



Managing your firm through the global financial crisis

A Practical Guide To Surviving And Thriving In A Downturn

Managing your Cashflow

Volume 2

A tough economic environment can present challenges to business that will threaten their very survival. It can, however, also offer great opportunities for those organisations which are well prepared to weather the economic storm.



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Other topics in the “Surviving and Thriving in a Downturn” series include:

- Corporate Governance and Risk Management
- Using Strategic Analysis and Planning to Drive Business Improvements
- Succession and Retirement Planning
- The Carbon Economy

2 Surviving – Managing Your Cashflow

2.1 What is Cash Flow?

Cash flow is often mistaken to be represented by net profit. Profit and cash flow are not the same measure, and are often considerably different in any given reporting period. Cash flow is simply your total cash receipts for a period, less your total cash payments for a period. This simple 'in/out' concept, differs to the calculation of net profit.

Cash Flow \neq Profit

$$\text{Cash flow} = \text{cash receipts} - \text{cash payments}$$

$$\text{Profit} = \text{revenue} - \text{expenses}$$

1. Some revenue is not cash and some cash receipts are not revenue
2. Some expenses are not cash and some cash payments are not expenses

Cash is king. Businesses can be profitable but will still fail when they run out of cash. Broadly speaking, profit is a function of sales (received or not), cost of sales (paid or not) and expenditure (paid or not). Profit does not include capital expenditure (e.g. purchase of new equipment) or movements in balance sheet accounts (e.g. creditors). Profit includes non-cash items such as depreciation and amortisation.

Cash and profit must be co-managed. Whilst a business may record a healthy profit for the period, net cash flow can be drastically different, after you add in capital expenditure and balance sheet movements (e.g. making a large repayment on a loan).

The Corporations Act 2001 defines insolvency as when a company is unable to "...pay its debts as and when they fall due". Clearly then, to avoid liquidation, a business must be able to pay its bills as and when they fall due. This is dependent upon having the cash on hand to do so.

Directors of companies that incur debts when they know there is little likelihood of the debt being repaid can be held personally liable for debts. In addition, there may be criminal consequences that arise in incurring such debts.

Cashflow management is critical for a business's success. This is further heightened in times of economic turmoil. Below are some indicators that your business may be experiencing cash flow problems.

Businesses fail when they run out of cash.

2.2 The Elements of Cash Flow

This section presents the elements that will affect your businesses cash flow, together with some tips on how to improve each element.

Figure 1: Balances Affecting your Cash Flow

Cash flow is affected by the level of your business:			
Working Capital			Other Capital
<p>Inventory</p> <ul style="list-style-type: none"> ■ There is a cost associated with holding inventory, ordering inventory and being short of inventory. ■ Businesses attempt to minimise these costs with inventory control 	<p>Debtors</p> <ul style="list-style-type: none"> ■ The longer your money is in the pockets of your customers, the longer your business has to fund their investments through other means ■ Please refer to the section below for a more in depth discussion on debtor management 	<p>Creditors</p> <ul style="list-style-type: none"> ■ During times when available cash is low, an organisation will endeavour to extend the payment terms of its creditors. Some creditors will not accept this and may respond by ceasing supply or changing the terms to cash on delivery 	<ul style="list-style-type: none"> ■ Capital receipts and expenditure affect cash flow ■ Loan proceeds and repayments affect cash flow ■ Other investment affects cash flow

2.3 Signs Your Cashflow Might be a Problem

As discussed in earlier volumes of this series, maintaining a healthy level of cashflow can be the difference between a business surviving tough economic times, and it failing. Following are some signs which are indicators that your business may be having cashflow problems:

- Your bank overdraft facility is sitting at its maximum all the time
- You are not paying your company's statutory obligations on time (e.g. tax liabilities, superannuation contributions etc.)
- You are stretching your payments to your trade creditors
- Stock levels are building up (stock turn is declining)
- Debtors are taking longer to pay you (average debtor days is increasing)

If your business is showing any of the above signs, you may be heading into cashflow difficulties or may not have been paying enough attention to its management.

