Transcript for Podcast Episode: 017

What To Do When Clients Refuse To Pay?

Hosted by: Michelle Ward and Shawn Cahill

Michelle: Hey everybody. On this episode of Profit Points, we talk about why or what happens when you have not received payment from your client or if your client refuses to pay. And we talk about what is needed in the business in order to determine if this is a business problem within your own practice or business, and what needs to be done in order to try and get collections from your clients or customers. And then ultimately, what does it look like if you don't get paid? So please join us on this episode of Profit Points.

Michelle: We are Modern CPA. Our purpose is to provide valuable information to small business owners. On our podcast Profit Points, we discuss business how tos, give tax tips and dig into real life experiences. In the crazy world of running your own business. If you find this podcast helpful, then like subscribe and follow us on social media.

Michelle: Hey everybody, welcome to Profit Points podcast, where we talk to professionals, industry leaders and small business owners about what they see in the crazy world of running your own business. And Shawn Cahill is here with me today. I'm Michelle Ward. And we are going to talk about what happens when your client refuses to pay.

Shawn: Yeah, it's kind of a tough thing because as a business owner, as a business, you do all this work to get the customer then to deliver your goods or services. And, you know, you want to get paid for all the efforts, your paying employees, you're paying all your operating costs, inventory costs. So, yeah, you want to get paid for sure.

Michelle: Yeah. And I know in my experience, the longer there's the time between the services that's been provided to the time that you get paid, the diminishing of the value or the perceived value is there. So most people who have been in business for quite some time understand the necessity to get paid promptly. So when you've delivered your product, either, you know, some people even take deposits upfront, but if you're delivering your product or your service immediately upon the delivering of that product or service, there is a payment of that. So the shorter the time frame that you have between the delivery and the payment is there's a higher perceived value than that.

Shawn: So absolutely there's a reason there. The cash registers are reached by the door to go out of the shop, you pay before you leave. There's a reason why you have to pay for your online shopping at the time you order it. That's because, you know, those organizations are not going to wait till later to get their money. Yeah. And a lot of contractors, especially with larger projects, want a percentage upfront of the total fee that they're going to charge, you know, some events to order parts and supplies. But some of it's just to lock you in, you know, to get that. You know, you have already invested in that project.

Michelle: Solid commitment to the project.

Shawn: Yes, exactly right.

Michelle: So, yeah, absolutely. And I know for service based businesses, it can be challenging to get paid on your service because some people tend to put off payment for the service, unlike going into a store, let's say Target, and you purchase something, you can't walk out and say, well, I'll pay you later, Target, you know, I'm going to take this product and I'll pay you later. Of course, you could use a credit card, but that's your way of making good on the transaction. But when you have a service based business, there can be challenges for getting paid timely because people don't see it in the same way that they see going into a store to purchase a product.

Shawn: Absolutely. And there's a lot of service based businesses that will require payment, you know, before they give you the deliverable. So in the accounting world, when you get your tax returns, before you get your tax returns, you have to pay, certain accounting practices will require that certain law firms would require payment before they give you your documents that they've drawn up for you. So that's it. There’s different types of ways of operating those types of practices. But yeah, if, if you're just invoicing after the delivery of your service, then that time period from you delivering your service till you get paid it. You got to try to get that done promptly and quickly. The longer it goes, like you said, the more diminished value, perceived diminished value from that recipient service.

Michelle: Now, we do have some people in our online community that are like mental health therapists or some sort of therapy practice. And most of the time, those types of practices require payment, either right up front prior to the session or immediately after the session. Now, there would be a lag time if a person provided you with insurance and you were taking insurances depending on how that works. But they've provided you with the form of payment in some capacity. Taking the copay is also really important for those practices as well. So knowing what insurance co-pays are or at least identifying the patient's co-pays ahead of time so that you can at least get paid on that portion, and then you would get paid on the insurance piece at a later point. But you have to remember, you are putting a lot of costs upfront in order for that service to be provided. So it's really important to to try and get paid as promptly as possible. So one of the things that we want to identify is when you have a client that refuses to pay you, why are they doing that? Right. That's a big question, is why are they doing that? It can be that they have their own financial problems and struggle with that. But there's some other things that maybe as the business owner or the service provider, you need to identify on your side to see what is happening there. Shawn, do you have any thoughts on what you think?

Shawn: Yeah. I mean, I guess the first thing is, how are you taking payments? Are you making it easy for the client or the customer to pay you? Are you only accepting checks? Do you only accept cash?

Michelle: Yeah.

Shawn: So, you know, the more options you have for people to pay you, the quicker you'll be able to get paid. So some practices don't accept credit cards or debit cards. But, like I said, the more you can, the more types of payments you accept, the quicker you'll get paid.

