THE ISSUE OF TRADE RECEIVABLES

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Abstract: In corporate practice, especially in the current difficult period, we encounter the problem of insolvency or even unwillingness to voluntarily fulfil payment obligations on the part of business partners. The consequence is mutual indebtedness of enterprises. Financial flows stop and the business system can collapse. Trade receivables are one of the risk assets of an enterprise. The success or failure or the future of an enterprise depends on their payment.

Keywords: receivable, trade credit, current assets, net working capital, receivables management.

1 Introduction

The Covid-19 pandemic, record inflation and the energy crisis had an impact on the development of the whole society and brought many problems and difficulties to businesses. A number of companies are still insolvent today, after the pandemic has ended, and this is reflected in their solvency or inability to meet their obligations to other companies arising from their business dealings.

One of the problems that we still encounter in corporate practice is receivables from customers and, in particular, the difficulties associated with their payment. At the same time, these trade receivables are a significant limiting factor in the solvency of the company. Neither the latest technology nor exemplary management can prevent a collapse if a company is unable to meet its payment obligations.

The aim of the paper is to highlight the issue of trade receivables and the need for their management. The paper is divided into six chapters, which follow each other. The first chapter is an introduction to the subject. The second chapter characterizes trade receivables as a trade credit granted, a component of current assets and an item of net working capital. The content of the third chapter is the revaluation of past due receivables by making an allowance for receivables or by writing them off. The fourth chapter presents the insolvency of Central and Eastern European enterprises. The management of trade receivables is dealt with in chapter five and the paper concludes with a conclusion in chapter six.

2 Characteristics of trade receivables

Receivables arising in the course of business interfere significantly with the day-to-day operation of the business. "A claim expresses the right of a creditor to demand performance of an obligation from another person - the debtor. The creditor has the right to enforce this performance, the debtor has the obligation to repay the claim" (Bartošová, Paliderová, 2018, p. 235).

According to the provisions of the Accounting Act, "the object of accounting is to account for the state and movement of assets, the state and movement of liabilities, the difference between assets and liabilities, income, costs, revenues, expenses and the economic result of an entity," (Accounting Act, § 2, section 2). Thus, from its inception until its extinction, a receivable is the subject of an accounting presentation.

The most frequent receivables in enterprises are trade receivables, i.e. receivables from customers. For an enterprise, they represent the right to receive monetary payment for the performance provided, i.e. the supply of products, goods and services. In addition to trade receivables, companies may also incur other receivables, e.g. from employees, shareholders, insurance companies, financial authorities, etc. In an enterprise's accounts, trade receivables are accounted for in Accounting Class 3 - Settlement relations. The recognition of trade receivables in the accounts is conditional on the existence of the actual documents evidencing their origin. Such documents are most often issued invoices or commercial contracts. The extinguishment of a trade receivable is primarily linked to its monetary settlement in favor of the creditor. At that point, the receivable becomes due.

2.1 Trade receivables as a form of trade credit

From an economic point of view, trade receivables are a form of granting trade credit to a customer. A characteristic feature of trade credit is that the funds are not granted in cash but in kind. The supplier shall supply the customer with products, goods or services on the understanding that the customer will pay after the expiry of an agreed period. It is therefore a credit relationship between non-banking entities. Trade credit is also historically the oldest form of credit. It makes it possible to overcome obstacles to the sale of products, goods and services arising from the fact that the customer does not have the relevant cash equivalent at his disposal at the time when he takes delivery of the products, goods or services. It therefore facilitates implementation, is administratively simple and flexible. However, it can only be provided by the supplier to the customer and not vice versa. Trade credit is typically short-term credit. Short-term loans are not essentially developmental in nature, i.e. they do not serve to permanently develop the enterprise's business. They are intended to overcome short-term shortages of payment means resulting from seasonal and other temporary fluctuations in the reproduction process. The credit relationship lasts from the moment of conclusion of the sale and purchase agreement, i.e. from the moment of realization until payment by the customer. The term for which trade credit is granted is determined by agreement between the supplier and the buyer.

