



Edition 52

Managing Your Debtors

INTRODUCTION

In the bookkeeping industry, as with any industry, cash is the lifeblood of your operations. Without payments from your customers, your business can not survive. Cash is needed to discharge a range of obligations including business overheads, and liabilities to parties such as the Tax Office. Indeed, during the current economic downturn, one of the main problems faced by business, contractors and sole traders alike is not just getting business 'through the door', but collecting payment once work has been performed.

This Bookkeepers Knowledge Base looks at the recourse you have as a bookkeeper when clients have not paid including:

- Retaining client documents
- Letters of Demand
- Engaging a debt collection agency, and
- Court action.

Because some of these options are costly and protracted, and therefore may not be realistic for smaller debts, we particularly examine the first of these options which itself is a common question asked by our member bookkeepers:

When a client has not paid – particularly when they sever the relationship with you – are you as their bookkeeper entitled to retain their documents until the account is settled?

We then conclude by providing some practical tips on how to manage your debtors and by doing so avoid the need to exercise one of the above courses of action in the first place; courses of action which may result in the end of the client relationship.

LIENS

Put simply, a lien is a form of security which permits A to retain B's property until B satisfies an outstanding debt to A.

Often for an individual contract bookkeeper or a small bookkeeping practice (including sole traders) a lien is of great benefit when amounts are outstanding, as many bookkeepers can not afford to undertake alternative courses of action such as pursuing the debt through the courts. As a bookkeeper, possession of the client's documents is sometimes the only leverage you have to get the client to settle their account.

The question is: do you actually have a legal right as a bookkeeper to exercise a lien?

Broadly speaking, liens are divided into two categories:

1. General liens, and
2. Particular liens.

General Liens

This type of lien only applies to particular classes of professionals. General liens allow a supplier of services/goods to retain all client property/documents in the supplier's possession (regardless of whether the outstanding debt actually relates to work performed on that particular property/document) until the client has settled their account.

Example

Jenny is a contract bookkeeper who has been engaged by Paul's Plumbing to perform the following tasks:

- Payroll services, and
- BAS preparation.

To prepare the BAS, Jenny has been provided with source documents such as invoices, bank statements and loan documents.

To perform the payroll services, Jenny has been provided with Tax File Number declarations, Withholding declarations, pay records, employment contracts and timesheets.

Having performed the services, Paul has failed to pay Jenny's in relation to the payroll services, but has paid for the BAS services, the fees for which were sent out on a separate invoice. A subsequent fee dispute has arisen and Paul now wishes to engage the services of another bookkeeper. Paul demands all his records/documents back from Jenny who agrees to hand them back once the account has been settled.

If general liens could be exercised by bookkeepers, Jenny would be entitled to keep all documents as security for the outstanding amount including the invoices, bank statements and loan documents relating to the BAS, even though Paul has paid his fee in relation to this aspect of Jenny's services.

In the services sector, Australian courts have recognised that a general lien applies to the following classes of professionals:

- Solicitors
- Bankers, and
- Stockbrokers.

To date, however, Australian courts have not recognised that general liens apply to bookkeepers or accountants for that matter. While the courts have not ruled that general liens do not apply to these classes of professionals, the issue has yet to be put before a court. Accordingly, it is prudent to proceed on the basis that you as a bookkeeper can not exercise a general lien over the documents of a client who owes you money.

From a legal standpoint therefore, you are obliged to hand back documents that the client owns (see later for coverage of who owns which documents) which have no relation to the outstanding debt.

Particular Liens

The second category of liens, particular liens, is the right of a supplier to retain particular property/documents until the outstanding debts in relation to services performed on those particular documents are paid.

Example

Following on from the earlier example, if Jenny were to exercise a particular lien, she would only be entitled to retain the documents that relate to the unpaid payroll services including the TFN declarations, withholding declarations, pay records, employment contracts or timesheets. She would not be entitled to retain the invoices, bank statements and loan documents as these documents are not property that relates to work she has performed for which money is still outstanding.

There are five basic conditions you must satisfy before you can exercise a particular lien:

1. The documents retained must be the property of your client – as distinct from your property (which you are entitled to anyway) or property that is owned (either partly or in full) by a third-party. Ownership of documents is addressed below.
2. The documents must have come into your possession through proper means – for example your client volunteered them to you in order for you to carry out your duties.
3. Work must have been performed by you on the documents or you have used the documents to perform work, or you produced the documents as part of your work – as distinct from merely sighting the documents.
4. The fees must be outstanding in respect of such work.
5. The documents must be in your possession. Once they are surrendered (either to the client or a third-party) you lose the right to exercise a lien over those documents.

