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"Customer Deduction"

By: David Balovich

Credit professionals are increasingly aware of the money that is tied up in customer deductions and of the time and effort needed to resolve them. In many cases, the work has multiplied to a point where it is disproportionate to the allotted resources available to tackle the problem.
A sizeable portion of the increase in the organizations trade receivables can be attributed to the growth of unresolved customer deductions. In some cases deductions have become the vehicle for both the seller and buyer to circumvent the anti-trust laws and provide lower pricing to select customers while forcing others to continue to pay published prices.

In fact, studies conducted by the Association of Independent Certified Public Accountants(AICPA)have revealed that a large percentage of companies have no time limit for requiring a deduction to be resolved or even written down. They also discovered that the majority of deductions, when paid, were settled for a reduced amount and the documentation to support the reduced amount was often non-existent. These actions further deteriorate any realized profit after taking into consideration not only the time value of money but also the cost of resources devoted to investigating the reasons behind the deduction. Perhaps the most significant result of these studies is the findings that the majority of firms included in the study wrote-down between 70 and 100 percent of all customer deductions.
To further emphasize the deduction phenomena these same studies by the AICPA show that many companies have a policy that permits the automatic write-down of customer short-payments without any documentation or management approval.

How long does it take for a customer to realize that they can deduct up to a specified amount from their billing with no inquiry?

While it may be cost effective for some companies within a industry to allow a deduction rather then allocate resources (people and costs associated with deduction management) to investigate the reasons for the deduction, there are companies that are operating on small margins that cannot afford to absorb any un-warranted deductions. This policy on the part of some in a particular industry could lead to an "industry standard" that could eventually cause some firms within the industry to go out of business. This is a major problem, and it continues to grow. One of the major impacted groups, we have witnessed in the past few years, are those suppliers of goods and services to the retail environment. The popularity and continued growth of the "big box" retailers has caused change in the operations of both accounts receivable and accounts payable as these large retailers become increasingly aggressive with their deductions. Compounding this is that studies show that 90 percent of all deductions by these super retailers are allowed after investigation, which would lead one to the conclusion that there are major operational problems in American businesses.

A deduction is often the hardest type of open item in accounts receivable to resolve because most all departments in our organization are involved in various degrees. The customer takes the deduction based on their policy and procedures, and it is up to us to prove whether they are entitled to the deduction or not.
Many organizations do not recognize deductions as a warning of operational dysfunction and often react out of confusion. Thus deductions are looked upon as a distraction to the business rather than

viewing them as a warning sign that something within the operation is wrong, and taking the opportunity to correct it.

If deductions are viewed as only a collection matter, the company is being derelict in its customer relationship and responsibility. Many accounting and management-consulting firms suggest the challenges to successful deduction administration are senior management recognition, cross-departmental cooperation, lack of resources, timely access to information and inefficient processes. While credit and collection is often charged with the responsibility of deduction resolution, they most often do not have the authority to correct the underlying problems causing them. Areas such as sales, customer service, distribution, production, IT, and management have to become accountable for their inefficiencies and mistakes.

One can identify the advent of deductions when organizations became more dependent on software integration for billing and retired the billing department. Up until then the billing department was not only responsible for billing the customer but also for insuring that the billing, was in fact, correct prior to it being sent on to the customer. To this end, billing would first produce what was known as a pre-bill. Once produced, the billing specialist, who was responsible for a select number of customers, would review the billing to make certain there were no errors in price, terms, shipping or delivery of product and no outstanding claims for shortages or returns. Once verified the final bill was produced and mailed to the customer. This due diligence insured the majority of customer billing was not only correct but also resulted in very few losses resulting from customer deductions.

It was not until the early to mid-eighties when computer software was created that integrated sales, production, distribution, credit approval and billing did we begin to see the increase in customer deductions. During this same period we began to see the disappearance of the billing specialist and the billing department became known as customer no service in most organizations.

