

## **Fast, Service-Oriented Follow-up Critical When Handling Deductions**

When it comes to handling payment deductions, make sure your company has a fast and systematic way to follow-up with this type of collection activity.

Deductions, also known as “short payments,” typically happen when a customer has quality problems, returns goods, experiences discount problems, billing errors or encounters other issues, according to Charles Gahala, Ph.D., CCE, CICP, author of *Credit Management, Principles and Practices*.

Carrying deductions in receivables—one study found they represent about 5% of all open accounts receivable— if they are not allowed is costly, as is assigning employees to resolve the deductions. Deductions are also an important customer relations consideration. For these reasons, it is imperative deductions receive a fast and systematic follow-up, Gahala says. Because this process of identifying, verifying and resolving deductions can become laborious, your follow-up system should include step-by-step procedures according to the type of deduction, with an emphasis on timing.

Deductions are usually resolved in three ways: a credit is issued for the full amount, the deduction is denied or a portion is allowed. They are categorized by a number of factors, including: cause, size, age and product. The credit manager should also take into account the following issues related to deductions:

- Whether they should age out as past-due items on an aging of receivables: Gahala says perhaps only certain types of deductions should age out.
- The threshold amount at which deductions should automatically absorbed: “Consider monitoring customers who may test the system that absorbs a specific amount,” he suggests.
- The number of days beyond a discount date when unearned discounts should be charged back, and how that number is monitored: “Some credit managers use the postmark on an envelope to monitor discounts,” Gahala says.
- Who should monitor discounts for the proper amount?: “Discounts should be taken on the net invoice amount, not on the gross invoice amount that includes promotional allowances,” he notes.
- Who decides whether a quality claim will be allowed, and how that decision is made?

As such, consider using a team approach to resolving deductions. “The team-based approach can create an increased level of awareness that can lead to a quicker resolution to problems,” Gahala said. And because deductions are often a result of many causes, a cross-functional team can better serve this purpose—there is typically someone on the team that brings the necessary understanding of the issue. Gahala suggested ensuring this team answers some of the following questions as a means to develop effective strategies to reconciling deductions:

- “What caused the open items?”

- What needs to be done to resolve the open items?
- Can business practices be improved upon so that the process that caused the deduction to occur be avoided or resolved more expediently in the future?