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CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	HR 2.0: A SOCIAL MEDIA BASED FRAMEWORK FOR EMPLOYEE ENGAGEMENT <i>ANUJ SHARMA & ABHISHEK TOTAWAR</i>	1
2.	CHALLENGES FACED BY ACCOUNTING ACADEMICS <i>AHESHA SAJEEWANI PERERA</i>	6
3.	THE EFFECT OF EXECUTIVE BOARD AND OWNERSHIP CONTROL ON QUALITY OF ACCOUNTING EARNINGS <i>MOHAMMADREZA ABDOLI, ALIREZA MEHRAZIN & EBRAHIM DEHROUYEH</i>	10
4.	MALAYSIAN REAL ESTATE INVESTMENT TRUSTS (M-REITS) AND THE FINANCIAL CRISIS: A PERFORMANCE AND COMPARATIVE ANALYSIS <i>NAI-CHIEK, AIK</i>	13
5.	ASSESSMENT OF RECEIVABLES MANAGEMENT OF MANUFACTURING COMPANIES IN ETHIOPIA <i>Dr. D. GURUSWAMY</i>	19
6.	IMPACT OF SOCIO ECONOMIC VARIABLES ON THE FOREST AREA OF PAKISTAN (1972-2005) <i>DR. NAILA NAZIR & DR. ABDUL QAYYUM KHAN</i>	23
7.	THE IMPACT OF NON-PERFORMING ASSETS ON THE PROFITABILITY OF INDIAN SCHEDULED COMMERCIAL BANKS: AN EMPIRICAL EVIDENCE <i>DR. N. KAVITHA</i>	27
8.	EVALUATING SERVICE PERFORMANCE OF ADVERTISING FIRMS: STUDY ON BANGLADESHI ADVERTISING COMPANIES <i>MD. MONIRUZZAMAN SARKER & NAFISA KASEM</i>	31
9.	SOCIOECONOMIC ANALYSIS OF POVERTY INCIDENCE AND FOOD INSECURITY IN KANO STATE-NIGERIA: 1990 - 2007 <i>DR. AHMAD MUHAMMAD TSAUNI</i>	35
10.	A MODEL SUPPLY- CHAIN MANAGEMENT FOR AUGMENTING MORE INCOME TO BASMATI FARMERS – FARMER EMPOWERMENT <i>NAVNEESH SHARMA</i>	40
11.	THE MICROFINANCE, ENTREPRENEURSHIP AND SUSTAINABILITY AS AN EFFECTIVE TOOLS FOR REDUCING POVERTY IN INDIA <i>DR. RAJNALKAR LAXMAN, AKRAM BASHA SAHEB B & DR. CHANNABASAVANAGOUDA P</i>	44
12.	MANAGING MULTICULTURAL ENVIRONMENT IN INDIAN IT SECTORS <i>DR. R. KARUPPASAMY & C. ARUL VENKADESH</i>	48
13.	IMPACT OF BASIS RISK ON THE PERFORMANCE OF RAINFALL INSURANCE SCHEME FOR COFFEE: A PERCEPTUAL ANALYSIS <i>M. PRABHU, D. P. SHIVAKUMAR & DR. G. KOTRESHWAR</i>	52
14.	WIDELY FLUCTUATING RUPEE AND ITS IMPACT ON INDIAN EXPORT PERFORMANCE FOR THE LAST TEN YEARS FROM 2000 TO 2009 <i>S. RAMESH KUMAR MEHTHA, AVINASH DEOSTHALI & VIJAYSHRI R. MEHTHA</i>	56
15.	CORPORATE FINANCIAL DISTRESS – AN EMPIRICAL STUDY <i>DR. V. K. SHOBHANA & DR. N. DEEPA</i>	62
16.	WOMEN IN MANGEMENT <i>DR. R. SAVITHRI</i>	66
17.	INDIAN BRANDS IN THE INDIANS' CONTEXT <i>J.J. SOUNDARARAJ & DR. D. V. S. JANAKIDAS</i>	68
18.	STRESS-WORK LIFE BALANCE - PSYCHOLOGICAL WELLBEING OF WOMEN MECHANICS IN BMTC <i>ROHINI SHIVANANDA & DR. ASHOK H. S.</i>	72
19.	DEPTH OF OUTREACH OF SELF HELP GROUPS - A STUDY OF SBS NAGAR DISTRICT OF PUNJAB <i>RUPNEET KAUR RANDHAWA & DR. PARAMJIT KAUR</i>	76
20.	EMPLOYEES JOB SATISFACTION: A STUDY OF PRIVATE PROFESSIONAL COLLEGES IN HARYANA STATE <i>ANIL KUMAR & NEELAM RATHEE</i>	82
21.	RECRUITMENT AND SELECTION PRACTICES ACROSS CULTURES <i>RADHIKA MADAN</i>	87
22.	FINANCIAL ANALYSIS OF TATA STEEL LTD- A CASE STUDY <i>BHARGAV H. PANDYA</i>	93
23.	CONTEMPORARY APPROACH TOWARDS EVALUATION OF SUSTAINABLE TOURISM DEVELOPMENT: A CASE STUDY OF GOA <i>SHAMIMA AKHTAR & ABRAR M SHAH</i>	98
24.	CUSTOMER SATISFACTION WITH SERVICE QUALITY: AN EMPIRICAL STUDY OF PUBLIC AND PRIVATE SECTOR BANKS IN TIRUPATI REGION <i>V. G. MURUGAN</i>	106
25.	GREEN BANKING: A UNIQUE CORPORATE SOCIAL RESPONSIBILITY OF INDIAN BANKS <i>MUKESH KUMAR VERMA</i>	110
	REQUEST FOR FEEDBACK	115