Michelle: So outside of expanding your payment options or the payment options, you know, things that you need to consider when someone hasn't paid you, is there some sort of value disconnect? Did the client feel that they didn't get the value from what you are doing? Has the job or the service been completed? You know, if you and this other thing is being clear on the communication which we're going to talk about, like has that job been completed where now it is time to make payment or was there an issue with the service? And maybe the client is feeling that things weren't done the way that they had hoped and maybe it's a hard discussion that needs to be had because of that. But you know, your business potentially would be better for it if you knew some of the hang ups that clients would have.

Shawn: Yeah. And some of that could be just communication up front. When you first accept the customer, accept the job as being forthright in what that engagement is going to look like, what that job's going to look like, and walk them through the steps as to when you're going to get invoiced for. If you're doing it in steps or if you're doing it all at the end, what is that? How is that going to look?

Michelle: And what's the acceptable practice here? What are the anticipated or the expectations from the clients?

Shawn: Yeah, over communication is key in these areas. And then once you do, once you do have that invoice ready, how are you going to get that to the client? Are you going to hand deliver it? Is it going to be mailed? Is it going to be some sort of online system where it's going to be emailed and making sure that you have the correct information to be able to deliver that. I mean, are your emails to the client going into their junk folder? They're just not seeing them. Yeah, I mean.

Michelle: And that can happen all the time. Yeah, I know that. I just saw the email. I'm sorry. Or it got misplaced or...

Shawn: Exactly. Yeah, just, I just had that recently with a client. She, you know, she, it's been three months since we finished her tax returns with the emails going out for the invoice and she just never saw them. They were going to junk. So, you know, that's on me to make sure that I had communicated properly to her how I was going to deliver it. Yeah.

Michelle: That's a really important point because I think that we assume that things are being like once we've done what we think is being done, that the other side is seeing it and they're just ignoring us, when in fact it could be that it never made it to them, like the junk email or the fact that maybe it got lost in the mail or got it to them in the mail and it was picked up in a pile of stuff and accidentally thrown away. So just because you haven't been paid within a certain amount of time as the business owner, maybe find another form of sending that in. Voice or picking up the phone and calling them and saying, Hey, I just wanted to make sure you got the invoice. You know, maybe there was some problem. And they said, Oh, my gosh, I never didn't know you even sent it. Right? So, you know, if you emailed, then maybe you need to mail, right?

Shawn: Give the customer a little bit of the benefit of the doubt. You know, for the first kind of communication.

Michelle: Time, a couple of times, you know, exactly a month or so, especially depending on how your invoices are structured, you know, do you give them 15 days? Do you give them 30 days? How does that look? So yeah.

Shawn: That's an important point, too. Have you communicated how quickly you're requiring payment? Is it 15 days? Is it 30 days? Is it upon receipt of the invoice? And what is the typical turnaround time for all of your clients? Are you getting paid, you know, within 15 days or 30 days, or are most of them paying within 60 days? If that's the case and you want to get paid quicker, you really have to change your practices of how you communicate that turnaround.

Michelle: And one of the good things about having an accounting system in place, whether it be even just excel, but having some kind of system that you're tracking, who hasn't paid you yet. This isn't a huge deal if you have a handful of clients because you probably know who hasn't paid you. But if you have a number of clients and all of those moving parts every day, it's very easy to lose track of who in fact owes you. And so when you have an accounting system, let's just say a QuickBooks system or some kind of online program system that has invoicing capabilities, you are able to see who, in fact, has not paid you on a regular basis. So you can go in there at any given point and pull a report to see how, how, who owes you and how long have they owed you? And I always say, and this is probably for a different discussion, but anything over 60 days, you need to start really looking at it because again, you're further and further away from the time of the product or the service was delivered, and that starts to lose that value.

Shawn: And some of those online systems like QuickBooks, when you invoice the customer through and it goes through email, you can see in the history as to whether they actually viewed the invoice. So you can go in there and say, Oh, this person hasn't...

Michelle: They haven't even opened it.

Shawn: They haven't even opened it. And so that could be a clue as to why they're not receiving it. And if they're opening it and then, you know, just ignoring you and not paying you, then that could be a potential problem. That's, you know, that's like the next step is, is there a problem with the services, the products that have been delivered? And is there some issue with your client that you need to talk about and talk through and have those hard discussions as to why you're not getting paid?

Michelle: Mm hmm. Many times what I see is that people go into these transactions, of these relationships and provide a service or product, and then they have trouble collecting on it. You know, I want to say, maybe present the client with an option like, you know, you haven't paid us, but maybe there's a payment plan that we can have that's like unofficial kind of payment plan that I would be willing to accept, you know, a certain amount of money over a couple week period or, you know, to give them the ability to kind of pay you. And, you know, you're trying to keep the relationship positive and so that you can work together again in the future. And just because they might be having a slight problem right now doesn't mean that they will in the future. If it turns into that, they continue to have problems paying you and every time you work for them, there's an issue in your hunting down the collection. You may want to examine that client relationship or that relationship with that person.

