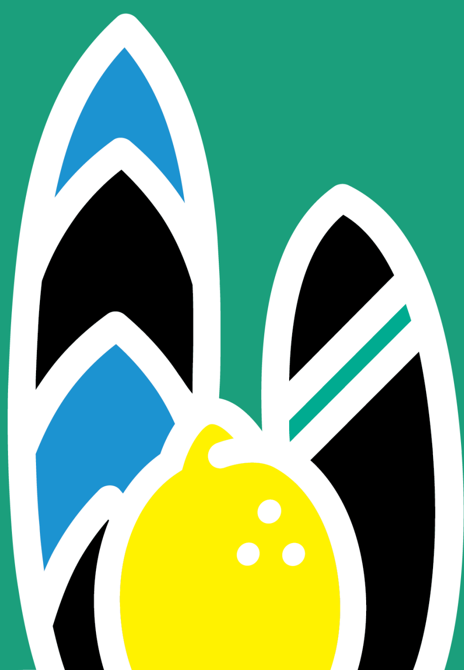
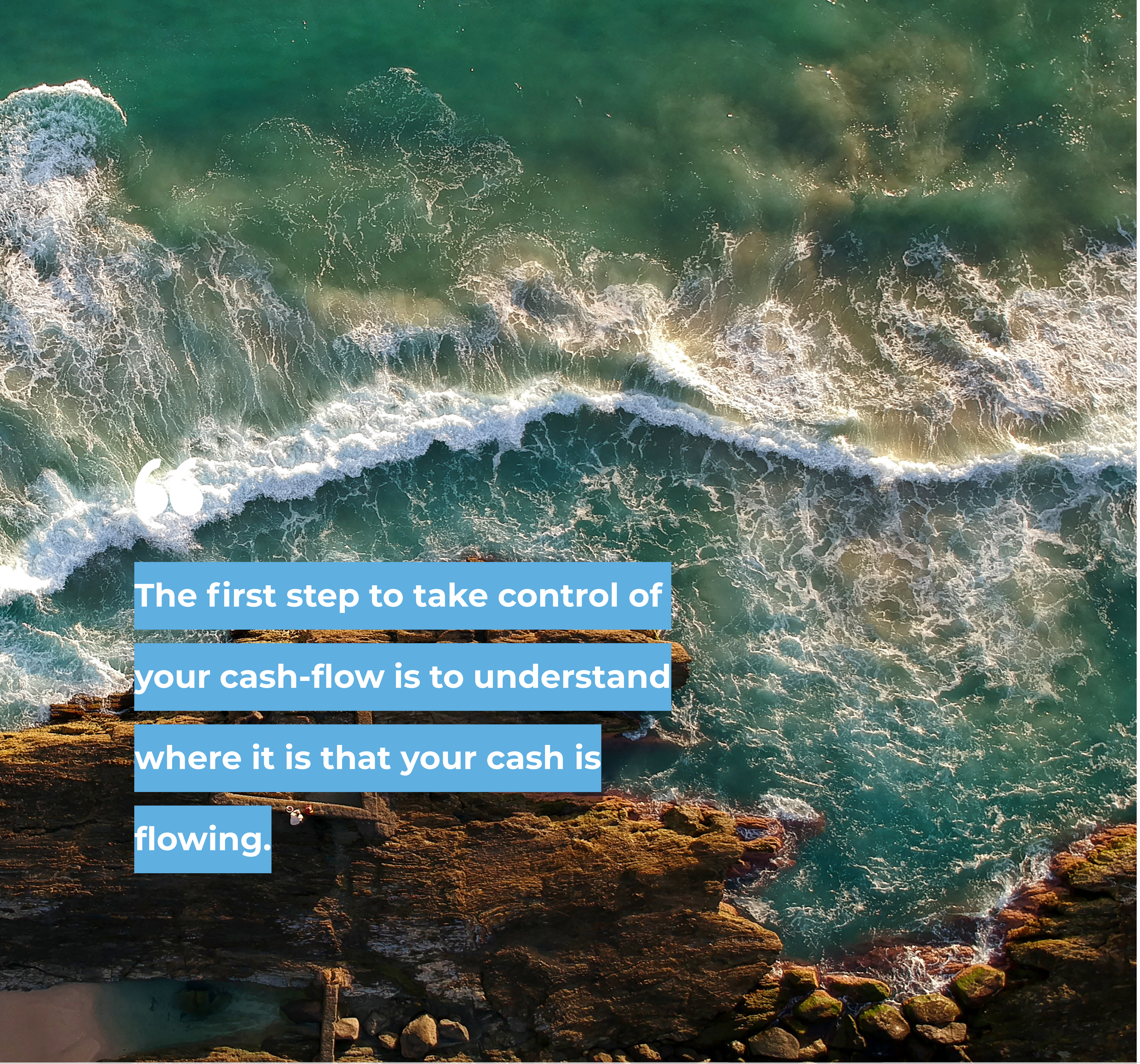
CASH CONTROL 101

