credit Limit Requests above *$...€ £ [enter amount]*

Credit assessments should be based on the customer's commercial and financial data.
Minimum Commercial Assessment Criteria (where available):

- Ownership structure
- Payment performance
- Years in business
- Industry trend / rating
- Directors'/Owner's track record (e.g. no bankruptcies)

2.3 Country Risk

[This section is applicable to all operations trading with countries outside their domiciled country] There will be a constant reassessing of the Credit Limits of existing customers. The frequency will be dependent upon the level of risk as detailed within the risk categories.
Sudden Deterioration of Country or Customer Risk Status
Where a sudden deterioration in country or customer credit status occurs, immediate action will be taken by Credit Department to minimise credit risk exposure. This will involve:
a) Holding all future shipments until uncertainty is resolved.
b) Liaison with relevant Business Unit Finance and Customer Services in order to minimise the risk of bad debts from existing shipments (preventing discharge of goods, etc).

2.4 Setting Credit Limits

Every customer must be assigned a credit limit. *[This section may contains methods of setting credit limits and also could refer to Credit Insurance approval if applicable]*

Customers must be re-assessed based on credit risk category and credit limit. *[Example below]*

Risk Category	***Set Value based limit***
A	*Every 18 months*
B	*12*
C	*6*
D	*As and when required*

2.5 Approval of Credit Limits

Credit Limits will be established for all customers by mutual agreement between Credit Management and Sales/Marketing, taking into consideration all aspects of Credit Vetting, Sales requirements and economic trends, to arrive at an Investment Level that is regarded as a reasonable

2.6 Assigning Risk Categories

All customers will be placed in categories, dependent upon the assessment as to their financial risk. *Example below*

Risk Category	**Type of customer**
A = low risk	*Government organisations and undoubted 'blue chip' companies*
B = medium risk	*Large Companies believed to be reasonably sound (you need to define what is a large company)*
C = high risk	*Companies with a low financial status or newly formed businesses with no track record*
D = very high risk , no credit allowed	*Customers on cash terms - risk is too high to allow credit*

2.7 Payment Security & Risk mitigation

[This section would describe the methods for risk mitigation and taking security] Securities should be taken to protect the company in the event that the customer defaults wherever the market environment allows (taking a risk based approach).

Examples of Securities acceptable in your country or company

Cash on Deposit

Bank Guarantees

Letters of Credit

2.8 Payment Terms

[This section would list the Company's standard payment terms]

All Terms of Payment will be agreed between Credit Management and Sales if the Terms differ from those recognised as Standard Terms. There are to be no unofficial Terms granted to customers.

2.9 Payment Methods

[In this section it is advisable to set out the payment methods preferred by the company]

The fastest method of payment should always be requested according to the value of the debt and customer risk type.

- Direct Debit – wherever possible this method should be promoted as the fastest and least administrative burden for both parties [*ensure this method is appropriate for the country of operation and buyer's country]*
- Bank Transfer – Request payment by bank transfer for all urgent payments (required on same day)
- Cheque – Least preferred due to time delays.
- Letters of Credit – see section 2.7 securities
- Other methods – may be agreed with the agreement of the Credit Manager

(3) Orders & Delivery Approval

Orders will be accepted and processed only if the account is:-

1. In good order i.e. paid up to date
2. Not regarded as an excessive risk.
3. Not already in suspense due to delinquency.
4. Not exceeding the agreed Credit Limit.

3.1 Acceptance & Suspension

In order to ensure that products and services are not delivered to customers who have exceeded their approved credit limit.
Credit Management retains the right to refuse to release a suspended order.

(4) Collection

Customers are required to settle their accounts in accordance with agreed payment terms. The overdue debt collection process must comply with all applicable legal and country specific requirements.

4.1 Collection process

[In this section it is important to outline the collection methods such as letter, email, telephone]

The customer's risk category and the age and amount of the overdue will define the timeline associated with the collection process.

4.2 Disputes & Invoices under Query

If a customer has a dispute about an amount owed, the customer is required to pay the undisputed portion of the amount due. Disputed invoices stay within the credit exposure. *[Detail here any responsibilities for resolving items in disputes as per the following example]*

4.3 Cash allocation

The posting of cash to individual customer accounts will be the responsibility of the *Credit Department. Financial Accounts [or appropriate department]* will supply sufficient detail to enable Credit Management to identify to which customer the values relate and over which invoices these values should be allocated.

4.4 Bad Debt Provisions

Consistent with the *Group Financial Accounting Policies*, provisions must be made when individual debts are considered doubtful or irrecoverable.

4.5 Write off Procedures

[Specify the reasons for a debt write off e.g]

Debt must be written-off when:

- All economic attempts to recover the outstanding amount have failed
- The debtor is insolvent
- The debt is disputed and the customer's liability cannot be legally proved
- The period within which the debt can be legally enforced has expired
- It is a very small payment difference
- Unable to locate the debtor (disappeared)

4.6 Debt Recovery

Attempt should be made to recover outstanding debts irrespective of whether they have been provided for or written off. *[This section could refer to third party collection agencies approved for use in recovering debt]*

(5) Contractual Agreements

All customers will be provided with the Company’s Standard Conditions of Sale before the commencement of trading.

5.1 Standard Terms & conditions

Refer to section2.8 Payment Terms

5.2 Special Arrangements

Refer to section2.8 Payment Terms

5.3 Service Level Agreements

When the company provides significant [*by value or volume]* services to other businesses, a Service Level Agreement must be defined in writing, detailing the service levels and times, performance, roles & responsibilities and charges.

5.4 Terms of Delivery / Shipment Terms (Incoterms)

[When selling to customers, it is critical that both parties know, accept and understand the terms of delivery (or shipment terms). To help avoid misunderstandings, the International Chamber of Commerce has developed a set of terms called Incoterms. Selecting the wrong Incoterms can result in the company being responsible for duties and fees that it had not planned to pay.]

Place here your preferred shipment terms such as FOB, CIP, DDP dependent upon the method of transport and final destination*.*

(6) Credit Insurance

Credit insurance offers protection in the event of the insolvency of debtors where a percentage of the debt outstanding (guaranteed amount) would be paid to the company. *[This section would be appropriate if the company is planning to insure customers therefore, specific mention of the insurance provider and any conditions related to administration of the policy would be applicable]*

6.1 Insurance Policy type and procedures

[This section would be appropriate in relation to the above therefore; specific mention of the insurance provider, type and any conditions related to administration of the policy would be applicable]

(7) Management Information & Performance Reporting

Monthly reports will be issued to Senior Management broken down by Product, Division, Business Area, Company or as requested*,[provide a list of all the reports available and timing for publication]*

7.1 Days Sales Outstanding

The DSO ratio expresses the period-end net trade receivables *[provide calculation, targets or maximum days allowed]*

7.2 Overdue Ratios

Overdue ratio measures the proportion of the total debts being overdue. *[Provide calculation]*

7.3 Cash Collection Targets

Monthly cash targets should be fixed and shown graphically for each Credit Controller responsible for a *Business Unit* and updated with the actual cash received on a daily basis. The Credit Manager will maintain a Company graph of total cash receipts

(8) Governance & Controls

[Place here any appropriate Corporate or Country requirements relating to Governance]

8.1 Authority

There will be formal Limits of Authority within the Department that will indicate who has the authority to sign and pass certain documentation.
[This section will contain the value of the authorities set if applicable]

8.2 Document controls

[This section will contain the approval process and controls for changing, amending or updating the credit policy]