Credit Review Checklist

Navigating Financial Health and Stability

This checklist is designed to guide you through the credit review process, ensuring a thorough and effective evaluation of credit risk. In today's landscape, maintaining a vigilant eye on the financial health and stability of your customers is imperative. This checklist serves as a tool for financial professionals, credit managers, and decision-makers who aim to safeguard their organization's financial interests while fostering sustainable business relationships.

Credit reviews are pivotal in identifying the early signs of financial distress, ensuring that credit policies align with the current risk landscape and supporting strategic business objectives.

Checklist:

1. Prep and Planning

- Identify accounts for review based on predefined criteria such as payment history, credit utilization, significant changes in credit score, etc.
- Schedule reviews by policy requirements, focusing on high-risk accounts or those showing signs of potential financial stress.
- Gather necessary documents and information, including financial statements, bank statements, credit reports, and any relevant correspondence.

2. Customer and Market Analysis

- **Review Financial Statements:** Analyze balance sheets, income statements, and cash flow statements to assess financial health and stability.
- **Calculate Financial Ratios:** Leverage ratios such as debt-to-equity, current ratio, and interest coverage to evaluate liquidity, solvency, and profitability.
- **Credit Score Analysis:** Examine the current credit score and its historical trend to assess credit risk.
- **Payment History:** Review the payment history for timeliness, frequency of late payments, and any defaults.
- **Credit Utilization:** Evaluate the level of credit utilization and how it has changed over time.
- Assess the current industry conditions and market trends that may affect the customer's financial stability.

3. Risk Assessment

- **Internal Risk Rating:** Apply your organization's risk rating system to determine the customer's current risk level.
- **External Factors:** Evaluate any external factors such as legal or regulatory issues that could impact the customer's creditworthiness.

4. Credit Terms Review

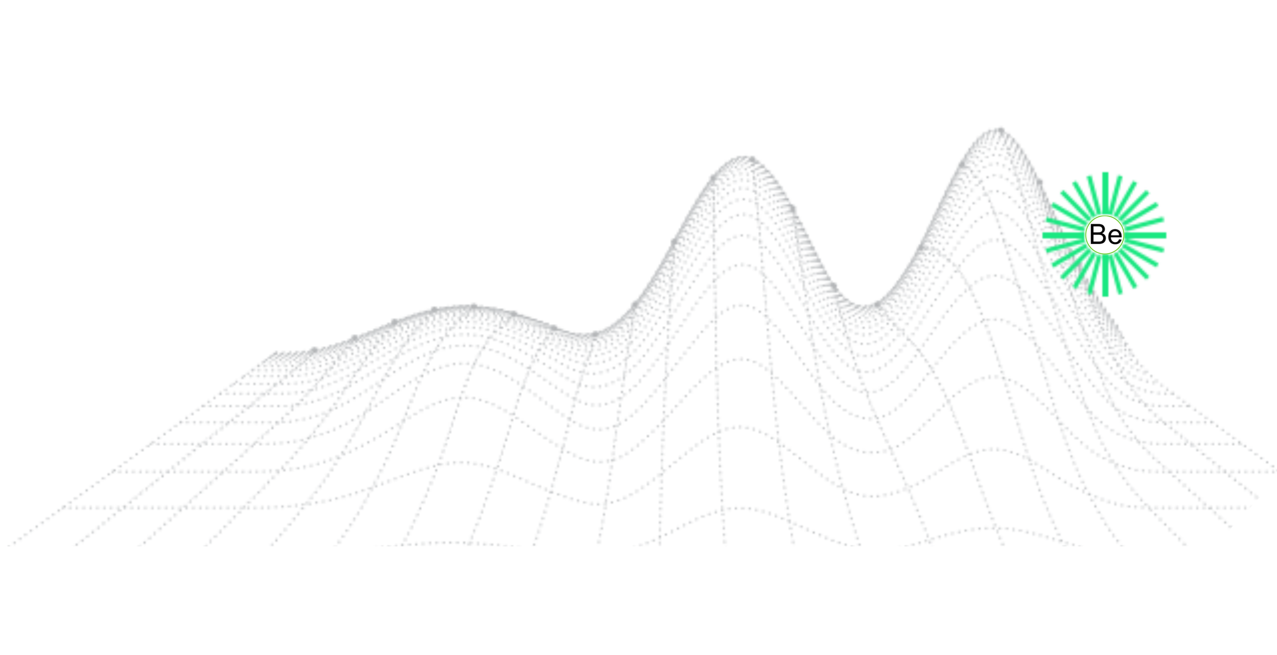
- Assess existing credit terms and limits based on the review findings.
- Determine if adjustments are needed to mitigate risk or accommodate growth.
- Document the rationale for the decision to ensure transparency and accountability.
- Communicate the decision and any changes in credit terms to the customer
- For any adverse decisions, provide clear explanations and possible steps the customer can take.