Shawn: Yeah, absolutely. And I mean, you know, there's always going to be clients or customers that, you know, that are really slow in paying and they wait till the last possible moment or string it out as long as they can. And then they do that over and over again if they're repeat customers. So, you know, is that detrimental to your business? Is it a large dollar number that you're floating for a time? Or is it a smaller, smaller number that you can live with that being out there? And then if it is out there that long, do you want to charge interest on those payments or..

Michelle: Or some kind of fee for not making payment timely?

Shawn: Yeah, because you may have engaged with a billing provider that is charging you money to bill and collect. And, you know, you may need to charge fees for late payments so that you can keep your costs.

Michelle: Yeah.

Shawn: Yeah. Pay your service provider.

Michelle: Yeah. It's a really good point because there's some people that in their business, they have other people working for them or they have to pay subcontractors to do certain work for them to get the job done. And when doing so, you're putting out money prior to getting paid potentially, if that's how you structured it. So you can only float that so long. We only have so much financial capacity to do that. And when someone doesn't pay, you gotta remember all of the costs that you're putting out upfront, even just overhead costs to run your business. All of that adds up and you don't get paid. You're the one that's basically financing all of this for them, for the service that you provided to them.

Shawn: You may have debt obligations that you need this cash flow for. And if you can't meet those debt obligations, you're going to get charged higher interest. So it's a you know.

Michelle: It's a cycle.

Shawn: Your vendors and your lenders want to get paid timely as well. So, you know, not having that cash flow could be costing you money on the back end by not being able to pay other providers.

Michelle: Yes. Yeah. So if you're not getting paid and you've gone down these multiple avenues, the next step might be that you need to send an official letter to the client or the customer saying, you know, we've provided you this product or service. We require payment on this. Maybe even mentioned that you wouldn't be able to do work with them in the future if they were not able to pay you. You know, and if it's important to the client, obviously, they're going to reach out and try and make some kind of payment plan or make full payment. And many times, letters like that can work and get the attention. And it's not just a standard invoice that they're getting. It's an actual letter.

Shawn: It's not a statement. It's not a reminder. It's more.

Michelle: No, it's a true letter from the business. Yeah.

Shawn: Yeah. Yeah. And then. And then if that doesn't work, the next step is, you know, you could have your attorney draft a letter. And, you know, and, you know, at that point, you're basically threatening debt collections. And that's, you know, that's going to be... Unfortunately, you could be in that situation and you may need to take those more drastic measures. If your attorneys got to do that for you, there's a cost to that. So you got to waive the cost benefit as well as the next step, which would be collections.

Michelle: Yes, exactly. So, you know, having an attorney do that is costly. But I can tell you that sometimes just the threat of going to collections or the threat of going to court, depending on the cost, is enough for the client to kind of address the situation. Like, Yes, I know I owe you. Maybe we can arrange something here so that we can make payment on this too, that neither one of us is going through a difficult court trial or that there's collections going to collections is the next step and it is going to be pretty costly, right? Way more than even the attorney writing a letter for you. So what you're going to collections for really needs to be worth the added expense of court or attorney fees. So we want to make sure that that makes sense to you.

Shawn: Absolutely. And if they can go back to if you're running into this often and you're always in this situation, again, go back and reexamine your policies and procedures and how you're communicating and and the types of payments you're accepting. Because maybe you need to change. How your front end processes and all that stuff.

Michelle: Yeah. The communication front. Absolutely. Signed engagement letters or signed estimated invoices that the client is aware of the quote that is involved so that things aren't a surprise. Some things are surprises to customers when they're not clearly communicated. Maybe not so much the upfront cost or the cost that they think it's going to be. But what if there's some up charges or some change fees? Basically, like the customer changed their mind on how they were going to do something. And because of that, there's an additional fee that needs to be assigned to the job. Well, that happens on a regular basis. People that are your customers need to know that that is a potential right. In the event that I change my mind midway through this project, whatever that project is, whether it be a life coach or whether it be a construction job at your house or your business, you know, if there's some sort of change to what was anticipated from you, you know, maybe not so much. I mean, maybe if it's a vendor issue because we're running into that a lot now. But if there's a change by you like, oh, no, I want a bigger sink and I want it over on the other side of the home. Well, yeah, that's going to have a change, a fee associated with that. So being upfront that those things are possibilities to kind of cover your own.

Shawn: But yeah, and you know, we experienced, you know, you're talking more like contractors, but...

Michelle: It's a good example.

