

An analysis of Current Practice in the Management of Receivables in the Czech Republic

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Abstract— The management of receivables is a set of rules and practices that minimize the risk of unsettled receivables and it is carried out in three phases – preparation, to maturity, and past due. Business risk management policies should be part of the management of receivables in each company. The aim of the paper is to present the results of empirical research conducted in spring of 2012 in the whole spectrum of business and institutions in the Czech Republic. Structured questionnaires were used as a basic tool. The dates were tested by statistical methods. Hypotheses were tested by hypothesis testing for variance, the regression and correlation analysis was then used to verify the test. The research has demonstrated that in the Czech Republic, the situation in the area of insolvency especially in the business environment is unfavourable. The survey showed that a total of 61 % of all organizations in the Czech Republic currently record an unsettled receivable in their accounts. The companies also do not use the effective instruments of the management of receivables.

Keywords—Business risk, management of receivables, maturity date, unsettled receivables

I. INTRODUCTION

THE paper deals with a relatively common problem of almost all companies worldwide. The same applies to the Czech Republic, as documented in the survey carried out. Receivables as an important part of working capital are associated with a high risk of non-payment. The amount and rate of pay has an impact on the liquidity and cash flow of the company. The aim of the paper is to analyze some possible solutions that would reduce the level of business risk and are necessary for the efficient management of receivables.

One of the objectives of the management of receivables is to contribute to an increase in market value of enterprises and their competitiveness through active interaction in the provision of liquidity of receivables and thus the solvency of enterprises. From a legal point of view, there are several possibilities in the Czech Republic how to enforce uncollectible

receivables which are defined by different laws. Legislation has been undergoing major changes in recent years. A new reform introducing a new solution to bankruptcy law has taken place; the possibilities of legal solutions include mediation proceedings, arbitration, litigation, and insolvency proceedings. The specific area involves tax adjusting items and depreciation of receivables. The basis of the management of receivables is the identification and accurate management of information on current and future customers, ensuring the prevention of receivables by negotiating contractual penalties, default interests or security in the form of bills or the purchase of receivables. Adjusting items may be created to questionable receivables or they may be secured through factoring and forfeiting [8, 16].

The paper analyzes examples of possible legal and accounting treatment of uncollectible receivables in the Czech Republic, for example, purchase of receivables, creation of adjusting items of receivables, securing through factoring or forfeiting. Each solution has, of course, advantages and disadvantages that should be considered before we start the enforcement. The most effective protection against unsettled receivables is timely security. The focus of the article is to present the results of empirical research where the principal aim was to analyze the current situation in terms of the management of receivables of various companies and institutions in the Czech Republic and subsequently verify the hypothesis that, in general, larger firms have a higher level of the management of receivables.

II. PROBLEM FORMULATION

Global competition in its essence does no longer concern states, but rather individual companies. The level of management affects the quality of production and it is actually the quality of production that opens the possibilities to reach the demanding world markets, and helps achieve business success also among the international competitors.

In the Czech Republic the trend of the management, the latest trend according to European documents of the European Community has been increasingly developing. Its primary objective is to increase business performance. According to Dr. Aubrey Daniels (2004), the performance management is a broad concept [3]. In 1970, performance was described mainly

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as a technology to control the behaviour and results, for which there were two key elements of what is known as performance. Sulak (2005) defines performance as the ability to assess investments made in business the best possible way [18]. Therefore, from these definitions is clear that unsettled receivables reduce such performance. By reducing business risks, the value of the relationship between a supplier and a customer can be increased. This relationship should result in mutually advantageous cooperation. While the traditional view of firms was directed at finding their own strengths, the current view focuses on identifying potential sources of competitive advantage beyond the organization in an extended chain of business relationships. Customer-supplier chain management can loosely be defined as an attempt to build such relationships with suppliers, distributors and customers that would help us provide customers with the highest possible value at minimal cost [8,14,10]. The orientation to client must represent a permanent direction in the management of all companies. Management must provide a good understanding of the client, good connection with the most appropriate communication methods between the client and the company [2].