Therefore, providing these five conditions are satisfied, you do have the right at common law to exercise a particular lien over a client's documents until the account is settled.

We recommend however that the client be informed upfront, ideally in the engagement letter, that the exercise of a particular lien is a possibility if there are outstanding fees. Suggested wording follows:

I may invoke a lien over certain documents until such time as an outstanding fee has been paid or other satisfactory arrangements have been reached. A lien is a right to hold certain documents until the outstanding fees that relate to work undertaken on those documents have been satisfied. This right may not however be held over property which belongs to a third-party or is needed to meet your tax obligations (e.g. Business Activity Statements or PAYG Payment Summaries).

OWNERSHIP OF DOCUMENTS

As stated, in order to exercise a particular lien, the documents must belong to your client – not to you or a third-party. So which documents are yours and which are those of your client? This question will generally be resolved by reference to the following three factors:

- (a) The engagement letter or verbal or written agreement between you and your client.

It is quite unusual for an engagement letter to specify which documents belong to you and which belong to your client. However, where this is the case, there is no need to proceed any further – this agreement will be decisive as to ownership.

- (b) The purpose for which the documents are created.

Documents brought into existence solely for your purposes, such as working papers, generally belong to you. By contrast, documents brought into existence for the purposes of your client (such as Business Activity Statements or profit and loss statements that you have been engaged to produce by the client) will belong to the client.

- (c) From who you have received the documents

Documents provided to you by the client will be held to belong to the client.

The table below provides specific guidance as to ownership, in the absence of any express agreement between you and your client. Remember that a lien is only effective over documents owned by your client. Moreover, knowledge of who owns which documents is useful regardless of whether a lien is being exercised.

OWNERSHIP OF DOCUMENTS

Document Type	Owned By Bookkeeper	Owned By Client
Documents given to you by your client such as: <ul style="list-style-type: none"> • Invoices • Employment contracts • Bank statements • Time sheets • Loan documents • Withholding declarations • TFN declarations • Pay records 		✓
Work that you have been specifically engaged to produce such as: <ul style="list-style-type: none"> • Accounting software file • Management reports • Balance sheets • Profit and loss statements • BAS/IAS • Payroll tax returns • Payslips • Payment summaries 		As the Bookkeeper has been engaged by the client to produce this work they are therefore acting as an agent <div style="text-align: center;">✓</div>

Drafts and office copies of the aforementioned	✓	
Correspondence – with third parties (e.g. accountant, Tax Office etc) where you are acting on behalf of your client		✓
Correspondence – where the client writes you a letter or email etc	✓	
Correspondence – where you write to a client and keep a copy of that correspondence	✓	
Notes – where you make notes of answers the client gives you in discussions with them	✓	
Advice – Documents you prepare for the client where you provide them with advice as part of your engagement e.g. letters, emails etc		✓
Workings – Documents prepared by you such as: <ul style="list-style-type: none"> • Work papers • Calculations • Drafts 	✓	

Therefore, the documents listed as owned by the client are those that you may be able to exercise a lien over.

To summarise, a lien is a right that arises through common law. You do not apply for it. Rather, it is a right that you may be entitled to exercise (subject to the exceptions outlined below) where a client has not paid their fee, and you satisfy the five requirements outlined earlier.

It would, however, be prudent to seek legal advice before exercising a lien.

DEFEATING A LIEN

Despite bookkeepers being legally entitled to exercise a particular lien, there are some instances where a lien can be defeated.

(a) Ethical Issues

Where the exercise of a particular lien will likely result in fines/penalties being imposed by the Tax Office or the Office of State Revenue etc, you have an ethical duty to consider alternative courses of action (such as debt collection services, court action).

As a bookkeeper you have a professional responsibility to act in the best interests of your client. Indeed, this duty is expressly spelled out in subsection 30-10(4) of the Professional Code of Conduct in the soon-to-be operative Tax Agent Services Act (2009) which is part of the new BAS Agent regime. The subsection states:

Tax agents and BAS agents must always act lawfully in the best interests of their client.

Additionally, the Code imposes upon BAS Agents a duty to the community to ensure that the tax laws are administered fairly.

