

A company who is both a supplier and customer to Johnson electric declared bankrupt, there is \$50K AP owed from JE but \$750K AP owned by the company to JE, as we are JE, what kind of SOPs suggest controls that we can do differently in the future to prevent these from happening?

To address the situation where a company that is both a supplier and customer to Johnson Electric (JE) has declared bankruptcy, resulting in a significant imbalance between accounts payable (AP) and accounts receivable (AR), the following controls and procedures from JE's SOPs can be implemented to mitigate such risks in the future:

#### 1. Credit Checking and Assessment

- **Credit Agency Reports:** Ensure that credit control obtains and reviews credit agency reports for all customers, including those who are also suppliers. This helps assess the customer's ability to pay and recommend appropriate credit limits <sup>1</sup>.
- **Verification of Information:** Use the credit report to verify the customer's billing and shipping addresses to ensure they are genuine business addresses <sup>2</sup>.

#### 2. Credit Decision and Limits

- **Setting Credit Limits:** Establish and enforce strict credit limits based on the creditworthiness of the customer. If a customer is deemed high risk, consider obtaining guarantees or reducing the credit limit <sup>1</sup>.
- **Warning Bands:** Implement warning bands around credit limits to trigger reviews if the customer balance approaches the limit. This ensures proactive management of credit risk <sup>1</sup>.

#### 3. Set-Off Procedures

- **Set-Off Agreements:** For customers who are also suppliers, ensure that any set-off of payable and receivable amounts is documented and agreed upon in writing by both parties. This agreement should clearly identify the invoices included in the set-off <sup>3</sup>.

#### 4. Monitoring and Reporting

- **Signs of Financial Distress:** Train sales staff and other JE employees to report any signs of financial distress in customers immediately. This includes trends towards later payments, unexplained failures to pay, and significant downturns in the customer's business <sup>4</sup>.
- **Reassessment of Credit Limits:** Reassess and reapprove credit limits if there are significant changes in the customer's profile, such as changes in ownership or significant merger and acquisition activity <sup>1</sup>.

#### 5. Account Reconciliations

- **Regular Reconciliations:** Ensure that all GL balance sheet accounts, including AR and AP, are reviewed, analyzed, and reconciled monthly. This helps in identifying and addressing discrepancies promptly <sup>4</sup>.
- **Quality of Reconciliations:** Maintain high quality reconciliations by ensuring that the preparer understands the account, includes all necessary documentation, and escalates any open items aged more than 90 days to the Regional Head of Finance <sup>4</sup>.

#### 6. Customer-Specific Inventory

- **Risk Profile Inclusion:** Include customer-specific inventory in the risk profile when setting credit limits. This ensures that inventory risks are considered in the credit decision process <sup>1</sup>.

By implementing these controls and procedures, JE can better manage credit risk and prevent significant imbalances between AP and AR in the future.

4 references

- 1) ACC009-Credit-Manual-2.3.E-2.docx - Part 1
- 2) ACC009-Credit-Manual-2.3.E-2.docx - Part 2
- 3) ACC009-Credit-Manual-2.3.E-2.docx - Part 3
- 4) ACC020-Account Reconciliations-1.0.a.docx - Part 1

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Tell me when I am making an investment that cost USD\$1M, but customer will pay \$800K, how shall I depreciate the assets? and how shall U account for the customer contribution? If there is a freight cost of \$100K too, can I record as expenses in my P/L- what shall I do to comply JE SOP?

When making an investment where the cost is USD \$1M and the customer will pay \$800K, the accounting treatment and depreciation of the asset, as well as the handling of the customer contribution and freight costs, should comply with JE SOP as follows:

#### Depreciation of the Asset

##### 1. Initial Cost and Capitalization:

- The asset should be recorded at its full cost of USD \$1M in JE's ledgers when acquired or constructed <sup>1</sup>.
- The asset remains in the books of the JE entity that uses it in manufacturing and is depreciated as if JE retained title <sup>1</sup>.

##### 2. Depreciation Calculation:

- Depreciation begins when the asset is first ready for use. For production equipment, this may be when successful final run at rate bulk testing is completed or when mass production has begun <sup>2</sup>.
- The depreciation expense should be calculated based on the full cost of the asset (USD \$1M) over its useful life.

#### Accounting for Customer Contribution

##### 1. Customer Contribution:

- The customer contribution of \$800K should be recognized as a reduction in the cost of the asset. This means the net cost of the asset to JE would be \$200K (USD \$1M - \$800K) <sup>1</sup>.
- The contribution should be amortized over the useful life of the asset, reducing the depreciation expense recognized in the income statement.

#### Freight Costs

##### 1. Freight Costs:

- The freight cost of \$100K should be capitalized as part of the cost of the asset, not expensed immediately. This is because freight costs are directly attributable to bringing the asset to its location and condition necessary for it to be capable of operating in the manner intended by management <sup>1</sup>.
- Therefore, the total capitalized cost of the asset would be USD \$1.1M (USD \$1M + \$100K).

#### Compliance with JE SOP

##### 1. Recording and Depreciation:

- Record the asset at the total cost of USD \$1.1M in JE's ledgers.
- Depreciate the asset based on the net cost after customer contribution, which is USD \$300K (USD \$1.1M - \$800K) over its useful life <sup>1</sup>.

##### 2. Amortization of Customer Contribution:

- The customer contribution should be amortized over the useful life of the asset, reducing the depreciation expense recognized in the income statement <sup>1</sup>.

##### 3. Freight Costs:

- Capitalize the freight cost as part of the asset's cost and include it in the depreciation calculation <sup>1</sup>.

By following these steps, you will ensure compliance with JE SOP and accurately reflect the financial impact of the investment, customer contribution, and associated costs in your financial statements.

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