Receivables as part of current assets are also a significant item of working capital. To ensure solvency in the short term, permanent working capital management is essential so that liquid assets are always available in the amount required by liabilities payable. This places high demands on the structure management of current assets. Receivables are a transition of the cycle of current assets and their management is to ensure company's liquidity and cash flow. [6,12].

Receivables are associated with a high risk of non-payment and may be divided into the following four basic groups is shown in Fig 1.

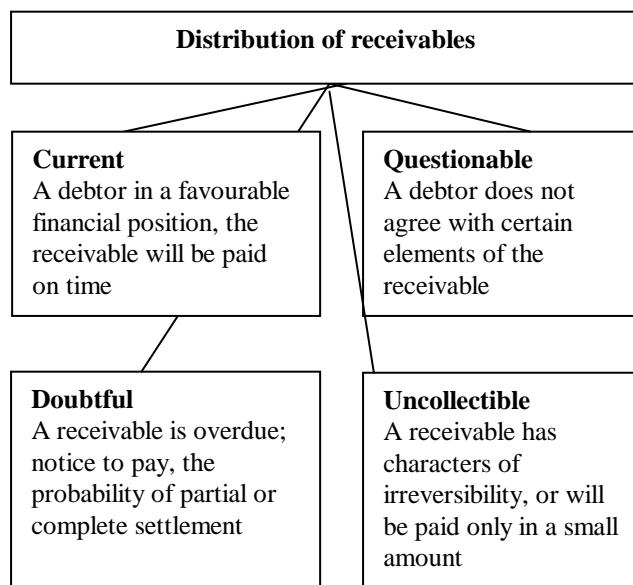


Fig. 1 Distribution of receivables Source: own research

In every business engagement there can arise the situation where one of the partners can find in primary or secondary insolvency [13]. The term "allocation of capital to receivables"

is viewed as its optimal alignment in the volume of receivables, their development, structure, profitability, maturity date, liquidity of receivables, selection of customers, and estimation of the risks associated with receivables. In the market environment, the allocation of capital to receivables evokes in company's financial decision-making a basic question:

What amount of capital can companies afford to commit in receivables?

The answer to this question is not easy, given that the enforcement of unsettled trade receivables is often very complex. If a customer fails to pay within the appointed time, the decision-making on the various options of the management of receivables takes place often resulting in court enforcement. Unfortunately, the whole process sometimes lasts several years and often ends in failure. [1,8,19]. Each of the variants of solving uncollectible receivables is also demanding on costs that shall be invested at the very commencement of the enforcement of uncollectible receivables.

The decision on the amount of the allocation of capital to receivables depends on several factors:

- The position of the enterprise on the market, the so-called image of the enterprise
- Compliance with financial stability, reporting favorable indicators of financial analysis and cash flow
- the ability and opportunity to obtain credit resources
- establishment of clear and stable conditions of sale to consumers by means of legally treated business contracts; concluding contractual relations based on verbal agreements is only possible in an environment with advanced legal and business ethics
- Alternative security of documentary collection of payment, e.g., advances payments, invoices, bills, factoring
- selecting the structure of customers, the possibility of rebates and discounts.

A. Instruments of the management of receivables – Risks associated with the management of receivables

The management of receivables is a set of rules and practices that minimize the risk of unsettled receivables. The purpose of the management of receivables does not involve a situation when a company has no receivables, but a situation when the costs associated with the management of receivables process are as low as possible [19].

The management of receivables is carried out in three phases: preparation, to maturity, and past due. The first phase is very important in particular to determine the rules of a specific supplier - customer relationship. The basis of successful management of receivables is to work with each receivable at the time of its creation, or before the moment it actually arises, and try to prevent problems that may occur during its non-payment. The most effective protection against unsettled receivables is their preventive security.

Business risk management policies should be part of the management of receivables in each company and should include:

- Analysis description of the external environment of a company and the trends in the market
- Proposed methods for handling receivables
- Expected creditworthiness of the customer
- Realizing the costs of the processing of receivables
- Responsibilities in managing the receivables in a company.