These duties mean that where retaining client documents is likely to place the client in a position where they can not comply with their tax obligations, the bookkeeper should consider alternative action.

(b) Tax Office

Section 263 of the Income Tax Assessment Act (1936) provides that:

The Commissioner, or any officer authorised by him in that behalf, shall at all times have full and free access to all buildings, places, books, documents and other papers for any of the purposes of this Act, and for that purpose may make extracts from or copies of any such books, documents or papers.

This provision will defeat a particular lien, and you will therefore be required to surrender documents that the Tax Office requests.

(c) Police Investigation

Pursuant to the Commonwealth Proceeds of Crime Act, the police have the power to seize documents. Unless they have your consent (which you should only give if the client agrees), the police must have a search warrant in order to seize documents.

(d) Bankruptcy

Where your client is bankrupt, you must surrender any document that the trustee in bankruptcy requests.

If your client is a company and either a receiver or a liquidator is appointed, this will generally not affect the existence of a lien. However, once a company is placed into liquidation, no further liens can be exercised over documents that come into your possession.

(e) Privacy Law

Under the Privacy Act, individuals may have a right to access documents even where those documents are subject to a lien. However, the following restrictions apply:

- Only bookkeeping businesses (including individual sole traders) with an annual turnover of \$3 million must comply with a request made under the Privacy Act
- Access is restricted to information which identifies an individual, and
- 'Access' is usually restricted to the inspection of documents and does not mean that clients can take the documents which are subject to a lien, back into their own possession.

ALTERNATIVES

As stated, bookkeepers have an ethical duty, and indeed have a duty under the imminent BAS Agent legislation, to consider alternatives to a lien where the exercise of a lien may expose the client to penalties from bodies such as the Tax Office or State Revenue departments. In this regard, alternatives may include:

Letter of Demand

Broadly speaking, a Letter of Demand is a letter sent to the debtor client following your supply to them of your bookkeeping services. The letter advises the client of the amount owing and threatens legal action if the amount is not paid. A Letter of Demand may also be tendered as evidence in court as proof of your attempt to settle the matter.

When sending a Letter of Demand, you should:

- Attach copies of prior invoices
- Not harass or abuse the debtor
- Provide a clear description of the goods/services provided
- Document previous attempts to obtain payment
- Provide payment details (e.g. bank account into which they can make the payment)
- Set a final deadline (usually within seven or 14 days of the date of the letter)
- Offer a compromise for a lesser amount (this is optional), and
- Do not make the letter appear as though it is a court document (this is illegal).

Such letters can be confronting, and should only be sent once other options (reminder telephone calls etc) have been exhausted. This is where you will need to exercise your professional judgement as the sending of such a letter could result in the client severing their professional relationship with you. Equally, however, you may not be concerned about jeopardising the relationship with a client who is not willing to pay your bill.

Sample Letter of Demand

Dear Madam,

I am writing to you concerning the amount of **(insert \$)** which was due to be paid on **(insert date)**. This amount remains outstanding despite my previous requests for payment which were made on:

- **(Insert date)** as per attached invoice
- **(Insert date)** as per telephone call.

The amount owing relates to **(insert description of goods/services)**.

I enclose the original invoice/contract, dated **(insert date)** for your reference.

I demand the payment of the full amount to me **(insert means of payment and any payment details required e.g. bank account number)** within **(insert number of days, usually seven or 14)** of the date of this letter.

If this matter is not resolved within the timeframe specified above, I reserve the right to commence legal proceedings, without further notice to you, to recover the amount owing.

Yours Sincerely,
(insert name, address, and contact details).

Whatever consequences you foreshadow in your Letter of Demand, they need to be followed up with action. Otherwise, debtors may view any mention of future action as empty rhetoric.

Debt Collection Agency

If a client fails to respond to a Letter of Demand, you may wish to refer the debt to a debt collection agency. The use of debt collection agencies to recover outstanding debts should not be commenced without consideration to the economic viability of such action. Fees charged by these agencies can include direct costs incurred in the recovery action as well as a commission charged on the recovered debt.

Employing the services of a debt collection agency does not necessarily mean the end of your relationship with the debtor. Good debt collection agencies are polite and professional and all are subject to codes of conduct which prohibit harassment.

