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Dear Friends:

When your CFO comes calling, will you be prepared? As media properties continue to face the challenges of a severe recession as well as an evolving technological landscape, high-level managers are pursuing any and all opportunities to cut costs and reposition their organizations for future growth. To those ends, they are becoming increasingly interested and involved in accounts receivable. This issue's feature article offers information and questions to ponder in anticipation of that all-important CFO visit.

As 2009 draws to a close, we look forward to our country's return to prosperity, and with it, a new decade of opportunity and growth for the media industry.

All of us here at Szabo wish you a very Happy New Year!

Robin Szabo, President
Szabo Associates, Inc.

How Will the CFO Evaluate Your Accounts Receivable?

Looking at Measures with a New Perspective

The longest and deepest recession the U.S. has experienced in more than half a century may be coming to an end. Although the National Bureau of Economic Research has not yet announced an end date to the recession which, according to the private research group, began in December 2007, the third-quarter 3.5% rise in GDP economic expansion reported by the Commerce Department serves as an unofficial determination that the downturn is over.

Does this good news mean that media executives will relax and revert to previous ways of doing business and evaluating departmental performance? They probably will not, nor should they, for a couple of reasons.

The first is that the economic data begs several questions about the major factors that contributed to the uptick in GDP. The recent report of economic expansion, while certainly encouraging, comes amid numerous economic analyses that express concern about the nature and sustainability of the recovery. While the larger than expected drop in inventories indicates that businesses must now produce more to meet demand, it must be noted that about 40% of the 3.4% third-quarter increase in consumer spending was the result of automobile sales, spurred largely by the cash-for-clunkers program. The second significant contributor to the jump was home-building, which was spurred by another temporary federal program, the first-time home buyers tax credit. Home construction fell sharply and unexpectedly in October due to builders' concerns over renewal of the tax credit, wiping out months of gain. Additionally, state and local governments may face further belt-tightening without further infusion of stimulus money. The staggering and growing federal deficit and a U.S. unemployment rate of 10.2% in October, which suggests that the job market is in for a painfully long recovery, continue to shake consumer confidence. And finally, the credit crunch continues to plague not only consumers but also businesses seeking cash to keep their operations going through these tough times.

The second reason has to do with the media industry itself. In addition to facing the challenges imposed by a severe recession, media properties are at the same time facing challenges imposed by digital technology and corresponding consumer expectations. The promising news in this regard is that consumers appear to have an insatiable hunger for

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media-delivered information; the sobering news is that they also have a seemingly endless array of choices. As technology and its players in the industry continue to morph at a dizzying pace, both new and traditional media are fighting to create a sustainable business model.

The CFO, whose primary role might simply be described as caretaker of the organization's value, may now need to be an agent of change who, along with other high-level executives, must redesign and reposition the company for post-recession growth. Today's business environment requires media chief financial officers to monitor liquidity, preserve assets, and expand sources of credit while aggressively seeking opportunities to cut costs, drive efficiencies, and increase profits. To those ends, many have assumed considerably more hands-on involvement in credit and collection matters that were previously within the sole purview of credit managers.

Credit and collection managers can best prepare for this involvement by first recognizing that accounts receivable, as probably the largest and most liquid asset in the organization, warrant closer scrutiny by high-level executives in difficult times. Many companies now are somewhat hamstrung in their ability to raise capital, and some are close to defaulting on financial obligations. CFOs must ensure that their organizations offset these problems as much as possible by optimizing cash inflow. Additionally, well-managed receivables help create a more favorable position with potential lenders.

To further prepare for CFO involvement, credit and collection managers should anticipate questions by the CFO which are designed to uncover any departmental deficiencies and failures. This is the time to objectively examine strengths and weaknesses with regard to your processes and your staff members.

Looking Beyond DSO.
Regardless of the state of the economy and any subsequent loosening of terms and conditions to accommodate an economic downturn, consistent measures and standards must be applied to monitor accounts receivable. While it may be wise to reevaluate measures on an annual basis, month-to-month changes in measures and standards will render the data meaningless.