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RESULTS & DISCUSSION

FINDINGS

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ASSESSMENT OF RECEIVABLES MANAGEMENT OF MANUFACTURING COMPANIES IN ETHIOPIA

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ABSTRACT

The sale of goods on credit basis is an essential part of modern competitive economic system that is used to attract customers and to increase profit. Since credit sales are used to increase sales volume, receivables created due to credit sales are important tool through which the firm competes in its industry either to maintain or to increase its market share. If the credit policies and procedures of collection are successful, receivables are the main source of revenue and help the organization to ensure timely collection of receivables and to minimize losses from uncollectible accounts. Granting credit and creating debtors amount are blocking the firm's fund and as substantial amounts are tied up with receivables, it needs effective and careful analysis of credit management. This implies that there is lack of understanding the correct procedure for management of receivables of the organizations. Therefore, this study is primarily concerned with the receivables management of Mesfin Industrial Engineering Plc in order to assess whether there is a proper understanding of the correct procedure for management of receivables or not.

KEYWORDS

Credit sales, Receivable Management, Manufacturing Companies, Mesfin Industrial Engineering.

INTRODUCTION

In the world, different organizations exist which run business activity in order to maximize profit. The sale of goods on credit basis is an essential part of modern competitive economic system that is used to attract customers and to increase profit. Since credit sales are used to increase sales volume, receivables created due to credit sales are important tool through which the firm competes in its industry either to maintain or to increase its market share. If the credit policies and procedures of collection are successful, receivables are the main source of revenue and help the organization to ensure timely collection of receivables and to minimize losses from uncollectible accounts. Having these benefits and costs of receivables, the present study is focused on the management of receivables in Mesfin Industrial Engineering PLC.

Mesfin Industrial engineering (MIE), which is run under the ownership of Endowment Fund for the Rehabilitation of Tigray (EFFORT), was founded in 1992 with an initial paid up capital of Br. 3 million and authorized share capital of Br. 10 million. The authorized share capital is 500,000 ordinary shares with per value of Br. 20 each. Today the authorized share capital is fully paid in cash and contribution in kind. The major shareholder is the parent company and holds 484,999 shares out of the total authorized shares.

The name of the company Mesfin is taken from a former heroic TPLF fighter who was fighting for the freedom of his people. MIE was initially established as an engineering company to design, manufacture, educate workers for mining, energy construction, agricultural, and transport sectors. Even though during its infancy the company involved in rendering support to workshops and small business as well as in reconditioning engines. MIE's major objective was to establish a capable industrial engineering firm and equipment manufacturer that would play a critical role in the country's industrial development. Now a days the company has become the leading manufacturing company in East Africa that produces diversified products, which are used by various industries and other customers. The company is producing its products under a shaded facility of more than 35,000 within 120,000 plots of land. It is equipped with state of art technologies including computerized pantograph and specialized mega rolling plant. MIE has grown well and achieved satisfactory results owing to its basic competitive advantages that are attributable to its distinctive competencies.