Shawn: Yeah, exactly. But you know, it can be in your service businesses as well, like, you know, like accounting firms or law firms. You know, you set up a set of expectations of what the job is going to be, what you're going to provide. And, you know, if the job takes longer or if the client requests additional documents from a firm like a law firm or additional services from the medical provider, then there could be additional fees that you need to communicate that upfront. And when they do request that, it's good to have that conversation right away instead of just invoicing them at the end. And there was a surprise. And if you're doing proposals and you're doing estimates and stuff like that, and you see that your proposals and estimates vary all the time from what your invoice is, then you definitely need to change how you're writing those proposals and providing estimates because you know you're not going to be successful and you're going to have problems with your customers if that's ongoing.

Michelle: Yes, absolutely. I mean, that happens quite often, you know, especially in the contracting industry where, you know, you're writing estimates up. And if you haven't really kind of perfected your process on how to determine those quotes, that can be detrimental to, one, the job that you're working on, but also how that customer or client refers you to other people. You know, they could be saying, oh, well, this guy told me it was... I say guy, but it could be a woman. This person told me it was going to be $3,000 and it turned out to be 10 and they never communicated that with me. So that is an issue. Now, if it's midstream and something changes, saying this is outside of the scope that we originally quoted you, I will give you another quote for the additional services, and you tell me whether or not that you want to do that. And that's a way of kind of making sure that you're getting paid for what you're doing. No one is in business just to give away their product or service. You've got to charge a fair price and make a living yourself. And so that all needs to happen.

Shawn: Yeah. And you also don't want to be taken advantage of by customers as well. I mean, there is a flipside to this because there are customers and clients.

Michelle: That would do that.

Shawn: That will do that. They do do that with experience. So, it happens. So, yeah, you need to be fair to your customers, but also accept fairness from them as well.

Michelle: So yeah. Yeah. So identifying if this is an ongoing problem, is it lying with you? Is it lying with the customer? It could be that the customer is a difficult customer to do the job for. And they are slowly paying me… That customer needs to be released into the wild to go run with other people, free them and be done. Because you're really not making any money on that job. You really are not producing a positive feeling in your business, working with people that kind of are difficult to work with and are not paying you for that difficulty.

Shawn: So they're probably causing you stress, your employees or your other contractors, they could be causing them stress.

Michelle: Yeah.

Shawn: So sometimes you gotta let 'em go.

Michelle: You got to let them go. Yeah. Yep. So, okay, so what happens when you've gotten to the point where you've exhausted your collections or you just feel like, okay, I am not going to get paid for this job? What happens then? What does that look like?

Shawn: Yeah. So then, you know, it becomes a bad debt. It becomes you have to write off that receivable. You know, if you're keeping receivables, which you probably should be, if you're invoicing a lot, then from from an accounting standpoint, that's an accrual basis accounting and you for accrual basis financials, you write off the the accounts receivable because it's already built in income, you get a deduction for that.

Michelle: And basically what that means is that it's an income and then you get a bad debt and it offsets. Right. It kind of nets down to zero. We have to be clear, though, that when you're looking at your finances, tax purposes may be very, very different because for tax purposes, not everybody is on an accrual basis, especially in smaller businesses, smaller service based businesses. You're not on an accrual based accounting for tax purposes.

Shawn: Right. So you'll be on a cash basis. So for a cash basis you recognize income when you receive it. So if you haven't gotten paid, you haven't received that income. So you get no deduction. When you write off that bad debt, you would already have paid. You've already expensed everything related to the products, the materials, the other costs related to providing that service or products. So those are still expenses that you can still keep on your books, but you just don't get that extra bad debt expense because you've never recognized the income. If you are on an accrual basis for taxes, you've recognized the income, so you get the deduction to offset that.

Michelle: A lot of people get confused about that and oh, I had this, but what happens if I don't get paid? I can write it off on my taxes, right? And it's like, well, no, you've incurred the expense for that. It's unfortunate that you're not getting paid on the income. That is a loss in your mind that you've put out that service and not getting paid for it, but you've never picked it up in income. So it's just a no income recognition.

Shawn: Yeah, it's just a non-event for cash purposes. But you know, again, you know, you're keeping your books on an accrual basis because you have receivables. So you do for your financials, accrual based financials, you get the expense on that. And if you are accrual for tax, you get the expense as well. So. Right, right, right. And it's especially important if it's in different periods, different years that, yes, you recognize the income and pay tax on it on an accrual basis in a prior year and then the next year you have to write it off, you get that expense in that year, you don't.

Michelle: Run it back.

Shawn: Unless the collections have been exhausted in that old period but you forgot to write it off. Then you could go back and admit. But are there specific tax rules related to the timing of when you can write off bad debt? So that's a discussion for off of this podcast.

Michelle: All right. Well, I think we pretty much highlighted the major points of the podcast. And we thank you for joining us today on this podcast. We like and subscribe to us on YouTube. We have a lot of great content on there to help small business owners run their businesses better and just be more educated. So thanks so much, guys. Take care.

Shawn: Take care, everyone. Thank you.

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