2.4 Do's and Do not's of Cashflow Management

	DO'S	DON'TS
INVENTORY	<input checked="" type="checkbox"/> Make sure your business has a good purchase order system	<input checked="" type="checkbox"/> Order stock in an ad hoc manner
	<input checked="" type="checkbox"/> Ensure you have an accurate listing of your supplies and prices	<input checked="" type="checkbox"/> Underestimate the level of cash tied up in inventory on hand
	<input checked="" type="checkbox"/> Ensure a competent person is responsible for ordering	
	<input checked="" type="checkbox"/> Have a documented set of procedures for ordering	
DEBTORS	<input checked="" type="checkbox"/> Review terms of trade with your customers – ensure they are up to date and signed	<input checked="" type="checkbox"/> Ignore the function of debt collection
	<input checked="" type="checkbox"/> Monitor your debtors closely and regularly	<input checked="" type="checkbox"/> Give further credit to those customers who have exceeded their trading terms
	<input checked="" type="checkbox"/> Choose your customers wisely	<input checked="" type="checkbox"/> Give credit before undertaking a credit check of the customer
	<input checked="" type="checkbox"/> Have a plan for recovering money owed to you	<input checked="" type="checkbox"/> Agree to additional time for payment without documented agreed arrangements
	<input checked="" type="checkbox"/> Consider offering discounts for early payment	
	<input checked="" type="checkbox"/> Consider obtaining personal guarantees from your customer's directors which can be used in the event of non-payment	
	<input checked="" type="checkbox"/> Include an "all-monies" retention of title clause. Consider having your terms of trade printed on the reverse side of your invoices with reference on the front of the invoice	
CREDITORS	<input checked="" type="checkbox"/> Seek suppliers willingness to supply stock on consignment	<input checked="" type="checkbox"/> Pay your debts late without contacting the relevant supplier(s)
	<input checked="" type="checkbox"/> Negotiate with suppliers to extend credit terms when appropriate	<input checked="" type="checkbox"/> Be unplanned when it comes to your suppliers
	<input checked="" type="checkbox"/> Maintain healthy relationships with suppliers and ongoing discussions. If a creditor is made aware of your difficulty to stick to the paying terms, they may be more willing to extend your credit.	
	<input checked="" type="checkbox"/> Develop a contingency plan on how to obtain supply of goods or services should a supplier fail	

2.5 10 Step Checklist to Effective Debtor Collection

■ **Develop a process to monitor and collect debtors. Stick to that process.**

This process should include implementation of an appropriate information system which can generate reports on outstanding debtors such as days overdue etc. Maybe have an assigned member of staff who makes weekly telephone calls to outstanding debtors.

■ **Ensure that you have written and signed terms of trade with your customers.**

Do reference checks on those customers and set strict credit limits on accounts. Consider requesting a personal guarantee from the customer's directors.

■ **Send out statement of accounts on a monthly basis.**

When a debtor is outside your terms of trade, insist that these are met.

■ **Contact all debtors outside normal trading terms.**

This may be in writing, by calling and speaking directly with them over the telephone or in person. Personal is preferable as they are more likely to commit.

■ **Consider placing debtors trading outside normal terms of trade on stop credit until their account is paid.**

Providing credit to bad debtors will only worsen your problem.

■ **Obtain a firm commitment from the debtor as to when payment will be received.**

Diarise this commitment and acknowledge this to the client immediately. If it is not met immediately contact the debtor to follow up payment.

■ **If a debtor requires additional time to pay an account ensure that you have a written acknowledgement of the outstanding debt.**

This way, should legal action be necessary at some later time, the debtor will not be able to dispute the debt. Consider also obtaining a personal guarantee from the debtor's directors if you have not already obtained these.

■ **If a debtor has made a commitment to pay, have them deposit the funds directly into your bank account and send you confirmation of payments.**

Follow up your bank to ensure the funds have cleared. This will ensure commitments are met.

■ **Send demand letters or threaten legal action where the debtor continuously fails to pay the outstanding debt.**

This will ensure you have taken all necessary action before legal proceedings.

■ **Take legal action to recover the debt.**

This can also mean repossessing stock under a valid retention of title clause contained in your terms and conditions of sale printed on invoice.

2.6 Recovery of Debts By Way Of Legal Action

Given the challenging economic environment facing business, it is important that debts outstanding from customers are carefully monitored to ensure they are collected in a timely manner.

When all non legal avenues of collecting long outstanding debts have failed, organisations will need to decide whether it is commercially viable to take legal recourse against a debtor to recover the amount outstanding. Legal action will normally take the form of obtaining a judgment against the debtor for the amount outstanding. By obtaining a judgment prior to taking any other form of action, ensures that any disputes regarding the amount outstanding are resolved.

Once a judgment is obtained, there are a number of ways that the judgment can be enforced. These include:

- **Obtaining a Warrant to Seize Property from the Court.** This procedure entitles the Sheriff to attend the debtor's premises and seize assets which are then sold to satisfy the judgment debt.
- **Summons for Oral Examination.** The judgment debtor may be summonsed to appear before the Registrar of the Court to be examined regarding what income, assets and available cash the debtor has to satisfy the judgment debt.