Resolving customer deductions as soon as possible can contribute significantly to reducing the carrying costs of receivables and can lead to personnel that are more productive. The method least practiced in deduction management is to write-off the total deduction during payment application and charge back the difference against the department responsible for the deduction; sales, distribution, production, etc., and let that department conduct an investigation if warranted. Thus, the impact of customer deductions continues to deteriorate both the financial and operational performance of American businesses.

Some organizations, in an attempt to resolve deductions in a timely manner, have created teams to administer the problem of deductions with greater emphasis being placed on the sales order as it is entered into the system.

These teams are convened to share information and also have the authority to make decisions. Their focus is either to research deductions as they occur, prioritizing their efforts, either by dollar amount, quantity, type or customer, or to investigate the cause of the deduction problem that is responsible for deteriorating profits.

The members of the team have complimentary skills and are committed to a common purpose and performance level.

These teams of subject matter experts have the authority to implement and manage the deduction problem and have proven to be one of the best methods of attacking customer deductions. Based on the success of these efforts we may see, in the near future, organizations seeking employees with skills and workgroup experience to not only investigate the causes of deductions but also have the authority to eliminate the causes.

Many buyer/seller relations are governed by a purchase order. This purchase order is often communicated verbally from buyer to seller.

If the relationship is to yield profit for the seller, care must be taken to not only follow the instructions and procedures set forth on the document but also to require the document be in writing so the seller can review the terms prior to acceptance and amend the purchase order, in writing, to allow for any variance in the original terms.

Significant amounts of customer payment deductions are a direct result of a lack of attention to purchase orders. Clearly, failure to follow purchase order instructions to the letter completely justifies the deduction from the buyer's perspective and this has been demonstrated time and again when dealing with the “big box” retailers. Greater care must be made to improve the quality of the orders being entered into our systems and concurrently provide greater attention to the review of order instructions to insure "quality in = quality out" versus “garbage in = garbage out”.

Although the automated write-off of small dollar deductions can reduce the overall cost of processing and resolving customer short payments. The costs for monitoring abusers to the auto-write-off tolerance must be weighed against the cost of the write-off.

As long as the monitoring costs are below the costs of writing the items off, then the company should be indifferent about the expense. However, auto write-off should be labeled with a unique reason code so that monitoring of the category can be facilitated. Suppliers know that customers will test their tolerance levels and, in many cases, short-pay an amount just under the tolerance level. Therefore, it is essential to monitor not only the class as a whole, but to pursue abusers individually and take appropriate action such as adjusting the tolerance level for a particular abusive customer.

Deductions are warning signs of a firm’s indifference, incompetence and failings. If we fail to pay attention and make the necessary corrections, as we become aware of them, then regardless of how many resources we utilize to deal with them we are doomed to continue to suffer their consequences.

I wish you well.

************************************ **JANUARY 2019**********************************

Day	Date	Group	Location	Time
Tues	8	Austin Construction	Las Palapas Restaurant, 6640 E Hwy 290 Austin TX	11:30
Tues	8	Corpus Christi Credit	Holt Cat, Corpus Christi TX/Telconference Call	11:30
Tues	8	Rio Grande Valley	Teleconference Meeting	12:00
Tues	8	Victoria Credit	Teleconference Meeting	12:00
Tues	8	Laredo Credit	Teleconference Meeting	12:00
Thurs	10	SW Food Credit Group	Las Palapas, 4802 Walzem Rd, San Antonio TX	11:00
Thurs	17	HVAC Credit Group	Texas Air Products, San Antonio TX	11:30
Thurs	17	Fuel & Lube/Heavy Eq.	Phone Conference Meeting 1-800-791-2345	2:30
Tues	22	Austin Construction	Las Palapas Restaurant, 6640 E Hwy 290 Austin TX	11:30
Tues	22	SA Construction	Las Palapas, 4802 Walzem Rd, San Antonio TX	11:30
Fri	25	SW Electrical Group	The Onion Creek Country Club, Austin TX	11:30

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