Providing trade credit to its customers represents a certain competitive advantage for the company, the benefits of which should be the acquisition of additional customers and an increase in turnover. Receivables as trade credit are always linked to the invoiced outputs of the undertaking, the cash payment of which from the customer is postponed in time by the so-called due date with the consent of the supplier.

2.2 Trade receivables as part of current assets

Until the trade receivables are collected, they become a specific current asset of the supplier. In our financial reporting system, they are part of current assets even if the contractually granted term of repayment is more than one year (i.e. the assets are non-current), which does not, however, correspond to the economic and accounting characteristics of the assets in terms of the time they are held by the undertaking.

Trade receivables are classified into long-term and short-term receivables according to their maturity. "Long-term receivables are receivables whose maturity period is longer than 1 year," (Bartošová et al., 2020, p. 70). Short-term receivables are "when there is a time lag between the delivery of performance and the collection of payment for that performance, with a maturity set at a maximum of 1 year," (Bartošová et al., 2020, p. 71). Short-term receivables are crucial for a business because this maturity period predisposes them as easily liquid assets of the business. In doing so, the liquidity of receivables, i.e. their ability to turn into cash, directly affects the solvency of the enterprise.

"Paying and issuing invoices is a normal part of everyday business life. In Slovak businesses, invoices are normally due for a minimum or maximum length of time. The minimum length of the repayment period is not set by law. Its length is agreed between the business partners on the basis of a contract or the acceptance of the terms and conditions. If you and your business partner do not agree on the length of time for which an invoice is due, you must pay as soon as the other party asks you to" (https://podnikam.sk/splatnost-faktury). "The maximum length of time for payment of invoices is already regulated by the Commercial Code and is set at 60 days from the date of receipt of the invoice or other demand by the creditor, or 60 days from the date on which the creditor has performed, whichever is later," (Commercial Code, § 340a, section 1). "Most commonly, the parties agree between themselves that the invoice is due within 14 or 30 days. However, the length of the due date is really up to the agreement of the parties, and when it does not exceed the aforementioned maximum of 60 days, any agreed-upon length of payment is fine," (https://podnikam.sk/splatnost-faktury).

In practice, trade receivables are monitored and evaluated using the accounts receivable turnover (collection) ratio, the accounts receivable to assets ratio and the accounts receivable turnover rate ratio.

The indicator of turnaround time (collection) of receivables expresses the payment discipline of customers, i.e. the time the company has to wait from the date of sale, invoice issuance to the date of payment from the customer. The longer the turnaround (collection) period, the greater the need for financial resources to cover it. A positive development of the indicator is when its value decreases. This means that the receivables turnaround time is getting shorter. Calculation of the indicator:

(volume of trade receivables / volume of sales) * 365 days.

The ratio of receivables to the assets of the enterprise measures the amount of receivables that are tied up in the assets of the enterprise. An increase in the value of this indicator indicates the inability of customers to repay their debts. A positive trend is indicated by a decreasing value of the indicator. Calculation of the indicator:

volume of trade receivables / volume of assets.

The receivables turnover rate indicator expresses the rate (number) of receivables turnovers for the period under review, or the amount of revenue per monetary unit of trade receivables of the enterprise. A positive development of the indicator is when its value increases. Calculation of the indicator:

volume of sales / volume of trade receivables.

2.3 Trade receivables as a net working capital item

As part of current assets, trade receivables are also an item of net working capital. "Net working capital is the difference between current assets and current liabilities," (Landa, 2007, p. 18). From another perspective, net working capital can be characterized as that part of current assets that - despite its short-term duration in the enterprise - is covered by long-term sources of financing, thus creating a certain buffer of liquid funds against maturing debts and reducing the tension in the financing of the enterprise's operating needs. Calculation of the indicator:

volume of current assets - volume of current liabilities.