Understand where your cash is and
how to manage it into the future





> **The first step to take control of your cash-flow is to understand where it is that your cash is flowing.**

About Us

Lemonade Beach is a boutique Accounting and Business Advisory firm based in Coolangatta on the Gold Coast. We assist businesses of all sizes, as well as individuals across South East Queensland and Northern New South Wales.

Our team has extensive experience in all areas of compliance and Australian Taxation Law. However, at Lemonade Beach we are not your average Chartered Accountants. Because we go beyond tax accounting to offer products that empower business owners to confidently engage with their financial data, helpng them to build strategy into business processes and allowing them to make sound, informed decisions.

Through the combination of visual reporting and regular advisor insights, Lemonade Beach connects you with your financial data in an easy to digest way, giving you complete confidence in your financial data today, tomorrow and beyond.

The best part is you're not required to bring your accounting work across to access these services - if your accountant isn't interested in helping you use your numbers for greatness, we're ready to assist and fill the gap whilst you maintain your existing accountant relationship.

Step 1:
Where is your cash?

The first step to take control of your cash-flow is to understand where it is that your cash is flowing.

If your accountant tells you you're making profits but you're struggling to identify where that profitable cash is, you're not alone.

Most business owners do two things to manage their cash flow:

1. They look at their bank account balance
2. They look at their Profit and Loss report

The problem with this approach is that a lot of cash outflows aren't on your Profit & Loss.

The balance sheet is where it's at.

Whilst most people can read a Profit and Loss, a Balance Sheet holds a lot of mystery – and likely the key to where your cash is flowing.

In accounting we can use two basis of reporting - cash or accrual. The differences are that accrual reporting tells you the full picture of your business; including invoices you've raised that haven't been paid for. Whereas cash basis shows what you have actually received or bills you've paid. Most software reports default to accrual basis, which is what we like, but if you're only looking at your profit and loss you're missing half the story.

The rest of the story is in your Balance Sheet. This tells you the net worth of your business. It should include all your assets and liabilities. As businesses grow they often purchase assets - this could be plant and equipment but also includes amounts that other people owe you. Your annual profits also get allocated here at the end of the year.

Action Steps

I want you to uncover where cash has flowed to in your Balance Sheet.

1. Run a Balance Sheet report in your accounting software for current financial year to date with comparative at last financial year end.

2. If your software allows, add a column to show you the difference between current year and last year
   - If your software can't do this, export the report you have to excel and add a formula to do the crunching for you.

Common places cash flows to:
- Purchasing assets
- Accounts Receivable
- Purchase of inventory
- Repayment of loans
- Owner drawings / loans

Reflection

1. Do you have any of the common hiding spots for cash flow?
   - Print out your Accounts Receivable List and decide some actions to recover overdue amounts
   - Take a look at what inventory you have on hand – if some has been there a long time, make a plan on how to turn it into cash

Step 2:

How much cash do you need?

Optimise your Profit & Loss

Many small business owners haven't optimised the layout of their profit and loss. Whilst your bottom number will stay the same whether you optimise or not, there's a lot of information you're likely missing out on seeing.