While Days Sales Outstanding (DSO) has been the traditional measure used to evaluate credit and collection, one of its main shortcomings is that the numbers may fluctuate due to factors beyond the control of the credit and collection department. Calculated from the total ending receivables for the period analyzed, total credit sales for the period analyzed, and the number of days in the period analyzed, DSO represents the average number of days that invoices are outstanding. Rather than establishing a specific number for a standard, which provides a rigid dividing line between what is acceptable and what is not, many organizations establish a range for their standard to allow for such factors as seasonal variations in sales.

In economically troubled times, credit and collection managers may find themselves with higher-than-normal DSOs, not only because of more slow-to-pay customers but also because of management's decision to extend sales terms and/or liberalize the company's credit policy. Because of this limitation, DSO is not always an accurate measure of personnel performance.

Additionally, an increase in credit sales that also increases the total receivables balance by the same amount will result in an increased DSO. As an example, if the total ending receivables balance is $7 million, credit sales for the period are $11 million, and the number of days in the period is 90, then DSO would equal $7 million divided by $11 million times 90, or 57 days. If we increase credit sales by $3 million, the revised calculation would be $10 million divided by $14 million times 90, or 64 days.

Finally, DSO fails to provide specific information about delinquent accounts or to indicate how much money is actually being spent on accounts receivable.

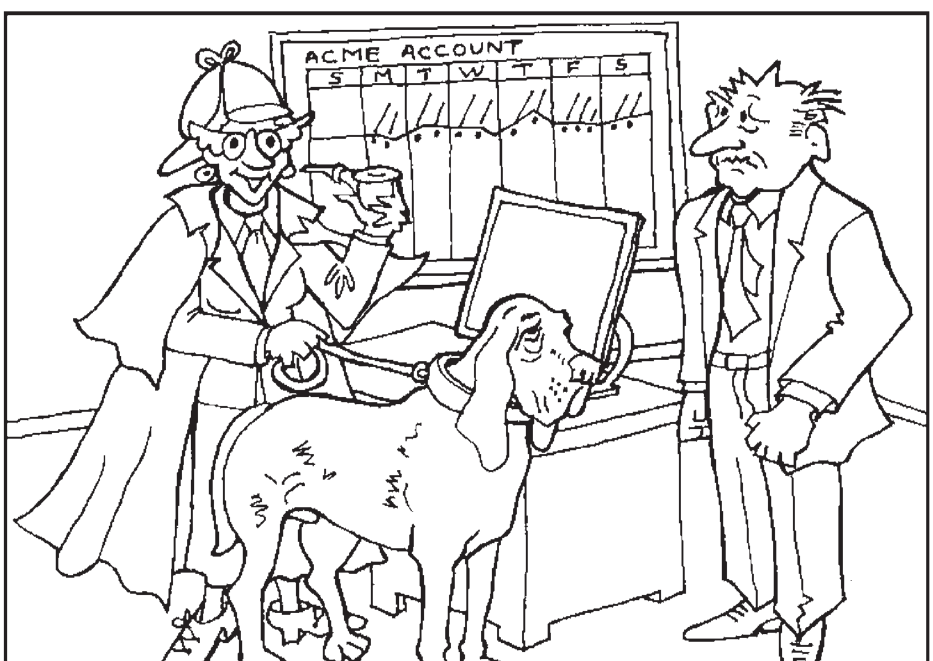
Evaluating Personnel Effectiveness.
A better method than simple DSO to measure personnel effectiveness is Average Days Delinquent (ADD), sometimes called Delinquent DSO (DDSO). This measure removes the terms of sales portion of DSO and gives you the average number of days invoices are past due. The formula requires the calculation of Best Possible DSO (BPDSO), which substitutes *current* receivables (outstanding receivables that fall within sales terms) for the *total ending* receivables for the period used in the DSO formula. The ADD is then calculated by subtracting the BPDSO from the DSO. The ADD is a valuable number since your department is charged not only with minimizing accounts receivable but also with controlling

resource investment in collections.