Thus, to ensure the solvency of the enterprise in the short term, it is necessary to manage net working capital so that liquid funds in cash form are always available in the amount required by the short-term liabilities that are currently payable. This place demands on the management of the structure of current assets, because their individual items are not equally liquid - their liquidity increases from inventories through receivables to financial assets. Meanwhile, the ongoing monetization of inventories and receivables is essential to raise cash to pay outstanding debts.

Through net working capital as a differential indicator, it is possible to monitor the impact of the volume and structure of receivables on the liquidity of the enterprise. In our practice, however, ratio liquidity ratios are more common, which "express and quantify the ability of an enterprise to pay its payable liabilities," (Kráľovič, J., Vlachynský, K., 2011, p. 65). Trade receivables as part of current assets enter into the current and total liquidity ratios. The current liquidity ratio, also called the Tier 2 liquidity ratio, is calculated as:

(current assets - inventories) / current liabilities.

The total liquidity ratio, also called the Tier 3 liquidity ratio, is calculated as:

current assets / current liabilities.

Short-term receivables provide the liquidity requirement out of which the short-term liabilities reported in the calculation of liquidity ratios can be met because their maturity is comparable to that of short-term debt. When the requirement to maximize liquidity ratios is met, it is clear that an increase in receivables has a positive effect on the value of the ratios. However, this is the case if we only look at quantity. If we also consider the quality, then only those receivables should remain in the liquidity ratios whose monetization during the year will not be jeopardized. Otherwise, this is an artificial overstatement of the liquidity ratios. This raises the question of whether the value (price) of each receivable that goes into the liquidity ratio is realistic. The problem of the fair valuation of receivables is also the problem of applying the precautionary principle in accounting in relation to the creation of provisions or the write-off of bad debts.

3 Realization of the value of assets in the form of trade receivables

Receivables that have not been collected when due shall remain with the supplier in the relevant asset accounts. They appear in the company's accounts under current receivables together with other short-term receivables due to maturity. The amount of overdue receivables is therefore not directly readable from the balance sheet. However, this information appears in the notes to the financial statements.

If an enterprise decides to revalue past-due receivables, it may make allowances for specific receivables or write off receivables.

3.1 Allowance for receivables

"A valuation allowance is created on the basis of the precautionary principle if it is reasonable to assume that the value of the asset has decreased compared to its valuation in the accounting records" (Measure of the Ministry of Finance of the Slovak Republic on accounting procedures in double-entry bookkeeping, § 18, section 1). The reasonableness of the creation of a write-down shall be ascertained at the time of the inventory. "An allowance for receivables shall be made in particular in respect of a receivable for which it is reasonable to assume that the debtor will not pay it in whole or in part, in respect of a disputed receivable against a debtor with whom a dispute is pending as to its recognition" (Measure of the Ministry of Finance of the Slovak Republic on accounting procedures in double-entry bookkeeping, § 18, section 7).

"The creation of an allowance for receivables may be included in tax expenses if a period of time has elapsed from the due date of the receivable in excess of:

a) 360 days - up to 20 % of the nominal value of the receivable or the outstanding part thereof, excluding accessories,
b) 720 days - up to 50 % of the nominal value of the receivable or of the unpaid part of the receivable, excluding any attachments,
c) 1 080 days - up to 100 % of the nominal value of the receivable or the unpaid part thereof, without any accessories, " (Income Tax Act, § 20, section 14).

An allowance for doubtful debts is created when receivables are temporarily impaired. If the receivable is permanently impaired, the receivable must be written off.

3.2 Write-off of receivables

The write-off of a receivable to expense is, in principle, irreversible and therefore the written-off receivable cannot be reinstated in the asset account. However, the write-off of a receivable does not legally constitute a surrender of the property right in the receivable. In practice, a receivable sometimes continues to be legally enforceable against the debtor even after it has been written off internally in the accounts, if the legal remedies available to the debtor are procedurally available. The eventual receipt of payment of such an already written-off receivable is recognized in income from written-off receivables.