Action Steps

1. Print out your last full year Profit and Loss

2. Review for Non-cash items
   - Often a profit and loss will include items that don't require any cash outflows. Things like Depreciation and Amortisation of Borrowing Costs.
   - Highlight these
   - Note where they are appearing in your report

   Typically these will appear in expenses

3. Review any lines that you only pay for if you sell a product
   - Items like:
     - Stock purchases
     - Merchant fees
     - Outward postage
     - Commissions that are based on sales
   - These are your Cost of Goods Sold (COGS)
   - Highlight these a different colour

4. Create an optimised layout for your Profit and Loss

Tip

Most accounting software allows you to create a different layout option for reports. This will make it much easier for you to find information that you need.

- Move all Non-Cash items you highlighted above to 'Other Expenses'
- Move all COGS items you highlighted above to 'Direct Costs' or 'COGS'
- Consider grouping like items: This will make keeping track of your costs a lot easier. You might like to group expense items that all relate to employing staff (wages, super, workcover) or all the items that relate to running an office (rent, power, internet, telephones) together so that you can get a total for these types of activities.

Save your optimised layout and make it the default layout that will be shown every time you run your Profit and Loss Report.

Run a new Profit and Loss Report ready for the next activity.

Ground Zero

Once you've discovered where your cash is flowing, the next step to take control is to work out how much cash your business needs to not only function but also grow.

Traditionally people have used a Break-Even formula to get to NIL PROFIT – Who wants to make no profit though? Not me!! – instead I want you to work out how to cover all your costs including a return to yourself for your hard work AND some profits that you can re-invest in your business to grow it. So instead of Break-Even lets call it 'Ground Zero' – enough cash to do what you want in your business.

Action Steps cont.

1. Using the Balance Sheet you used in Step 1, make a list of all your recurring payments such as loan repayments.

2. Seriously consider how much cash you want to take from your business.

If you operate as a company or trust, give some thought to employing yourself through payroll. I've found this makes things a lot easier for many business owners as tax is taken out each pay period and you return to putting some money into your superannuation.

If you're a sole trader, consider drawing a regular amount for your living expenses and also putting some money aside each month in preparation for your tax. (You might want to set up a new bank account for this)

Use the following website to work out your Gross (including tax) amount for the year and your periodic (weekly, fortnightly, monthly) pay.

- Think about any investments you need to make in your business over the coming year and how much cash you're going to need to do this.

e.g. Equipment Purchases, new staff members, premise expansion

If you plan on financing equipment purchases or lease fitouts also consider what your monthly repayments on these financing activities could be.

3. If you have some overdue debts include an amount for how much you want to pay off these during the year.

4. Work out your Gross Profit Margin.

Use your Optimised Profit and Loss report to work out your Gross Margin

Gross Margin = Gross Profit / Revenue

- Use the following Ground Zero workpaper to calculate how much cash you need to bring into your business through sales.

Step 3:

Generate more cash

Now you know how much you need, the next step is to work out ways to generate more cashflow into your business.

Start by reflecting on the calculation you've done above.

How do the total sales you need compare to where your business currently is at?

Next consider what changes you could make in your business:

- Whilst you can cut unnecessary expenses, try to avoid cutting costs on necessities or items that make you more efficient.
- Reflect on your Gross Profit Margin – is this what you expected? Perhaps you need to review your pricing

Pricing is perhaps the first place to start.

Many business owners don't truly understand all the components that go into them delivering their product or service. Back in step 2 you noted all the costs that you only pay for when you sell / deliver a product – how does this compare to what you first thought? Each cost here reduces your overall profit every time you make a sale, reducing costs here can have a multiplier effect on your bottom line.

Action Steps

Review current pricing

- Compare pricing of similar products in the market – how does your price fit with offerings available?
- Consider who your target customer is – are they buying on price alone or do they make their purchasing decision on other factors such as quality, brand awareness etc?
- Consider whether you can increase your prices and note down the % increase.
- Next look at ways to increase your margin further:
  - Look for new suppliers that can either supply at a lower cost or on better terms
    Don't forget to have the conversation with your current supplier about this too.
  - Go further than your base product – look at merchant and shipping fees too
- Now go and rework your Ground Zero calculation to see the difference these measures have had on total sales target.