Companies should appoint an employee who would be responsible for regular upgrade of the list of monitored customers. In that case, you will not forget to verify whether your key and new customers are willing to make payments. Management of receivables is a set of rules and procedures whose purpose is to mitigate the risk of customers' failure to pay receivables. These rules and procedures of the management of receivables are to be defined by internal regulations that will establish, for individual groups of customers, unambiguous, clear and controllable credit limits, periods of maturity, securing of receivables, source of payment information, dates and forms of telephone and written reminders, out-of-court and court enforcement. The company may charge its employees with management of the receivables or it may hire a specialized company to do so. Low costs, high efficiency and other advantages of outsourcing are to the benefit of the supplier especially if the number of customers is high. The company just provides the ID number of the customers it wishes to monitor and it will receive outcomes of the monitoring once in three weeks.

A receivable may only arise on the condition that a contract has been made. What is important for enforcement of a receivable is the content of the contract, the delivery and payment conditions. Usually it concerns contracts between a seller and a buyer, but sometimes the contracts may involve more parties. In such a case, agreement of all the parties is necessary. Each and every receivable should be secured by, e.g., documentary letter of credit, documentary collection of payment, bill, security transfer of a right, right of pledge, contractual penalty, bank guarantee, or by insurance of the receivables.

B. A preventive measure for securing receivables and possibilities of securing receivables

A preventive measure for securing receivables may consist in prepayment. The amount of the prepayment is not specified by any regulation. It depends on the agreement between the supplier and the customer.

A preventive measure for the creation of receivables consists in concluding a contract. For enforcement is important, what is the content of the contract, what are the terms and conditions. Most contracts are concluded between a seller and a buyer, but there can sometimes be more participants as well. In such a case, there should be an agreement concluded among all participants. Approach to customers must be individual, it is essential to think about the risks that could complicate the course of the transaction. Resolving potential complications already provided in the agreement will ensure a predetermined

process solution with which both parties agreed. In addition to the basic provisions that the contract must contain, we should not forget to secure receivables. Possibilities may include a penalty, the amount of penalty interest, pledge, insurance, security, retention of title. For new customers it is advisable to obtain a reference to determine the creditworthiness of the customer. Entering prepayments in the suppliers' records is shown in table 1.

Table 1 Prepayment

	Document	Accounting transaction	Amount	Debit	Credit
	Bank Statement	Prepayment received	500	bank	Short-term prepayment
2	Invoice out	Issued invoice	1000	Customers	Revenues from goods sales
3	In-house Statement	Transfer of prepayment	500	Prepayment	Customers
4	Bank Statement	Balance of the receivable	500	bank	Customers

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In the next stage, it is appropriate to include the customer into segments according to the importance and risk. Individual segments are determined conditions for the payment, maturity, discount, prepayment, the option of supplier credit, bill payment, timetable for repayment, credit line, etc.

Another option of preventive protection lies in, e.g., the protection by documentary letter of credit, documentary collection, and bills, securing the conveyance of title, lien, contract penalty, bank guarantee or receivables insurance. One of the securing instruments is also a universally recognized right of lien, which is regulated by both the Civil and the Commercial Code [5,15,20].

The right of pledge is, in general, recognized as another security instruments. In the Czech Republic the right of pledge is governed both by the Civil and the Commercial Code. An example of entering the pledge into the accountings from the point of view of a debtor listed in the table below.

Table 2. Example of entering the pledge into the accounting

	Document	Accounting transaction	Amount	Debit	Credit
1.	In-house Statement	Pledge on a movable thing	50,000	Separate pledged movable things	Separate movable things
2.	Bank Statement	Payment of the obligation	30,000	Securities	Bank statement
3.	In-house Statement	Return of the movable thing	50,000	Separate movable things	Separate pledged movable things

Receivables from abroad may be insured, as international business brings about a lot of risks. Changes may occur as a result of political development, and this may lead to insolvency, inability of the buyer to transfer money to the Czech Republic due to his serious economic difficulties, as a result of insolvency. In the Czech Republic, there are companies that specialize in insuring payments. By making the insurance contract, the company gains access to the information about customers. Accounting entities must convert receivables and payables in foreign currencies as of the moment of their measurement to Czech crowns in accordance with the current exchange rate of the Czech National Bank or a fixed exchange rate. Foreign currency exchange losses and gains should be recognized in the income statement [17].