When writing off receivables to expense, it is necessary to take into account the provisions of the Income Tax Act, where the cases when the write-off of the nominal value of the receivable or its unpaid part, including interest on delay, is recognized as a tax expense, are specified in an exhaustive manner. "These are:

1. claims against a debtor whose petition for bankruptcy has been dismissed, stayed or cancelled by the court due to lack of assets,
2. claims which have not been satisfied in bankruptcy proceedings, restructuring proceedings or debt settlement by instalment plan,
3. claims against a debtor who has died and the claim could not be satisfied even by recovery from the debtor's heirs,
4. claims against a debtor whose assets are insufficient to cover the costs of the enforcement proceedings or the costs of enforcement of a court decision, and the court discontinues the enforcement proceedings at the request of the creditor or the enforcement of the decision,
5. receivables for which an allowance of 100 % may be made," (Income Tax Act, § 19, section 19, letter h, r).

The creation of an allowance for doubtful debts and the write-off of a receivable are among the accounting settlements of overdue receivables. Other monetarily effective methods of settlement, apart from judicial recovery, are, for example, assignment of the receivable, set-off of the receivable or contribution of the receivable to a trading company, i.e. capitalization of the receivable. For overdue claims, it is important to bear in mind limitation periods so that recovery action can be taken before they expire. Slovak legislation sets a four-year limitation period.

4 Insolvency of Central and Eastern European companies

Loss of profit and missing finances are the most common problems for businesses struggling with unpaid invoices from customers or late payments from customers. "The Covid-19 pandemic and the subsequent economic downturn, as well as the economic impact of the war in Ukraine, have raised concerns not only about macroeconomic activity and commodity markets, but also about the solvency of businesses. The number of insolvent companies increased last year in CEE countries, mainly due to high energy prices, interest rate hikes, the highest inflation in decades and uncertainty related to the war in Ukraine. As shown in Table 1, eight countries experienced higher insolvencies (Bulgaria, Croatia, Hungary, Latvia, Lithuania, Poland, Romania and Serbia) and four countries experienced a decrease (the Slovak Republic, Czech Republic, Estonia and Slovenia). The Slovak Republic is among these countries. Tight liquidity and expensive financing encourage larger companies to hold back liquidity, to the detriment of smaller companies, which then delay payments. Despite the slowdown in inflation in 2023, most businesses in CEE countries are expected to experience weaker growth. Indeed, inflation will remain well above central bank targets. They will thus continue to raise rates, which will have a negative impact on the solvency of businesses. Therefore, the number of insolvent companies will continue to increase in 2023," (https://coface.sk).

Lack of solvency brings with it serious cracks in the smooth running of business. Unpaid trade receivables are felt by every business. Measures must therefore be taken to help businesses to manage financial shortfalls in a way that puts as little strain on them as possible.

Table 1 Share of influences in the total number of active companies

Country:	2019	2020	2021	2022	Dynamics 2021/2022	Insolvency rate 2022
Bulgaria	405	488	516	532	3,1 %	0,13 %
Croatia	5 132	5 445	5 101	5 498	10,5 %	2,08 %
Czech Rep.	1 081	978	1 035	1 024	-1,1 %	0,25 %
Estonia	264	330	268	222	-17,2 %	0,08 %
Hungary	5 187	4 053	4 359	8 111	86,1 %	1,54 %
Latvia	590	388	268	308	14,9 %	0,21 %
Lithuania	1 641	815	817	1 041	27,4 %	0,85 %
Poland	1 019	1 040	2 054	2 752	34,0 %	0,08 %
Romania	6 384	5 564	6 113	6 531	6,8 %	1,12 %
Serbia	6 446	6 096	4 445	9 149	105,8 %	6,69 %
Slovak Rep.	445	330	388	347	-10,6 %	0,17 %
Slovenia	1 294	1 125	679	575	-15,3 %	0,27 %
CEE Total	**29888**	**25013**	**25917**	**36090**	**39,3 %**	**0,54 %**