The company has competitive advantage over its competitors mainly on two areas. First MIE has latest equipment and machineries with up to date technology, which is imported on continuous basis. Second, the company has motivated and qualified human resources. Hence, efficiency in human resources is one of the drivers of competitive advantage.

In order to help the company to compete successfully in today's competitive market, MIE has well qualified and trained workers such as engineers, certified welders and quality assurance experts. It also has material testing laboratory, which is equipped with modern equipment and Instruments including radiographic testes. It also has concrete batching plants, trans-mixers, tippers and other construction equipment. It also involved in the manufacture and construction of steel bridge and steel buildings.

It is also with annual capacity of 3,000 trailers and semi trailers, and biggest single trailer manufacturer in Africa. It designs and manufactures vehicle bodies, trailers as well as high and low bed semi trailers. Currently the company has 1495 workers and owns four factories.

1. Vehicle Equipment and Trailer Factory (VETF)
2. Industrial and Construction Equipments, and Electromechanical Workers (ICEEMLW)
3. Automotive Assembly Factory (AAF)
4. Vehicle Maintenance and Rent department (VMR)

The name of the factories is self explanatory as to what each factory produces. Details of products that the company produces and intends to produce are listed below together the discussion of the companies objectives. Previously MIE has not clearly defined vision, mission, and objectives. But now it has established strategic vision, mission and objectives, these are presented below.

VISION OF MIE

Basically, the vision of MIE stems from the vision of EFFORT, and these are:

- To be successful competitor in the global market
- To be on the line of continual development and improvement
- To be a good example of corporate citizen in the engineering.

MISSION OF MIE

To maximize the wealth of EFFORT by continually earning profit

EFFORT has established various profits generating organization in order to perform its activities successfully and on a sustainable manner. Like the other organizations, which are organized under EFFORT, MIE is engaged in profit generating areas. It is obvious that MIE cannot involve in activities, which do not yield revenue and play no role in EFFORT's wealth maximization.

ENVIRONMENTAL DEVELOPMENT

Though MIE is involved in profit generating activities so as to meet the objective of EFFORT, it believes that the areas of activities that the company undertakes should contribute to the development of the environment. Moreover the activities should create working environment for local development partners and that create job opportunity for citizens.

OBJECTIVES OF MIE

- MIE produces products that promote government policies, enhance farmers' productivity and agro processing activities and create favorable market condition sustainable base.
- Production of construction and handling equipments such as crushing plants, asphalt batching plants, concrete batching plants and earth moving machines.
- Rendering industrial maintenance to all organizations under EFFORT and all factories in Ethiopia. Such services include mechanical maintenance repair service, electrical repair service and electronics repair service.
- Under taking the electromechanical and steel structure erection services like electromechanical erection of factories and components, such as, components for cement, brewery, textile and tannery factories etc. production of different spare parts such as: ducts conveyor, hopper, silos, overhead crane, waste water treatment plant, multipurpose storage tanks and different spare parts.
- Production of different types of equipment that serve for hydropower generation transmission and distribution such as: Penstock, gets, generators turbines, transformer, transmission towers, distribution towers.

STATEMENT OF THE PROBLEM

Credit grants as marketing tools are intended to promote sales and thereby profits. However, extension of credit involves risk and costs. The customers who buy on credit may be risky to pay on the due date and granter incurred different kinds of costs like collection costs, capital cost and bad debt expense. So that costs should be analyzed with profits. Granting credit and creating debtors amount are blocking the firm's fund and as substantial amounts are tied up with receivables, it needs effective and careful analysis of credit management. This implies that there is lack of understanding the correct procedure for management of receivables of the organizations. Therefore, this study is primarily concerned with the receivables management of Mesfin Industrial Engineering Plc in order to assess whether there is a proper understanding of the correct procedure for management of receivables or not. And also to the best of the researcher's knowledge, there is no previous research study in "Assessment of Receivable Management of Mesfin Industrial Engineering Manufacturing Company".

OBJECTIVE OF THE STUDY

1. To see the accounting issues relating to receivables management.
2. To show the importance of proper credit and collections policy.
3. To identify the credit standards those are used in the organization.

SIGNIFICANCE OF THE STUDY

This paper is useful because it discusses the effect of not having proper credit and collection policy but also analyses the effect of having large of receivables for long period of time. It is also helpful to evaluate and recommend the procedures and management of credit policy of manufacturing companies.