Plan for growth

Now that you know your sales target for the year, you need to think about some strategies to get there.

You may need to extend your marketing efforts, you might try targeting a new market segment. If you're services based you might look further at profitability of each client type and decide to focus on high-returning work or clients.

Make a list of steps / projects to explore. Don't forget about your actions from above to increase your margin. Set a due date for each and work out a plan of attack.

Convert existing assets to cash

Back at the beginning of this workbook we explored where your cash was hiding – remember, its in the balance sheet. To get more cash into your business without having to make any additional sales, you need to convert this hidden cash into money you can use.

Action Steps cont.

This means collecting outstanding amounts you are owed. I want you to print out your Accounts Receivable and make a plan on how you are going to contact anyone with outstanding accounts. It could be via email or phone. I want you to get a firm undertaking from them of when you can expect payment. If you have no luck with this, consider referring the debt to a debt collection agency, sure they will charge a commission for collection but if you end up with a percentage of what's owed to you, it is still better than 0%. Finally, I want you to stop doing any more work for anyone that has debts 90 days or more overdue – don't make the problem bigger than it needs to be. Decide what you would like to happen in order for you to keep working with these customers (if that's what you want) and negotiate to get it.

Next you need to consider how you let people owe you so much money in the first place. Do you need to stop offering credit until you've worked with someone for a reasonable time-frame? If you operate on payment terms, how are you enforcing your terms? Most accounting software these days will send reminders automatically to your customers, utilise this feature by setting up templates and timeframes that work for you. With most invoices being delivered electronically now, I find it's very easy for things to slip through – sometimes it's not that people don't want to pay you, it's a simple mistake – so make it easy for them and eliminate the 'I didn't receive that invoice' excuse. I like to send a friendly reminder that an invoice is becoming due a few days prior to due date, this just helps prompt customers to allocate the payment in their next payments run. I then have automated follow ups that increase in urgency and language as time goes on.

Look at the availability of a similar feature in your invoicing software and set up templated reminders for overdue amounts.

So now you've got a plan to get the money you're owed and reduce chances of this amount getting large again – what else can you convert to cash?

Stock – if you've got a large balance in 'inventory' or 'stock on hand' you need to review what you have for anything that is obsolete.

Perform a stocktake

- ✓ Is there any 'old' stock?
- ✓ How much did this stock cost you to purchase?
- ✓ What would you be prepared to sell it for?
- ✓ Discount the stock or bundle it with other items with good margins and put a sales campaign in place.

Whilst you're here – if you sell a range of products with different mark-ups / margins - put a spreadsheet together of each item you sell and work out the margin on each product. This can help you with your strategy from above as you can focus on higher earning products and consider discontinuing low margin items.

Plant and Equipment – if you have equipment that your business owns but doesn't use, consider selling it to convert it into cash that your business can use. If this equipment is financed you should first check what your payout figure on the finance is so that you are clear just how much cashflow a sale can generate.

Step 4:
Take control

Now that you know where your cash is currently flowing, how much cash you actually need in your business and you have a plan to get it, it's time to take control and set up some systems that will help you manage the cash within your business.

ATO Payments

One of the most prevalent issues we see with businesses is that when a bill comes from the tax office there is rarely enough free cashflow to pay for it.

The first step to overcoming this is to change your mindset. If you charge GST you need to realise that this portion of your sales is not yours, you're just holding it for the tax office – you're their tax collector. You need to have this much cash put aside each quarter when your BAS is due. Go back to your balance sheet, there should be a line item under current liabilities called GST (or GST collected and GST Paid) - this is how much you are holding on behalf of the tax office.

If you also pay staff, you likely withhold tax from their payments. This should be shown as another line item on your balance sheet called 'PAYG Withholding' or 'Amounts Withheld'. You probably also have superannuation to pay for staff – this should be on your balance sheet as 'superannuation payable'.

Just as we optimised your profit and loss, it's time to do the same with your Balance Sheet. Group these accounts together and total them as 'ATO Payables'. I know you don't pay superannuation to the ATO but you do have to find that money every three months, just like the GST and PAYGW.

Now open a Business Savings account and transfer the total you've just calculated across. Regularly check this total to ensure that you always have enough cash put aside to pay the ATO when you have to.