- Attachment of Earnings Order. The Court may make an order that the debtor's employer make payments to the creditor from the debtor's earnings in satisfaction of the judgment debt.
- Attachment of Debt (Garnishee). The Court may order that all debts due to the judgment debtor from another party be paid to the creditor in satisfaction of the judgment debt. This may also include money in a bank account.

The two most common options, however, to enforce a judgement debt are:

- Individuals – Bankruptcy
- Corporations – Liquidation

2.6.1 Bankruptcy

- The debt must exceed \$2,000
- A Bankruptcy Notice is issued which includes a certified copy of the judgment debt. Penalty interest can be claimed on the judgment debt.
- The Bankruptcy Notice is to be served upon the judgment debtor. This is normally done by way of personal service.
- If the judgment debtor fails to comply with the Bankruptcy Notice by paying the amount outstanding, within 21 days from the date of receipt, he or she will have committed an Act of Bankruptcy.
- Once an Act of Bankruptcy has been committed, bankruptcy proceedings can then be commenced by the judgment creditor through the issuing of a creditors petition. Note that there is no obligation on the judgment creditor to proceed with bankruptcy proceedings despite issuing a Notice of Bankruptcy.
- The creditor may nominate the bankruptcy Trustee of his or her choice. Should no Trustee be nominated, in the event that the debtor is made bankrupt, the Government Trustee (also known as the Official Trustee) will become Trustee of the bankrupt estate.
- Bankruptcy proceedings are issued in the Federal Magistrates' Court.
- Once the Creditors Petition is issued, the Court will list it for hearing in around 4 to 6 weeks. If the Court is satisfied that the debtor has committed an Act of Bankruptcy or the debtor fails to appear at the hearing, the Court will normally make a Sequestration Order against the estate of the debtor and a Trustee is appointed.

2.6.2 Liquidation

- Where a debtor, which is a company, has not paid its debts, a creditor may apply to either the Supreme Court or the Federal Court to have the company wound up and placed into liquidation.
- A Statutory Demand is issued against the debtor company for debts exceeding \$2,000. This is not a Court document. Rather it is document prescribed pursuant to Section 459E of the Corporations Act 2001.
- The onus is on the Debtor to either pay the debt, come to a suitable arrangement with the creditor or to apply to the Court to have the Statutory Demand set aside. This must be done within 21 days of service of the Demand, failing which the debtor will be deemed to be insolvent and the creditor can issue winding up proceedings in either the Supreme or Federal Courts.
- A Statutory Demand can be set aside, by application to Court, if there is a genuine dispute over the debt or if the Demand Notice is defective. Whilst it is not necessary, it may be desirable to first obtain a judgment in respect of the outstanding debt in order that there can be no dispute regarding the quantum claimed.
- A Statutory Demand only remains valid for 3 months from the expiration of the 21 day time frame.
- The creditor may nominate the Official Liquidator of his or her choice. Should no Official Liquidator be nominated, the Court will choose an Official Liquidator based on a rotation system.
- Once the application to wind up the company is filed with the Court, it normally takes between 4 to 8 weeks for the application to be heard. In certain circumstances, a Provisional Liquidator may be appointed at any time after the filing of the application if the Court considers that the company's assets are at risk.



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The HLB Mann Judd National Association consists of 6 member firms and 3 representative firms and has approximately 80 partners and 550 staff members. It provides a full suite of professional accounting, financial and business advisory services including business services, taxation consulting, corporate finance, financial services, carbon accounting, audit and assurance services and business recovery.

Our principal aim is to provide profit-generating solutions to our clients' business problems and give them the assistance and support they need to be successful. For further information please visit www.hlb.com.au.

HLB Mann Judd, trusted advisors to the printing industry.

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The Printing Industries Association of Australia (*Printing Industries*) with a history dating back more than a century, is the peak advocate and support organisation for companies operating in the print, packaging and visual communication industries in Australia.

The Association is an independent not for profit member based organisation, representing some 2000 companies nationally more than 90 per cent of which comprise of small to medium sized companies.

Reflecting the general diversity of the industry membership covers all imaging and communication sectors and includes printers, desktop publishers, graphic designers, prepress houses, publishers, software and hardware manufacturers and distributors, paper and paper board manufacturers, paper merchants, ink and other consumable suppliers, sellers of printing equipment, packaging and flexible packaging, paper converting, binding and finishing, communication and media services.

A national network of offices manned by 31 full time staff provides support and representation.



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The first level of service offered through Enterprise Connect is a comprehensive Business Review. The Business Review is a thorough analysis of a firm, carried out on site, by skilled and experienced Enterprise Connect Business Advisers. It examines aspects such as:

- the strengths and weaknesses of the firm;
- potential areas for business improvement; and
- strategic business issues;
- potential areas for growth.

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