METHODOLOGY

This research work was designed as a case study type with the purpose of analyzing receivable management in Mesfin Industrial Engineering Manufacturing Company. The judgmental sampling technique was used in order to select the employees for conducting interviews. Both secondary and primary data sources were used. The secondary sources of the data for this was from Financial Statements of the company, news papers, articles and books. The primary data was collected through interviews with purposely selected employees of the company who are working related to managing receivables. The researcher has also made physical observation on the documents utilized in the company.

SCOPE OF THE STUDY

This paper was concerned only receivables management of MIE typically accounts receivables and special emphasis is given to bad debates, credit policy and collection procedures.

LIMITATIONS OF THE STUDY

The study was limited to conduct at MIE head office, Mekelle and the data was collected from the head office only. The study period was limited from 2006 to 2009.

DISCUSSION AND ANALYSIS

This part focuses on the analysis and discussion of the data collection from both primary and secondary source about management of receivables of Mesfin Industrial Engineering.

RECEIVABLES AND THEIR CLASSIFICATION

Receivables include various receipts from clients and other entities; the party against whom the firm has claim settles them through payment of cash or assets or else provision of service. Based on the time they are outstanding, receivables can be classified as current and non-current. If they are expected to be collected within a period of one year or current operating cycle they are called current receivables. Otherwise, they are non current receivables. Receivables can be classified in the balance sheet as trade and non trade receivables.

Receivables of MIE are classified in the chart of accounts of the company into four groups. These are trade debtors, staff debtors, sundry debtors and sister companies (to mean receivables from sister companies). Each group is controlling account for a number of subsidiary ledger accounts. It can be shown on the following of table-1.

TABLE-1: GROUP OF RECEIVABLES AND THEIR ACCOUNT NUMBER

Account No	Account Description	Account Type
1330	Staff debtors	Account Receivables
	Trade Debtors	Account Receivables
	Sundry debtors	Account Receivables
	Sister companies	Account Receivables

Source: The Chart of Accounts of MIE

The term debtor represents claims against other parties arising from operations of the company so it has equivalent meaning to the term receivables. For example staff debtors designate claim from employees of the company. This classification is not in accordance with how receivables are classified in many books

for financial statements purpose as reviewed easier. Basis of classifying receivables as trade and non trade or current and non-current are not taken in to accounts.

MIE'S receivables are classified according to the nature of the initially recorded transaction made with specific party or customer. If the first transaction is related to the ordinary business activity, it is recorded as trade debtor on the other hand. If a given customer initial transaction is not related to the ordinary business of the company his/her account is always maintained under the group of receivables called sundry debtors, again in this case it does not matter what the nature of subsequent transaction made between the customer and the company.

Receivables of any nature that are due from sister companies are categorized as receivables from sister companies with account number 1330. As the receivables from these grow from time to time, MIE realized that maintaining a separate account for them is helpful in managing and controlling its receivables. Staff debtors are another group of receivables which are claims against the staff (employees) of the company included in this category are salary advances, business advance, loans, premium advances and medical advances with separate respective subsidiary ledger account. Staff debtors arise when MIE gives money to its employees either in the form of advance or loan on a refundable basis.

FACTORS TO BE CONSIDERED IN VALUATION AND RECOGNITION OF RECEIVABLES

Recognition and valuation of receivables are crucial accounting issues that warrant due attention. In recognizing receivables, at time of recording transactions, factors such as discounts, returns and allowance should be considered when receivables are valued. Factors to be considered are uncollectible account receivables. They are recorded and reported on the balance sheet at a value equal to total accounts receivables less allowance for uncollectible accounts. Almost all of the factors mentioned above are taken into account when MIE's receivables are recognized and valued. One exception is sales returns and allowance. This factor is not considered and even not experienced by the company. This may be perhaps, because MIE produces most of its products on Job order basis so that product specifications are met.

In addition the above mentioned factors in recognizing receivables of MIE, the company follows that a number of factors are considered in the valuation of prospective cash inflows from receivables. One factor is the profitability of the company that receivable actual will be collected. For specific receivables of the company this will be difficult, but for large groups of receivables, can be estimated. Another factor the considered is the length of time until collection.

Accordingly, to bourn profitability of the company MIE gives more credit than other factory in Ethiopia. On average, 80 million and above credit is given to customers.

The following table is described the amount of birr given to the customers.