Source: https://coface.sk/pocet-insolvencii-firiem

5 Trade receivables management

Receivables management is a wide range of procedures and methods that provide information for the financial decision-making of an enterprise. Since in our environment it is not so much difficult to sell as to collect cash for the sale, it is obvious that receivables management needs special attention.

The initial stage of receivables management is the decision to grant or not to grant trade credit. This decision is very important for the short-term financial management of the business. Ensuring the timely payment of supplies of products, goods and services is a complex problem which can by no means be limited to the recovery of overdue debts. Prevention of bad debts should be a fundamental concern already at the stage of preparation and conclusion of sales contracts.

In terms of time, the whole process of these measures and activities to detect and mitigate the risks of trade credit can be divided into the following phases:

a) activities preceding the conclusion of the sale and purchase agreement (information on the customer),
b) the negotiation of the terms and conditions of the contract (negotiation of payment terms),
c) taking care of receivables (monitoring and treatment of receivables at the time they are due, when they are due and after they are due).

If a trade credit has been granted to a customer on the basis of a good assessment, it is necessary to review at regular intervals indicators that may reveal the beginnings of its insolvency:

- decreasing equity,
- change of legal form,
- the withdrawal of a shareholder who is liable for all the assets of the company,
- the emergence of high losses,
- low professional competence of the managing directors,
- decline in the quality of production,
- outdated professional programme,
- the cessation of operations or plants,
- casualization of work,
- reducing the number of company representatives,
- the dismissal of skilled workers,
- opaque accounting,
- high inventories,
- poor production quality,
- frequent change of suppliers,
- abnormally increasing number of complaints,

- negative reports from other suppliers or external personnel.

In managing the receivables already provided, the decision-making activities of the enterprise must be focused on a number of basic areas, namely:

1. Evaluation of receivables through indicators.
2. Credit risk management.
3. Management of doubtful debts.
4. Management of losses on bad debts.
5. Forecasting cash flow from receivables.

If trade receivables are not paid by customers when due, overdue receivables arise. In that case, the following steps must be taken:

- remind the payment of the receivables by telephone,
- send a reminder,
- collect the debts out of court or through the courts,
- make an allowance for receivables or write off receivables.

The process of trade receivables management therefore starts even before a receivable is created, by selecting a business partner and ensuring protection against negative impacts related to problematic receivables. Once prevention has been set up, the receivable management process focuses on the origination of the receivable itself to its successful collection through registration, monitoring and recovery, which occurs in the event that the trade receivable is not settled even after thorough hedging.

6 Conclusion

The receivable in our businesses relates to the performance of the business, the proceeds of which are subject to income tax. In the case of double-entry bookkeeping, sales become taxable income whether or not they are collected. Indirect taxes, which are part of the invoice value of the performance, are also attached to the receivable and fall heavily on the supplier. The supplier must account for the indirect taxes at the same time as the sales are made and subsequently remit them to the State budget, irrespective of whether they have been collected from the customer.

Thus, if the receivable is to fulfil its function in commercial relations fairly for both partners, its liquidity, i.e. the ability of the buyer to meet its obligations, must be ensured. This requires the customer to be creditworthy and solvent, as well as willing to meet its payment obligations. It is the responsibility of the trade credit provider, i.e. the supplier, to find out these facts about its business partner, as underestimating them can have an immeasurable impact on its financial situation. This clearly shows the necessity of managing receivables already at the stage of preparing business contacts. Precautionary measures and the principles of concluding business relationships can save many additional costs for the company and the receivable can become a symbol of the voluntary granting of trade credit to the customer.

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