C. Accounting aspects of receivables after maturity date – adjusting items, depreciation of receivables and factoring

The forms, organization and orientation of accounting process are determined by the Accounts department itself in line with internal rules and regulations [9].

Adjusting items of receivables are created for doubtful receivables and reflect a temporary reduction in value due to the potential risk of loss. As already mentioned, they are created in the case of fear that the given receivable will not be paid in full and, therefore, will have to be written off by debiting the expenses in the future. If the reasons for creating adjusting items do no longer exist, this adjusting item will be written off by crediting the expenses. The adjusting items of receivables may be created only for receivables which are not out-of-date. If a company enters into the liquidation process, it cannot create statutory adjusting items. The following chart 2 illustrates the recording of adjusting item and the subsequent cancellation.

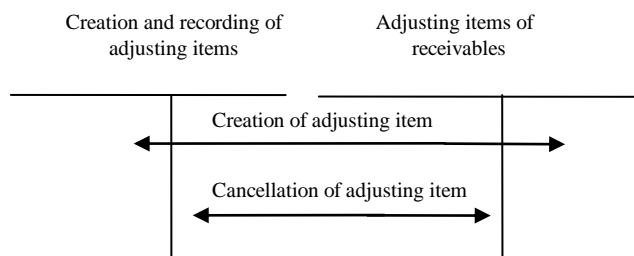


Fig. 2 the recording of adjusting item and the subsequent cancellation.

Depreciation of receivables means that a company gave hope for the receivable to be settled, which represents the irreversible impairment of receivables. The company does not expect the future repayment, and therefore writes off the receivable to the expenses and excludes it from the register. But the fact that the company has identified the receivable as uncollectible and has written it off does not mean that the debtor is not obligated to pay it. In this case, according to Czech legislation, it is necessary to distinguish the depreciation created by the company presumptions and the tax deductible depreciation accounted under the Income Tax Act.

Forfeiting the company as well as factoring companies buy in receivables from its clients. Furthermore, forfeiting companies buy receivables due to be paid within, at least, 90 days, but also within more than 4 years. However, the assigned receivable must be secured, e.g., by documentary letter of credit, bank guarantee or bill. There are about 6 companies that deal with forfeiting in the Czech Republic. Companies must decide whether they will enforce receivables with the help of specialized collection agencies or on their own. The costs of enforcing receivables on one's own are hard to be predicted, they are not directly visible in the accountings. However, neither a collection agency has to be reliable.

Table 3 Assignment of receivables to a factoring company

	Document	Accounting transaction	Amount	Debit	Credit
1	In-house statement	Opening balance Claim Assignment of receivables to factoring	250 250	Customers Other receivables	Customers
2	Bank statement	Payment of debts before maturity factor	200	Bank	Other receivables
3	Bank statement	Reimbursement from the factor for recoveries	25	Bank	Other receivables
4	In-house statement	Interest on advances	20	Expenditure	Other receivables
5	In-house statement	Costs associated with factoring	5	Expenditure	Other receivables
6	In-house statement	Accounting for claim	220	Other receivables	Other receivables
7	In-house statement	Accounting for financial services	25	Other receivables	Other receivables

III. PROBLEM SOLUTION

A. The Methods Used

To obtain the information necessary for complex processing of the issue some of the basic methods of scientific research were used, especially the methods of induction and deduction, analysis and subsequent synthesis. The methods usually complement each other and, in consequence, overlap.