TABLE-2: CREDITS GIVEN TO DEBTORS

No	2006	2007	2008	2009
Amount (birr)	109 million	101 million	84 million	114 million

Source: Financial Statements of MIE (Various Issues)

ANALYSIS OF MIE'S UNCOLLECTIBLE

MIE has large number of customers spread all over the country. This is associated to the fact that the company uses credit sales as a means of expanding its market share and boosting its sales volume. Ofcourse for most customers it would also be difficult to pay their bills on time of the sale like any other business forms MIE cannot make a total (100 %) collection of credit sales. In effect, as the volume of credit sales increase the risk of uncollectible also rises at the same time.

Review of the financial statements of the company reveals that bad debts have shown an increasing trend for the last years. This can be shown on the following table.

TABLE-3: UNCOLLECTIBLE BY VOLUME YEAR AND PERCENTAGE

Bad debts				
No	Fiscal year	Amount in birr	As %of total	% increase or decrease
1	2006	5,746,388	16.50	-
2	2007	7,300,000	20.96	3.71
3	2008	9,689,822	27.82	6.81
4	2009	12,091,082	34.72	6.85
Total		34,827,292	100	-

Source: MIE Financial Statements (Various Issues)

The above table shows that the magnitude of uncollectible increases from year to year. Bad debts have increased by 3.71, 6.81 and 6.85 % in the fiscal years 2007, 2008 and 2009 respectively. In addition the table shows the increase in bad debts by companying each year's bad debts to that of four years total. Bad debts in 2007, 2008 and 2009 occupy 20.96, 27.82 and 34.72 percents of the sum (total) respectively. Specifically in these two years (2008 and 2009) there is high increasing in bad debts and this shows increase in sales volume, which is an indication of growth and in parallel increase in receivables. It shows that here are some customers who do not pay according to the contract. At this juncture the company should take necessary legal actions against the client who fail to pay within due date. Because of various reasons, MIE does not need to institute a legal action up on its customers, but the company could not consider the time valve of money by extending its credit sales.

Rather it loses a considerable sum of receivables, which could not be earned in short period of time. These receivables are outstanding receivables not for months farther for years.

Of the uncollectible accounts in the table above, the 6 (5.75) million is already written off, because of its uncollectible. In addition the 7.3 million is also in court process. In this case the company profitability is decreasing from time to time.

ACCOUNTING AND FINANCIAL POLICIES FOR RECEIVABLES OF MIE

Accounting and financial policies are crucial to any business firm to maintain consistent accounting and financial methods. Techniques and procedures, consistent accounting procedures are prescribed by GAAP to be adhered when preparing financial reports MIE as a business entity has developed accounting policies. The accounting manual specifies such policies and procedures. The accounting policy of MIE covers many aspects of accounting activities practiced by the company.

This does not mean that those policies cover every point regarding the accounting task of the company. The credit policy of the company specified in the marketing and sales manual describe few points about credit standards on the bases of which of credit customer should be selected. These are listed bellows

- Credit sales shall be given to upon and after careful consideration and evaluation of company liquidity, quantity advantage, credit worthiness of buyer, product shelf life and other factors.
- For credit sales legally accept contract agreement/purchase. Orders shall have to be received from the buyer.

MIE has clear credit and collection policies. However, those credit policy some projects are not fully applied in practice and, variables like credit term, which includes credit period and discount techniques and collection, are missing. Hence, it is possible to say that MIE has clear credit and collection policy but not fully practiced.

COLLECTION METHODS OF RECEIVABLES IN MIE

Although the company has clear credit and collection policies, it does not fully apply in all projects of the company. It is already experiences the costs and benefits related to credit sales. The presence of credit sales indicates that the importance of collection efforts, which gives rise to a position of the cost of credit sales these collection efforts necessitate some level of expenditure.

The level of expenditure varies depending on the methods of collection employed. The methods of collection practiced by MIE are letters, telephone calls, personal visit and legal action. Collection letter is used as a first step in the process a formal letter that clearly indicates the amount that appears in the customer's account in four or MIE, together with statements of account is sent to the customer.

If efforts through letter seem to fail telephone calls are made to discuss with the customers on the issue. If the money is not collected yet, a cashier is sent to the customer's premises and collects the money intact on the spot. If all these efforts seem to be fruitless a legal action is taken as a last resort.