Court Action

Although this option may on face value seem costly, small claims can be resolved relatively inexpensively. As well as cost, in taking court action you should consider:

- Whether the client can actually pay. If they have a number of creditors and are basically insolvent, it may not be worth pursuing the debt.
- Whether there is a dispute over the facts. If you have not got a strong case, it may be a waste of time and resources to pursue the other party in court. You may only wish to do so where the facts are settled – such as when there is no dispute that the client owes you a debt and no dispute as to the size of the debt.

It should also be noted that you do not need legal representation to pursue a claim. If you decide to proceed, the action you take for an outstanding debt varies depending in which state or territory you reside:

Queensland

Is the debt for an amount less than \$7 500?

YES – You can pursue the debt through the small claim's arm of the Magistrate's Court. To initiate the process, complete [Form 3](#) and file it with your local court registry. For more information, including fees and charges, visit the [Queensland Courts website](#).

NO – You must pursue the claim through the Magistrate's Court, however it will not be treated as a minor debt claim. You can initiate the process by filing a [Form 2](#) and a [Form 16](#) – Statement of Claim – with the court registry. For more information, visit [this](#) website.

New South Wales

Is the debt for an amount under \$10 000?

- YES** – You can pursue the debt in the small claim's division of the Local Court. To lodge a small claim, you need to file a Statement of Claim with the Court. This form is available online at: www.lawlink.nsw.gov.au/lawlink/spu/ll_ucpr.nsf/pages/ucpr_forms. For more information, including fees and charges, visit the [Local Courts website](#).
- NO** – Your action will still be brought in the Local Court, and you will still need to complete a Statement of Claim and file it with the Court. It will not, however, be heard in the Court's Small Claims Division. Visit the above Local Courts website for more information.

Victoria

Is the debt for an amount under \$10 000?

- YES** – You can pursue the debt in the Victorian Civil and Administrative Tribunal (VCAT). To initiate a claim, you need to complete an Application to Civil Claims List form which you can obtain on the [VCAT website](#). You should then send the form to VCAT along with a small filing fee. Visit the above website for more information, including fees and charges.
- NO** – The Magistrate's Court hears claims of up to \$100 000 in its civil jurisdiction. More information on the Magistrates' Court, including court costs and locations, may be found at www.magistratescourt.vic.gov.au

Tasmania

Is the debt for an amount under \$5 000?

- YES** – You can pursue the debtor in the Minor Civil Claims division of the Magistrate's Court. To do so, you will need to complete a Civil Claim Form which you can obtain [online](#). You should then lodge this form with your local court registry. For more information, visit their [website](#).
- NO** – The General Division of the Magistrates Court hears claims from \$5 001 to \$50 000. For more information, visit their [website](#).

South Australia

Is the debt for an amount under \$6 000?

- YES** – Your claim can be heard in the Civil Minor Claims division of the Magistrate's Court. Your first step before bringing a claim should be to notify the debtor of your intention to make a claim. To then commence proceedings, you must complete a Minor Civil Action – Claim Form. For more information, including accessing this form as well as fees and charges, visit the court's [website](#).
- NO** – Your claim will come under the general division of the Magistrate's Court.

Western Australia

Is the debt for an amount under \$10 000?

- YES** – Your claim must be pursued in the Magistrate's Court. To make a claim you will need to complete the Minor Claim form. Lodge the completed form together with the application fee in person at the court registry. A small fee is payable when you lodge your claim. For more information on the fees and forms, visit their [website](#).
- NO** – To make a claim you will need to complete the General Procedure claim form (for claims between \$10 000 and \$75 000) which you can obtain from the above website.

ACT

Is the debt for an amount under \$10 000?

- YES** – Your claim must be made in the Small Claims Court. To obtain a Small Claims Application Kit, visit their [website](#).
- NO** – Claims of more than \$10 000 must be brought in the Magistrates Court. Of course, you do have the option of abandoning the amount over \$10 000 and undertaking your action in the Small Claims Court which is quicker and cheaper.



Northern Territory

Is the debt for an amount under \$10 000?

YES – A claim may be made in the Small Claims Division of the Local Court ("Small Claims Court"). To commence a claim you must fill in a Statement of Claim form, which you can obtain from any Local Court office or the Court's [website](#).

NO – Civil cases involving debts, damages or other actions to a maximum of \$100 000 are heard in the Local Court.

OTHER TIPS FOR MANAGING YOUR DEBTORS

Direct Debit

Setting up payment via direct debit is a proactive way of ensuring payment is made. Direct debit takes the timing of the payment out of your client's hands and puts you in charge of when the payment is made.