The paper presents results of research conducted in the spring of 2012. Methods of qualitative and quantitative research were used, with the primary aim to examine the current state records of unsettled receivables in the accounts of

the surveyed organizations from the Czech Republic. Qualitative and quantitative research is always based on samples. As the basic tool used for a data collection method was chosen a questionnaire survey, with a total of 450 people addressed in form of a random sample when all types of profit and non-profit organizations were approached. The statistical analysis included 128 completed questionnaires, thus the response rate was 28.5%. For the questionnaire survey were chosen methods of e-mail correspondence as well as face-to-face contact, using the cooperation of students. The questionnaire responses prevailed closed answers with the possibility of open answers. Statistical methods were used for data analysis and interpretation of findings, including quantitative research, where the basic types of dependencies were demonstrated and basic hypotheses tested, including the null hypothesis verification.

Hypotheses were tested by the hypothesis testing for variance, the regression and correlation analysis was then used to verify the test. The main task of the regression analysis is to capture, by the regression function based on the knowledge of empirical pairs of x_i and y_i values, the course of dependence between two variables which will enable us to carry out assessment of values of dependent variable y selected on the basis of independent variable x [4]. The linear regression function was selected describing the dependence. This problem is one of the most important tasks throughout the regression analysis since the success of performed regression estimates depends on the accuracy of the choice of the regression function.

B. Research – Analysis of Actual practice in the Czech Republic

The present research is linked to a previous project (carried out in 2007-2008) aimed at comparing and analyzing the development of unsettled receivables in Czech firms at the beginning of the economic crisis [8] and at present. Structured questionnaires were used as a basic tool. Using the questionnaire survey, issues were examined relating to receivables, records and security of receivables, including the enforcement of uncollectible receivables. In 2008 there were compiled sources of 220 questionnaires of various companies from the Czech Republic. The aim of the research was to use accounting information for financial analysis. Main field of activity were 38% production, 40% services and 22 % business.

The next research was conducted in the spring of 2012. In terms of the specialization of the target group for the research, both profit and non-profit organizations were taken into account where main activities consist of activities focusing on trade, production and services. The structure of respondents in 2012 was divided according to the type of company, the predominant activity in terms of organization size [7]. The decisive criterion for company size was the number of employees. The specific structure of the surveyed companies is shown in Fig. 3, 4 and 5.