IMPORTANCE OF RECEIVABLES IN MIE

Receivables refer to amounts due from individuals and others companies or they are manual claims expected the collected on cash against people and organizations. If all take attention, because they are immediate source of cash for the company. If it is moneyed efficiently it attracts customers and bourn (expand sales volume) of the company according to the response of the finance manager of the company.

The finance manager added that unless they are properly moneyed and controlled, the company will suffer firm huge losses and even the company will not be able to finance its operations properly. In addition, poor screening of applicants and in efficient collection policy may result in large loss.

Hence, the finance manager concludes that strong accounting controls and effective management of receivables are typical characteristics of MIE currently.

INTERNAL CONTROL OVER RECEIVABLES

The task of recording credit sales and collecting accounts receivables should be separated from cash related tasks such as handling cash receipts and preparing bank reconciliation. If a single person carries these tasks control could be lacking.

- In MIE accounting and financial tasks are well segregated the tasks of recording sales and accounts involved in cash related activities and bank reconciliation. All the accounting records are done at the general accounts division of finance department. The actual cash receipts, deposits, withdrawal and disbursements are made by the cashier who has a separate office from the general accounts division recording subsidiary ledger accounts and general ledger are also done by different employees. So that the work as one could be reconciled against that of the other.

Credit is usually approved by three persons on MIE, i.e. up to 20000 by the finance head, up to 500000 by the DGM (deputy general manager) and above 500000 by the general manager a delegated party, but the task of sales person is just kindling customers and inform to the management. Hence the sales person is not involved in credit approved. Because MIE has no separate credit department adjustments for subsequent valuation of receivables are made by higher bodies in the firm. All these procedures are helpful in controlling accounts receivables. For the purpose of efficient management of receivables, according to their segregated responsibility on the company (MIE) on time invoicing, on time reconciliation, aging uncollectible doubtful accounts and application of appropriate accounting policies like ERP (Enterprise Resource Planning) are introduced and by finance department or MIE and applied in Mekelle (head office) and in Emad (its garage). In addition it controls its credit risk by ascertainment of credit worthiness of its customers, monitoring of debt on continuous basis and by applying credit limits to its customers.

MAJOR CAUSES FOR UNCOLLECTIBLE ACCOUNTS IN MIE

The major valuation problem in MIE is to evaluate the property that customers will pay their accounts. When goods or service are sold without immediate receipt of cash, apart of the claim against customers usually proves to be uncollectible.

According to the interview with the finance head of the company the major causes for the uncollectible accounts are in efficient control mechanism because the screening of credit customers is not effective in the company. Due to this the company follows negation mechanism to collect its credit sales.

CORE CONSTRAINTS FOR UNCOLLECTIBLE IN MIE

Bankruptcy are the debtor or some other problems of are debtor is one of the most positive indications of particular total worthlessness of receivables on the company. The most core constraints of the company to collect the uncollectible accounts are legal process (court process) e.g. in legal process it takes for more than stress to collect the uncollectible accounts. Due to this company takes an action to be write offs the doubtful accounts. According to the financial statement 2009 of the company write offs from the previous year uncollectible accounts amounted 5746368.

CONSEQUENCES OF POOR MANAGEMENT OF RECEIVABLES IN MIE

When the receivables of the company are not collected on the specified period, it cause a long term for legal court case and high cost for all actions and follow ups. Finally, if this process is not successful, it may cause liquidation of the general company.

CONCLUSIONS

The purpose of this paper is to examine management of receivables in MIE. Receivables of MIE are classified in to four groups: trade debtors, staff, debtors, sundry debtors and sister companies.

Sister companies are group of receivables recently established. The classification of receivables in MIE is not as trade or non-trade receivables. It's based on the initial transaction. If initial transaction made between the company and customer is purchase of company's products or services than the customer's account is classified as trade debtors other with it is classified as sundry debtors.

MIE considers all receivables as account receivables as evidenced by the chart of accounts newly developed. In MIE, returns and allowances are not common uncollectible of the company are estimated by selecting some customers, which the company believes, are going to default payment and adding their account balances.

This practice matches neither the direct write off nor allowance method of recording uncollectible. The company's accounting manual fails to include the method and procedures used to manage and control receivables and related uncollectible. Without phase policies it is very difficult to manage receivables effectively and efficiently. In practice, the company has very liberal credit policy to sister companies but very strict credit policy for other customers. But it introduces new accounting method i.e. enterprise resource planning and applied in Mekelle head office and its part of the company.

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