On completion of a direct debit authority (see below for a sample) payments can be deducted from a client's bank, building society or credit union account.

Some clients actually prefer this method of payment, as it saves them money (i.e. cheque fees, stamps etc) and time (i.e. writing out a cheque, mailing the payment) as well as the hassle of remembering when to pay.

A direct debit can be for a fixed or variable amount and operate at regular intervals or pre-determined dates.

Below is a sample direct debit authority. While this wording is indicative, please be aware that your bank will likely have their own stipulations as to how the direct debit authority must read.

Sample Direct Debit Authority

Part 1 - Customer Authority (Customer to Complete)

Name.....
Phone.....
Address.....

I (**customer inserts name**) arrange for funds to be debited from my account at the financial institution identified below. This authority is to remain in force until it is revoked in writing.

Part 2 – Details of Account to be Debited (Customer to Complete)

Name of Your Financial Institution....
Account Holder's Name....
BSB Number....
Account Number....

Maximum Amount to be charged...
Interval at which to be charged...

Part 3 – Authorisation (Customer to Complete)

We authorise the following:

1. Payment of funds due for my account
2. Authorise (insert your name) to verify the above details with my financial institution

Signature.....
Date.....

Follow Ups / Reminders

To remind customers of when to pay, you firstly need a system to remind you when payments are due.

MYOB and QuickBooks feature Receivables Reports which list current debtors. You can define your own periods and run reports for debts that are 30, 60 or 90 days overdue for example. This is handy as you will usually take differing action depending on how long a debt is overdue. For example, you may



wish to send out a standard template letter reminder to debtors who are 30 days overdue, whereas you may wish to follow up 60-day debtors with a personalised telephone call, whereas 90-day debtors may need to be referred to a debt collection agency.

Alternatively, a cost-effective, foolproof method is setting up auto-reminders in your Outlook calendar. For those who do not use Outlook, you can use similar online email services such as:

- Gmail (Google Mail) via [Google Calendar](#)
- [Hotmail Calendar](#)
- [Yahoo Calendar](#).

In terms of client reminders, those with a personal touch are often more effective. In this regard, phone calls or personal email messages are best as they personalise the issue and can often result in putting your debt ahead of others in the queue. By contrast, reminders sent in the mail containing standard paragraphs, are often more easily ignored.

Often making a telephone call to your debtor is all it will take to get them to pay. You should always finish the call by obtaining the debtor's commitment to make the payment. Make another follow up call if the amount is not paid on the promised date or, better still, undertake to pick up the cheque/cash from the debtor's premises on the day promised.

Always act professionally and courteously with follow-ups. Aggression, rudeness or calling outside business hours may not only delay payment but result in the loss of custom.

Bill Regularly or at Milestones

Particularly in relation to larger jobs, instead of sending out a client's bill in one big lump sum, bill them in smaller amounts, more regularly as the work is being performed. Not only will these progress payments give you a steady stream of cash flow, but clients are more likely to pay smaller amounts than if you save the billing up and do it in one big lump sum. The smaller the amount, the more likely it will be paid.

Also, do not be afraid to ask for upfront payments or large deposits particularly in relation to big jobs you are performing for clients with a poor payment history.

Stop Work

If a client has not paid a bill by the due date (either a final sum or a progress payment) consider not performing any more work for them until payment of the previous sum is made.

By continuing to perform work, you are not only making the debt bigger, but you are sending these debtors the wrong message which may only encourage them to delay the current payment further and not pay on time in the future.

General Tips

- Whatever your system, have a set routine for debt collection – have a process in place and stick to it
- Outline your payment terms upfront and stick to them
- Personalise your debt collection practices where you can, and
- If a client is a serial late payer, don't be afraid to take a hard line even if it means losing their custom. Bad debtors, even if they are repeat customers, are a drain on your business.

Disclaimer—the information contained in this edition is current as at time of writing (September 2009). Information contained herein is general in nature and is intended to provide guidance to bookkeepers in providing bookkeeping services for their clients. It is not intended to be taken as a substitute for you or your clients seeking professional advice in relation to their own specific circumstances.

Copyright—Except for use with other staff members or contractors of your bookkeeping firm, no part of this publication may be reproduced without the express permission of Australian Bookkeepers Network Pty. Ltd.