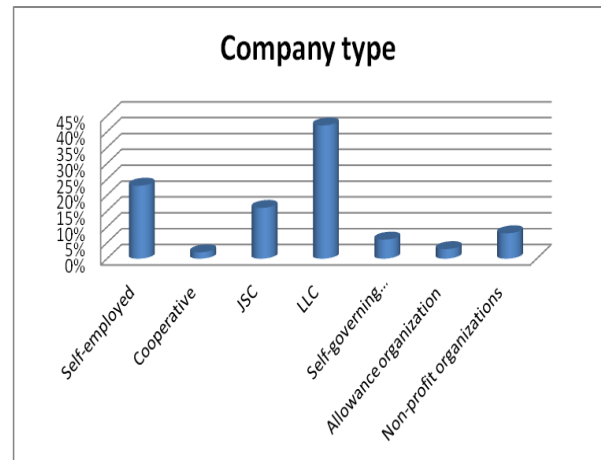


Fig. 3 Company type, Source: own research

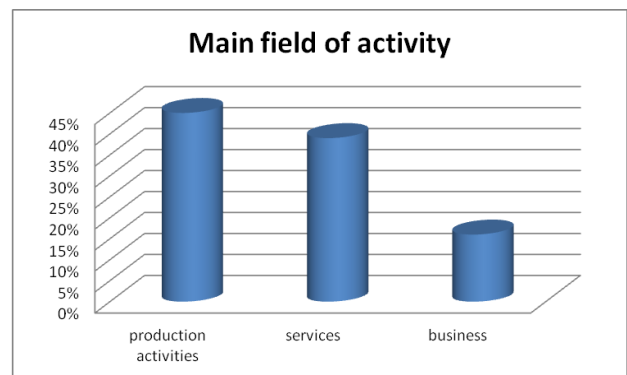


Fig. 4 Main field of Activity. Source: own research

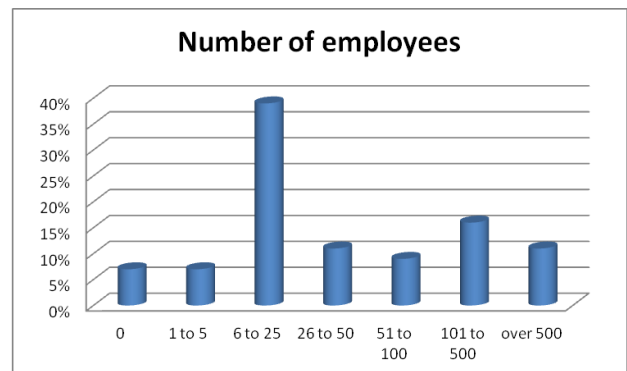


Fig. 5 Number of employees Source: own research

The target group structure was evenly distributed, representing all types of companies from the Czech Republic. Companies working in the field of services predominated. Most of respondents were companies employing between 6 and 50 employees, which in terms of size are small and medium-sized enterprises. This was also confirmed by the fact that 42% of respondents were from limited liability companies. 82% of respondents were registered as VAT payers, 61% were audited companies and 52% of respondents have supplier-customer relations with foreign countries.

The structured questionnaire was focused on:

- Record and age of unsettled receivables
- Measures for securing receivables
- Sources of obtaining information about customers
- Provision of foreign receivables
- The application of forfeiting and factoring
- Adjusting items
- Enforcement
- Judicial settlement
- Interest in training and education in the field of financial management

The evaluation of the entire target group testing resulted in findings presented in Fig 4 - the answer to the question of whether respondents record uncollectible receivables in their accounts and in Fig 6 - age of unsettled receivables.

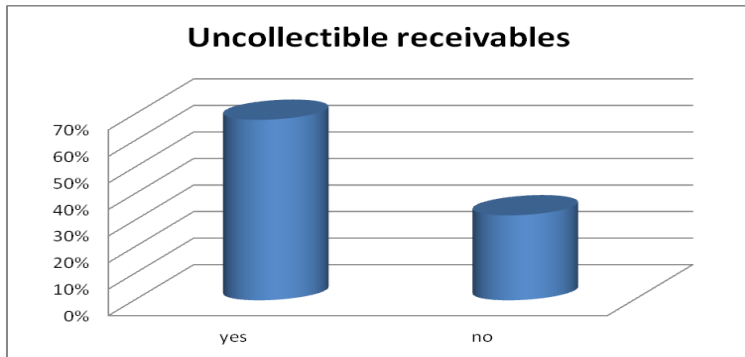


Fig. 6 Uncollectible receivables Source: own research

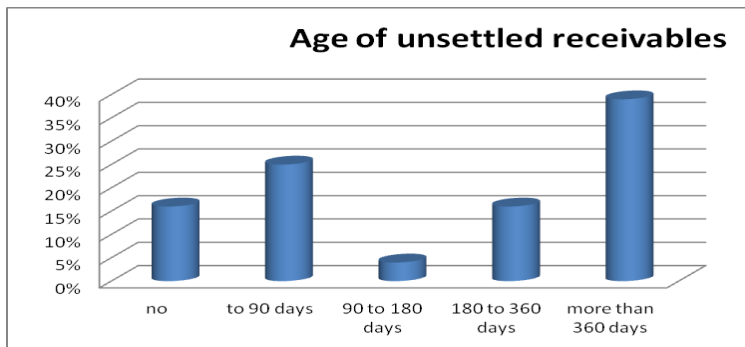


Fig. 7 Age of unsettled receivables Source: own research

Should we compare the results of the survey with selected outcomes of similar inquiries at the beginning of crisis [8] and at present, we see that the situation in the records of uncollectible receivables in the accounts of Czech companies has not changed much, see the table 4. The total number of firms that record an overdue receivable fell from 71% to 62%, but business entities currently involve approximately 76% of respondents. In particular, overdue receivables for more than one year represent a major burden for companies and significantly affect cash flow.

