

Best Practice/ Peter Charles/ Accountancy Age

Keeping an eye on cashflow

Only one way exists to avert a cashflow crisis. And that is to keep a close eye on the cash. If you think that sounds a statement of the obvious you would be astonished by how many organisation fail to monitor cash properly.

Monitoring cash properly means looking at cashflows on a weekly basis. It is unbelievable the number of companies I work for with who realise they are in financial difficulties and still fail to keep a perpetual watch on cash. 'A close eye' is weekly cashflow forecasts that are shared among all the directors and senior managers of the company.

One warning sign of an impending cash crisis is poor communication between the managing director and the finance director. Countless times I've seen managing directors create problems for their finance directors by making decisions which have an impact on cashflow, but failing to consult, or even tell, the FDs before they act. It is equally astonishing how many FDs have a great grip on cashflow, knowing what the balance at hand is, and what the likely receipts and payments are, yet fail to let on about the cash position to their senior colleagues. Keeping the cash balance in the FDs head will work when there isn't a problem. We have all been in the situation where we've shoved a cheque in our desk drawer to tide us over the month end or until a promised receipt finally arrives. And such tried and trusted methods are OK when all is well, but if there are problems there needs to be more transparent and formal procedures.

All advisers who start working for a new client should ask to see the cash flow forecast, even if that is not strictly part of their job. After all, accountancy firms may as well check that their clients are going to be able to pay them before they clock up the chargeable hours.

If your new client presents you with a weekly cashflow forecast that rolls out for the next 13 weeks and shows a good healthy cash position then you can probably rest assured that all is well. That is after you've done the most basic of checkings – such as a glance at the original bank statement.

If you are handed a annual cash flow which hasn't been updated since it was produced – maybe as much as a year ago – then you should start to feel a little nervous. An annual cash flow forecast has its place but as you come towards the end of the financial year, the directors should start to feel like medieval sailors as they set off across the sea armed with a map that said 'here be dragons'. Expect these days there is no excuse for such ignorance. Cash is a key indicator by which any business steers. If the directors don't have the measure of the cash, how they can manage it and the rest of the business? A number of my turnaround clients have been sound commercial propositions that simply ran out of cash.

And if the FD stares at you blankly or claims that he/she doesn't believe in such nonsense then after you have checked whether he/she is qualified you have got a choice: you can seriously think about resigning prior to starting the work or, perhaps more positively you can see a fee opportunity and offer to prepare a cashflow as an add on service.

While it is sound business practice to prepare a cashflow, it matters little in what way you prepare it. While off the shelf accounting solutions offer decent forecasting solutions, I am satisfied that a cashflow forecast is one of the reasons why the Excel spreadsheet was invented. Indeed there are good reasons for keeping the cashflow separate from the system that produces the budgeted profit and loss account and balance sheet.

Cashflow statements should be prepared from scratch they should not be fund flow statements in disguise that are knocked out from the P&L accounts by adjusting the timing on the receipts of cash from debtors and payments to suppliers and so on. A cashflow prepared that way risk missing items – payments to the revenue authorities and money shelled out for capital expenditure items are the most annoying – i.e. biggest – items you're likely to see omitted.

Owner managers and advisers could argue that their business/client does not need a rolling 13 week cashflow forecast prepared religiously every seven days. And for stable profitable, cash-generative businesses I would reluctantly agree. However, for those businesses it is imperative that a cashflow forecast is prepared whenever a significant commercial event occurs. For instance, when a business wins a new major customer after you've popped the champagne corks it's time to review the cash position. The new business may add to the bottom line but the cash may take a hit first. Businesses often forget that to fulfil the new contract they may need to increase stock levels, up the headcount, buy new machinery. In other words spend, spend spend before the cash starts flowing in.

More obvious changes that need a cash impact analysis are when big clients walk out of the door: or when the directors realises a product is doing badly; there is a change in the market or if they see a general slowdown looming; or if the company is embarking on a major capital expenditure programme, or acquiring another business. Hoping to luck and the overdraft is not enough.

Cash should also be managed more carefully if there is a major change to a business process. For instance, one client I worked with switched to an offshore solution away from suppliers it had worked with for years. Local suppliers were used to waiting a while every so often for payment. They knew they got paid. The new offshore solution wanted payment in advance and no deviation from the payment schedule. The effect on the cashflow in the short term was quite traumatic.

A classic sign of poor cash management is when businesses start squeezing the working capital other than cash – stock, debtors and creditors. Businesses need to know the limits for these procedures. Clearly businesses need clear, methodical procedures in place to ensure debtors pay in time. And if they do let debtors drift they need to tighten up. But

most business – especially smaller entities – can do little to squeeze payments out of debtors much faster. You may have more joy with creditors. Turnaround specialists spend a lot of time dealing with suppliers in a bid to sort of their troubled client. There are two key lessons in negotiating with suppliers. First if, as part of a solution to a cashflow crisis you want to delay payment by three weeks then ask for six, certainly in the UK. A very British negotiating stance is to split the difference. More seriously if you have negotiated a standstill then keep to the terms. Suppliers are remarkably patient as long as they know cash is coming. Most will welcome payment on account with open arms. But if you let them down you are unlikely to get a second chance.

The final warning sign is where businesses are having trouble with their basic bookkeeping and accounts. If the system isn't working –or whatever reason – then the accounts staff may be so busy posting to suspense accounts and trying to sort out reconciling items that they forget to manage the cash. A broken management system may lead onto problems with creditors- there may be unrecorded liabilities that will need paying, or the stock control system may be buckling which means stock levels will be either too high or too low. Either way any problem with the business will soon find its way into being a problem with cash.

Side Bar

A cautionary tale

Beware companies that are pre-occupied with their image, they may be less focussed on cash. My task for my first-ever client was meant to be putting in an accounting system to cope with their growth. The assignment turned into turnaround job. The international company had two floors of a large, smart office block. Outside a company flag fluttered on a flag pole. One floor was the showroom for the jewellery the company sold. The other floor included the company's reception, decorated entirely with marble. Had I pitched my fees too low? When I saw my office I realised I had. The office I was to use was big enough to dance in, the area outside would have held a five-a-side match. The view from the office looked down on the atrium where – yes, you guessed it – the fountain gently played.

An e-mail from my contact asked me to ascertain the cash position. My first port of call was the cashier. Despite the job title, he didn't actually handle cash management. Neither did the next person I was sent to, he looked after consolidations. Instead I was sent to the international accountant.

The schedule I received – several days later – was so riddled in errors it took nearly a month to get a grip on every bank account in every country and to reach a cash position. By which time further £2 million had gone through the bank account in terms of timing issues and reconciling items.

In fact the cash accounting was in such a mess that £5 million went through the cash book in terms of payments and £3 million in terms of receivables, hence the net £2 million. The complexity was appalling. There were bank accounts for each country/territory and for each trading division. The way that the finance department was

structured was also incomprehensible. No one seemed to have overall control and no had been charged with overall responsibility. It seemed to me to be a mess that could have been easily avoided. It was a pattern I've seen repeated countless times since.

By then the assignment turned into turnaround job. It was a good lesson to learn. Now every time I work for a new client, day one sees me checking out the short-term cash position and the systems for producing the most vital of numbers.

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