Supplier Payments

Many small businesses don't have systems in place around how and when they pay suppliers. They often have software that can help them with this but keep to a manual system – it's time to get that software subscription working for you and making your life easier.

Supplier Payments cont.

The first step is to start to enter in every bill you receive together with it's payment due date. You might already be doing this, but if you're simply reconciling bank statement lines as they appear, chances are you aren't. Once you get all your Accounts Payable into your accounting software you can start to run reports on what is due when. This helps you optimise your cashflow as you can pay suppliers on time but not 'early', meaning the cash is available for you to use longer. Decide on a system that will allow you more control over supplier payments – this could mean that you do payments once or twice per week so that you start to know and decide exactly how much cash is leaving your business at each interval.

Owner Payments

When we calculated your Ground Zero, I suggested you consider how much cash you want to take from your business. Hopefully you've given that some thought.

As business owners we can either pay ourselves first or last – when you calculated your Ground Zero you decided to pay yourself first, by ensuring that there is enough cash flow to meet your needs. You may have adjusted this figure on reflection. Whatever your final figure is now, it's time to put some processes in place.

If your business runs through a Company or Trust – speak to your accountant about putting you on the payroll. If you operate as a sole trader, set up a regular drawings into your personal account.

Once you've done this – don't take anymore cash from the business unless there is excess cash flow.

This is another mindset shift – you need to see the business separate from yourself. The business is there to produce income for your lifestyle, but if you don't have a plan around what cash you need personally and have ensured that the business can accommodate this, you will end up taking money from the business that is meant for suppliers and the ATO. As your business grows, you can review what you are taking and increase it, just as you would if you worked for someone else.

Plan for the future

When you calculated your Ground Zero, you included some possible purchases or expansion expenses. This exercise should be completed regularly and can be achieved through a three-way forecast.

A three-way forecast is a projection of your business into the future. It includes a projected Profit and Loss, Balance Sheet and Cashflow statement and can be very useful for recognising where you may have tight cashflow situations.

If your business is seasonal, a forecast can help you see and set targets for your busy times, whilst preparing you for the quiet times. It can help you recognise how much cash you need to put aside for your quieter trading periods so you're not caught short.

These forecasts are also useful as you start to plan out the future of your business. You might need more staff, a premise refit or need to purchase new equipment. By performing a forecast you can see where you might need more cashflow or finance into your business, and make decisions accordingly.

Once you've got a forecast the final step is to monitor how you are going against it. This can help you identify areas in your business that require further attention from you. A dynamic forecast will also update your projected future for what has already occurred. For example, if you originally thought you would have 10k in the bank, but at the end of that period you had 8k, your projected bank balance will adjust to show you that you're 2k behind and that this might cause some cash flow issues into the future.

Conclusion

Ultimately, managing cash flow is a common issue amongst business owners – this workbook should help you to achieve the following:

1. Understand where your cash is currently going
2. Work out how much cash you actually need
3. Put a plan in place to achieve your cash target
4. Take some actions to convert items on your Balance Sheet into cash
5. Set up systems to help you manage your obligations into the future

There is a final checklist over the page to help you make sure you've covered all of these items.

At Lemonade Beach we're passionate about helping small business owners to truly understand their business finances – including cash flow. We have products that help you to confidently engage with your business numbers and make better decisions. If this is something you'd like to explore, please do reach out to us for an obligation free chat.

Checklist

	I found where my cash is currently going
	I optimised my Profit and Loss Layout
	I know my Gross Profit Margin
	I know how much cash my business needs
	I have an Accounts Receivable system in place
	I have a system to recognise and sell old stock
	I'm getting the best deal from my suppliers
	I understand my target customer
	I've reviewed my pricing and set according to my target customer
	I have a plan to meet my sales target
	I know which of my products / services are my most profitable
	I've set up a savings system for ATO payments
	I'm using my accounting program to help me determine who I need to pay when
	Owners are on regular drawings or salaries (talk to your accountant)
	I've set up a forward cashflow and profit projection
	I'm monitoring my actual results to my projection

Notes

Notes

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