Table 4 Age of an overdue receivable Source: own research

Age of an overdue receivable	More than 90 days	More than 360 days
Survey from 2008	51 %	23 %
Survey from 2012	52 %	35 %

Joint-stock companies were divided into three groups by number of employees

- Companies with up to 50 employees
- Companies with 50 to 500 employees
- Companies with more than 500 employees

In case of joint-stock companies, the calculated value of test criterion χ^2 is 32.4; the number of degrees of freedom is 5. The significance level $\alpha = 0.05$. We reject the hypothesis of independence at this level of significance because $\chi^2 > \chi^2_{0.95}(5)$. The test showed that for joint-stock companies the record of receivables depends on company size.

Limited liability companies were divided into two groups according to the number of employees, since limited liability companies with a higher number of employees were not represented in the sample.

- Companies with up to 50 employees
- Companies with 50 to 500 employees

In case of limited liability companies, the calculated value of test criterion χ^2 is 45.5. The number of degrees of freedom is 10. The significance level $\alpha = 0.05$. We reject the hypothesis of independence at this level of significance because $\chi^2 > \chi^2_{0.95}(10)$. The test showed that for limited liability companies the record of receivables depends on company size.

To demonstrate the results of previous investigations the regression and correlation analysis were used, which have proven a causal relationship between the firm size and the management of receivables. The tests included responses to the question whether respondents use any of the methods of preventive measures for securing receivables. They could provide more methods. A linear regression function was selected reflecting the dependence.

The survey resulted in findings listed in the table below.

Table 5 Basic data for regression and correlation analysis

	Firm size - x	Number of positive responses - y
1	Up to 50 employees in LLC	135
2	Up to 50 employees in JSC	109
3	50 – 500 employees in LLC	65
4	50 – 500 employees in JSC	135
5	More than 500 employees in JSC	180

Using the regression coefficient (1) slope of a straight line was calculated, which indicates the average change in the dependent variable y for unit change in the independent variable x, where n represents the number of questions.

$$b_{xy} = \frac{n \sum_{i=1}^n x_i y_i - \sum_{i=1}^n x_i \sum_{i=1}^n y_i}{n \sum_{i=1}^n y_i^2 - \left(\sum_{i=1}^n y_i \right)^2} \quad (1)$$

n – Number of questions
x – Independent variable
y – Dependent variable

The value of regression coefficient (1) was 0.00289. Regression line slope equation is

$$Y = 0.00289 x + 3.8107$$

and determines the linear regression, where X is the independent variable and Y is the dependent variable. Using the equation of slope of a straight line we will create a line graph of linear dependence.

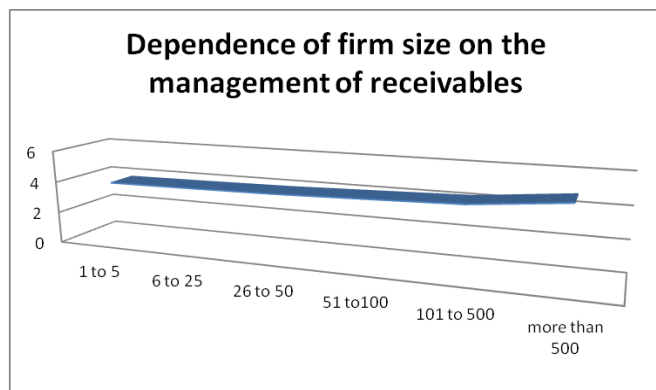


Fig. 8 Number of small and large firms Source: own research

From the observation of pairs x and y, we calculate the correlation coefficient, which is used to measure the tightness of dependence.

$$r_{xy} = \frac{n \sum x_i y_i - \sum x_i \sum y_i}{\sqrt{n \sum x_i^2 - (\sum x_i)^2} \cdot \sqrt{n \sum y_i^2 - (\sum y_i)^2}} \quad (2)$$

n – Number of questions
x – Independent variable
y – Dependent variable

The correlation coefficient (2) was r_{xy} 0.844478 and the result indicates a strong direct linear dependency between the firm size and the management of receivables for both types of companies, i.e., JSC and LLC, as proven by two methods, the hypotheses testing for variance and the regression and correlation analysis.

