

Article # 1060

Technical Note: Understanding the Customer Finance Charge Feature

Difficulty Level: Beginner Level AccountMate User

Version(s) Affected: AccountMate 12 for SQL and Express
AccountMate 11 for SQL and Express
AccountMate 10 for SQL, Express, and LAN
AccountMate 9 for SQL, Express, and LAN
AccountMate 8 for LAN

Module(s) Affected: AR

Posting Date: 04/21/2021

Finance charges are additional fees imposed for nonpayment of obligations within a specific period. AccountMate calculates and applies finance charges on past-due invoices based on parameters set in the **AR Module Setup**, **Pay Code Maintenance**, and **Customer Maintenance** functions. The following parameters determine whether finance charges will be applied:

Function	Field/Checkbox
AR Module Setup > Finance Charge Tab	Charge Period (Days)
AR Module Setup > Finance Charge Tab	Minimum Statement/Invoice Balance
Customer Maintenance > Settings Tab	Apply Finance Charge
Pay Code Maintenance	Eligible for Finance Charges
Create Invoice	Invoice Due Date (calculated using Invoice Date and Net Days value of the Pay Code assigned to the invoice)

Requisites for Finance Charge Application

Finance charges will be applied only when all of the following conditions are met:

1. The Customer must be set up to Apply Finance Charges.
2. The outstanding invoice must be assigned a Pay Code that is Eligible for Finance Charges.
3. The date when the finance charge will be applied must be after the invoices have become due.
4. Finance charges will be calculated only for those invoice or statement balances that have reached the minimum balance specified in the **AR Module Setup > Finance Charge** tab.

To illustrate how AccountMate selects the invoices that will be applied finance charges, consider the example provided below:

Example 1: Requirements to Qualify for Finance Charge Application

Given:

Apply Date = 02/06/2021
Days Interval = 30 days
Charge On Past Due Invoice Balance
Minimum Invoice Balance = \$400

Customer A = set to Apply Finance Charge
Invoices for Customer A:

Invoice#	Balance	Due Date	Pay Code
1001	\$450	12/12/2020	Not Eligible for Finance Charges
1002	\$390	12/01/2020	Eligible for Finance Charges
1003	\$420	11/30/2020	Eligible for Finance Charges
1004	\$410	12/10/2020	Eligible for Finance Charges
1005	\$475	02/07/2021	Eligible for Finance Charges

Customer B = not set to Apply Finance Charge
Invoices for Customer B:

Invoice#	Balance	Due Date	Pay Code
1006	\$500	12/31/2020	Eligible for Finance Charges

Solution:

Finance charges will be applied only to Customer A's invoices since Customer B is not set up to be eligible for finance charges.

Among Customer A's overdue invoices, finance charges will be applied only to Invoice #s **1003** and **1004**. No finance charges will be applied to the rest of the invoices due to the following:

- Invoice # 1001 uses a pay code that is not eligible for finance charges.
- Invoice # 1002 has an outstanding balance that is less than the minimum requirement.
- Invoice # 1005 is not yet due as of the apply date.

Finance charges calculation

The finance charge amount depends upon the values entered and options chosen in **AR Module Setup** for the following:

- Charge on Past Due Statement Balance vs. Charge on Past Due Invoice Balance
- Percentage Rate vs. Fixed Amount
- Minimum Charge Amount
- Charge on Outstanding Finance Charge
- Apply Payment to Finance Charge Balance First

When a user decides to charge on outstanding **Invoice Balances**, AccountMate will compare the minimum balance requirement against the outstanding balance of each qualified invoice for a qualified customer. This is clearly illustrated by the scenario provided under Example 1.

When the user decides to charge on outstanding **Statement Balances**, AccountMate will sum up the outstanding balances of all qualified outstanding invoices for a qualified customer. The result will then be compared against the minimum statement balance requirement.

Example 2: Charge on Past Due Statement Balance

Given:

Same scenario in Example 1, except that the finance charges will be applied to the past due statement balance, and the *minimum statement balance requirement is set at \$1,250*.

Solution:

Though Customer A is eligible for application of finance charges, the outstanding customer statement balance does not meet the minimum balance requirement. Among the various overdue invoices, Invoice #s **1002**, **1003** and **1004** are qualified as chargeable invoices. The sum of these three invoices is \$1,220, which is \$30 short of the minimum statement balance requirement of \$1,250; thus, no finance charges will be applied to Customer A.

Finance charges may be applied as a fixed amount or as a percentage of the chargeable balance; depending upon the settings you set up in the **AR Module Setup > Finance Charge** tab.

When finance charge is applied as a percentage of the statement balance or invoice balance, a **Minimum Charge Amount** can be specified. When the calculated charge is lower than the minimum charge amount, AccountMate will apply the minimum charge.

Example 3: Calculating Finance Charge as a Percentage of the Chargeable Balance with a Minimum Finance Charge Amount Set

Given:

Same scenario in Example 2, except that the minimum statement balance requirement is set at \$1,000 with the following additional parameters:

Charge Percentage = 2%
Minimum Charge Amount = \$30

Solution:

The calculated finance charge will be \$24.40 (2% of the sum of \$390, \$420 and \$410). The finance charge that will be applied, however, is \$30 as the calculated value is lower than the minimum charge amount.