Another way to measure performance is the Percent Current measure, which is determined by dividing the current receivables for the period analyzed by the total receivables for the period analyzed, or by dividing Best Possible DSO by the DSO. The advantage of using Percent Current is that it adds the dimension of relativity, which is useful to executives who want to compare departments and personnel.

A third measure of performance is the Collection Effectiveness Index, which measures the effectiveness of collection efforts over time as opposed to a single point in time. The closer to 100 percent, the more effective the collection effort. CEI is the ratio between total amount collected over a period of time and the amount collectible over the same period. Originally developed to measure collection performance over one year, the formula can be adjusted to measure performance on a more frequent basis.

Many other credit and collection measures and accounts receivable measures can be useful: Sales Weighted DSO, Days Average Collection Rate, Prior Month's Past Due Collected, Percent over 61 Days (or any age), Bad Debt to Sales, Active Accounts per Credit and Collection Employee (total department), Active Accounts per Credit Representative or Collector, Operating Cost per Employee, Cost per Sales Dollar, Cost of Collections, High-Funds Accounts, and High-Risk Accounts. Because of its almost universal acceptance among credit professionals, Days Sales Outstanding remains among the most valuable measure. Average Days Delinquent, Percent Current, and Collection Effectiveness Index offset some of the weaknesses of DSO, allowing credit managers and CFOs to better evaluate both the quality of receivables and effectiveness of personnel.



"I've been monitoring the Acme account, Boss . . . In the past week the CFO was sighted going into the chiropractor's office twice, popping aspirin at the water cooler four times, and ordering extra shots of espresso in his latte five times. I'd say it's time to raise the red flag from half-mast to the top of the pole."

Evaluating Subjectively. While quantitative measures are an essential part of any objective examination of your credit and collection operations, they are by no means a substitute for honest and subjective evaluation of your department. Numbers may illuminate and quantify, but only by being "in the trenches" day to day can you gain a perspective that measures fail to provide.

Preparation for your CFO's visit should include making a list of questions about your organization and department, and then answering them candidly and thoughtfully. Here are 21 to consider:

1. Are you satisfied, overall, with your company's credit policy?

2. Have any changes to policy for credit extension occurred because of the economic downturn? Has your procedure for analyzing customers changed?

3. Have your terms and conditions regarding payment changed because of the economic downturn?

4. Have your collection procedures changed as a result of the economic downturn?

5. How have changes to policy affected your department's effectiveness in managing accounts receivable?

6. If your policy has become more lenient, what, if any, changes have you made in your collection processes to minimize DSOs?

7. Does your company have a greater tolerance for rising DSOs because of the downturn?

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8. Do you believe your measures paint an accurate and thorough picture of your department's performance?

9. Do your measures support the objectives of your department and company?

10. Are the measures used consistently?

11. Would the use of any additional measures add value?

12. Has the recession affected the level of training in your personnel?

13. Has the ratio of accounts to personnel changed?

14. Has your department experienced a higher staff turnover rate in the past year?

15. How would you rate the overall quality of your accounts receivable? How does this compare to pre-recession receivables?

16. Are you satisfied with your department's ability to collect receivables? Does its performance reflect its ability?

17. Are you satisfied with your process for monitoring and evaluating the performance of your third-party collection company?

18. Does your company process invoices and cash applications accurately and in a timely manner?

19. Do you feel adequately informed about changes that may have occurred in your company's condition as a result of the recession?

20. Are you satisfied with the level of cooperation between the credit and collection department and the sales department? How can it be improved?

21. What additional support from management would you like to have?

Looking to the Future.
It is becoming increasingly clear that recovery from the current recession is not likely to follow the usual pattern. Some analysts believe that another downturn will occur shortly after the initial recovery, while others predict a modest loss of momentum.

Facing uncertainty about the time frame for economic recovery and availability of credit, many of today's CFOs are seeking ways not only to prevent their organizations from losing ground now, but also to position their organizations to gain access to capital and move forward when the economy improves. By anticipating areas of scrutiny and facilitating the evaluation process, credit managers have an opportunity to enhance their value and to play a vital role in maintaining the organization's competitive advantage. ♦

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