5. Documentation and Record Keeping

- Document all findings, decisions, and communications related to the credit review.
- Ensure records are stored securely and are accessible for future reference or audits.

6. Monitoring and Follow-Up

- Set up a schedule for regular monitoring of high-risk accounts (6 months or less)
- Plan follow-up actions for accounts that require closer observation or additional information.
- Conduct reviews for good standing accounts every 6 months



Recognizing Signs of Distress

In general, companies do not experience sudden downfall Instead, they typically follow a clearly defined path toward insolvency that spans many years. To optimize this risk, frequent credit reviews and account updates are necessary.

The 3 phases of distress

Phase 1: Management Defects

You can observe defects in:

- Structure of top management or turnover at management level
- Avoidance of financial discussions
- Improper cash flow planning
- Inadequate budgeting
- Inaccurate cost projections
- Deficient response to change (not keeping pace with a changing world)

Phase 2: Operating Errors

If one of the defects from Phase 1 exist, it is usually a matter of time before the company starts displaying Phase 2.

- Hearing about issues from other suppliers (late payments, increased liens, etc.)
- Declining revenues, profit margins or increasing debt levels
- Negative remarks on credit reports
- Sales turnover increases faster than profits
- Non-equity > Equity finance = larger loans, overdrafts, leases
- A project that is bigger than the company's resources

Phase 3: Creative Accounting

- Lawsuits
- Regulatory penalties or compliance issues
- Rise in overdrafts
- Slow payables
- Slowdown of activity
- Altman's Z-Score and the likelihood of bankruptcy

As the financial manager, it's crucial to implement a comprehensive credit monitoring system that includes regular review of these indicators. This proactive approach allows for early detection of distress signs and optimizes the risk portfolio. Make informed decisions regarding credit management, including when to hold back on granting credit increases to protect your company's financial health.

What to collect during a review?

- [ ] Financial statements
- [ ] Credit reports and scores
- [ ] Legal and regulatory information (liens, bankruptcies)
- [ ] Business plans and projections
- [ ] Trade references
- [ ] Market and industry analysis
- [ ] Credit and loan app information (purpose of loan, amount requested, collateral offered)
- [ ] Ownership and management profile (ownership, stakeholder etc.

Account Review Criteria

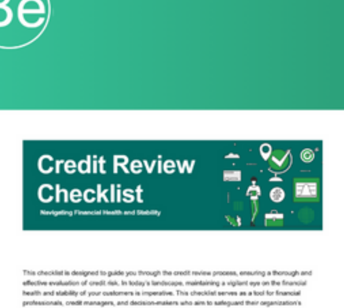
- [ ] High credit utilization
- [ ] Customer drops in risk rating range
- [ ] More than 6 months since last evaluation
- [ ] Not active or has no recent activity
- [ ] AR balance exceeding credit limit repeatedly
- [ ] Contains a general good standing pay history
- [ ] Consistent late payments
- [ ] Irregular payment patterns (financial stress)
- [ ] Request for credit increase
- [ ] Industry or economic changes
- [ ] Change in business ownership/management
- [ ] Sudden changes in spending patterns
- [ ] Customers facing legal challenges
- [ ] Request for extended payment terms
- [ ] Reduction or avoidance in communication

By using these criteria, Credit Departments can proactively manage credit risk, adapt to changes in customer behavior or circumstances, and make informed decisions about credit terms. It's also beneficial to leverage technology and analytics to systematically identify accounts that meet these criteria, ensuring a consistent and efficient review process.

Take the next step: Enhance your credit management.

Dive deeper into safeguarding your organization's financial future with our comprehensive suite of credit management tools and resources. Whether you're looking to refine your credit policies, streamline workflows, improve risk assessment techniques, or stay ahead of market trends, we have the expertise and tools you need to succeed.

Get personalized advice and insights from industry leaders to optimize your credit management strategies. Learn more at Bectran.com



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