Finance charges are usually applied only to the outstanding balance from the principal obligation; however, it may also be charged on finance charges previously applied to an outstanding obligation.

Example 4: Calculating Finance Charges on Outstanding Finance Charges

Given:

Same scenario in Example 3 except that a finance charge amount of \$30 was previously applied.

Solution:

AccountMate will calculate the finance charge as follows:

Charge on Invoice # 1002 = 2% x \$390 = \$ 7.80	
Charge on Invoice # 1003 = 2% x \$420 = \$ 8.40	
Charge on Invoice # 1004 = 2% x \$410 = \$ 8.20	
Charge on Finance Charge = 2% x \$30 = <u>\$ 0.60</u>	
Total Calculated Charge	\$25.00
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The actual finance charge to be applied will still be \$30 as the calculated finance charge is less than the minimum charge amount.

Payments will reduce the chargeable balance in the finance charge calculation when these are first applied to the principal obligation; however, the calculation will slightly differ if the following conditions are present:

1. Payments are first applied to the finance charge balance (**Apply Payment to Finance Charge Balance First** checkbox is marked in the **AR Module Setup > Finance Charge** tab); and
2. Finance charges are calculated based on the principal obligation only (**Charge on Outstanding Finance Charge** checkbox is not marked in the **AR Module Setup > Finance Charge** tab.)

To illustrate the conditions above, consider the example below:

Example 5: Calculating Finance Charges when Payments are First Applied to Finance Charges

Given:

The scenario is similar to the one described in Example 3 with the following additional information:

Minimum Charge Amount = 0
Finance Charge Previously Applied = \$25
Total Payment Received from Customer A = \$15

Calculate the finance charges when (5.a) payments are first applied to the principal obligation; (5.b) payments are first applied to the finance charge.

Solution:

- a. If payments are first applied to the Principal Obligation, the calculation will be as follows:

Invoice # 1002	\$390
Invoice # 1003	\$420
Invoice # 1004	<u>\$410</u>
Gross Chargeable Amount	\$1,220
Payments	<u>(\$ 15)</u>
Net Chargeable Amount	\$1,205
Charge Percentage	<u>x 2%</u>
Calculated Finance Charge	\$24.10
	=====

- b. If payments are first applied to the Finance Charge, the calculation will be as follows:

Invoice# 1002	\$390
Invoice# 1003	\$420
Invoice# 1004	<u>\$410</u>
Gross Chargeable Amount	\$1,220
Payments	<u>(\$ 0)</u>
Net Chargeable Amount	\$1,220
Charge Percentage	<u>x 2%</u>
Calculated Finance Charge	\$24.40
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Notice that there is a \$0.30 difference (\$24.40 - \$24.10) in the calculated finance charges. The variance is caused by the payment that is applied to the finance charge ($\$15 \times 2\% = \0.30).

Posting Finance Charges

Regardless of the **Apply Date** used when the finance charge is created, AccountMate will apply each finance charge to each **Charge Period** that has not yet been applied. If you have not applied finance charges for about three charge periods, the next time you apply finance charges, the finance charge application will be intended for the first of the three periods that you missed. Each application will generate a finance charge for only one charge period. Consider the example below.

Example 6: Timing of Finance Charges Applied

Given:

An invoice that was due on 01/05/2021 is eligible for a finance charge of 2% on the outstanding balance of \$250. Finance charges are to be applied at 30-day intervals. You applied finance charge on 01/10/2021 but failed to apply finance charges thereafter. The current Apply Date is 04/10/2021.

Solution:

Regardless of the apply date, AccountMate will calculate the applicable finance charge for 02/09/2021 (30 days from 01/10/2021). If you wish to apply finance charges all the way to April, you will need to run the function two more times to apply finance charges for the chargeable periods of 03/11/2021 and 04/10/2021.

If the finance charge is applied to the **Statement Balance**, AccountMate treats each finance charge as a separate invoice transaction. These finance charge transactions are shown as separate invoices with an invoice number of "FCHG" in the customer record. If the finance charge is applied to the **Past Due Invoice Balance**, the finance charge will be embedded to the past-due invoice amount of the original invoice to which it was applied.

Journal Entries

When finance charges are applied, an entry is created to increase the balance of the **Interest Income** GL Account ID set up in **AR Module Setup** and the customer's **Accounts Receivable** GL Account ID. The journal entries created will be posted to General Ledger in the period that corresponds to the **Apply Date** specified when the finance charges were generated.

Finance Charge Reports

Finance Charge Report – generate this report to obtain details about all the finance charges applied in AccountMate
AR Status Report – generate this report to view a list of all paid and unpaid finance charges.
Finance Charge Exception Report – generate this report to obtain the list of AR invoices that contains only finance charges.

Familiarize the finance charge setup and how each setting works to tailor-fit your finance charge schemes according to your company's policies and procedures.

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