IV. DISCUSSION

However, let us now ask why companies do not use all known and effective instruments of the management of receivables? According to the survey, a prepayment is used most often out of the following selected management of receivables instruments, as a preventive measure for securing receivables.

Prepayment is a common preventive measure for securing receivables. The survey showed that it is used by 37% of companies surveyed. The amount of prepayment is not specified by any regulation. It depends only on the agreement between the supplier and the customer. Advance invoices are accounted for the needs of users of financial information as well, but there are arguments against the registration of prepayments due to the misrepresentation of receivables and liabilities.

Liability is a security relationship between the creditor and a third person, other than the debtor. This reduces the risk associated with the payment of the receivable. Liability may also serve for securing a future (not yet existing) receivable. The creditor is obliged to satisfy the receivable, should the debtor fail to do so. This method was used by none of the respondents.

Bill is used in the Czech Republic as a means of securing trade receivables in a small number of cases only. As demonstrated by the research, it is used by only 3% of the investigated organizations. This is caused by traders who lack enough experience with the issue. Even when issuing bills, mistakes often arise as well as the inability to enforce the right of the bill. A bill may also secure an uncollectable receivable if it is issued after the maturity date of the receivable and serves as a security instrument for creditors and as a way of postponing judicial debt collection.

Factoring consists in the purchase of short-term receivables prior to maturity. Receivables are purchased by specialized factoring companies. Factoring companies buy receivables that are not secured by any security instruments. Factoring companies agree contractually to pay a certain part of the receivables to the supplier regardless of whether the customer really pays the receivable or not. Approximately 5% of the companies surveyed are engaged in factoring.

Forfeiting - forfeiting companies buy receivables due to be paid within, at least, 90 days, but also within more than four years. However, assigned receivables must be secured, e.g., by documentary letter of credit, bank guarantee or bill. Only 1.5% of respondents reported using forfeiting.

V. CONCLUSION

The role of the management of receivables is to negotiate with business partners such a management of receivables instrument that will suit both parties and ensure the lowest business risk. The aim of the use of one or more management of receivables instruments is an effort to avoid the creation of

overdue receivables. It follows that there are many instruments which can ensure that the customer has paid his receivable to the supplier and avoid the risks of secondary insolvency.

The research has demonstrated that in the Czech Republic, the situation in the area of insolvency especially in the business environment is unfavourable. We may wonder: Why is it so? The conclusions of the survey showed that a total of 61% of all institutions and organizations and more than three quarters of business entities in the Czech Republic currently record an unsettled receivable in their accounts. The tested hypothesis of the dependence on the size of management of receivables on firm size has been confirmed, in general, larger firms have a higher level of management of receivables. It can be stated that larger firms reduce the level of business risk by the efficient management of receivables prior to their actual rise. These conclusions should be further compared with a similar survey in the area of non-profit sector, and certainly with the situation in other EU countries or in companies worldwide. Thus, this will be the subsequent focus of the research initiated in this area.

The paper analyzed examples of possible legal and accounting treatment of uncollectible receivables in the Czech Republic, for example, purchase of receivables, creation of adjusting items of receivables, securing through factoring or forfeiting. Each solution has, of course, advantages and disadvantages that should be considered before we start the enforcement. The most effective protection against unsettled receivables is timely security.

In conclusion we may state that receivables belong to the most significant component of current assets, influence the liquidity of the company by their enforceability, speed of collection, payment discipline of customers, the level of trade agreements. The proper management of receivables can contribute to a higher market value of the company, through liquidity management when the solvency of the company in terms of both management and external entities is the main factor influencing company's financial position, performance and competitiveness. To motivate firms to use the efficient management of receivables can be used various forms of education and training.

The survey showed that there is a quite strong interest among firms in training in the area of receivables, improving financial management or financial accounting.

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