Managing cashflow guides

The Managing Cashflow guide series is produced by the Institute of Credit Management (ICM)
in association with ACCA.

About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 154,000 members and 432,000 students in 170 countries, helping them to develop successful careers in accounting and business, with the skills needed by employers. We work through a network of over 80 offices and centres and more than 8,400 Approved Employers worldwide, who provide high standards of employee learning and development.

FOR FURTHER INFORMATION

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Experienced practitioners know that late payment and poor cashflow are leading causes of small business failure even in the best of times.

During the economic downturn of 2008/9, ACCA teamed up with the Institute of Credit Management to promote ten quick and user-friendly guides to optimising cashflow for small businesses.

The guides can be helpful to small business clients as a quick reference and to practitioners as a trigger for more in-depth discussions on cashflow and related services.

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MANAGING CASHFLOW GUIDES

1. Knowing your customer

Unless you know exactly who you're trading with, you won't be able to check if they are good for the amount of credit you need to grant, you won't be able to commence legal action effectively if it becomes necessary.

Can you answer yes to all these questions?

- Do you know the exact name and trading style of the business? The people or company that own the business, and are liable for any debts, may not be the same as the name under which the business trades. Types of business include, amongst others, limited companies, partnerships and sole proprietors.
- If it's not a limited company do you know the name(s) and personal address(es) of the proprietor or partners?
- Have you seen headed paper or documentation that verifies this information?
- Have you used a credit reference agency to check their details and credit status?
- Does the information support the amount of credit they'll need? There are many sources of information, the most common and readily available being credit agency reports and references.
- Have you talked to other suppliers of the business to obtain references?
- Do the details on the order match those you were given earlier?
- If they were previously dealing with your competitor, are you happy about their reasons for coming to you?

FIVE TOP TIPS

1. Check out the exact name and legal status of the business you're supplying. If it's a sole trader or partnership, the proprietor or partners are personally liable so make sure you have their full details. Businesses can disappear much more quickly and easily than individuals!

   For limited companies you can undertake a free check on a limited company's basic details using the Companies House WebCheck service.

2. Don't be afraid to push for all the information you need – if you can't get it now, it will be far more difficult later.
3. Watch out for 'friendly' references that the potential customer gives you. Referees that you choose are far more effective.
4. Invest in credit reference information – it could save you a bad debt.
5. Set some rules that you (and all your employees) always follow and don't be tempted to break them, even if you're put under pressure to supply urgently.

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2. Payment terms

If payment fails to arrive for goods or services you have provided, your cashflow can be under real pressure. Cashflow keeps business in business and – if you think you are being paid on one date and your customer has a different date in mind – you could be in trouble! Making assumptions is dangerous and formally agreeing payment terms in advance is vital.

Can you answer yes to all these questions?

- Do you discuss and agree payment terms with your customers (and with your suppliers) before you accept (or place) an order?
- Do you confirm the agreed payment terms in writing before you accept (or place) an order?
- Do you negotiate payment terms with your suppliers that allow you longer to pay than the terms on which you are paid by your customers?
- If the answer to the question above is no, do you have finance or a finance facility in place to bridge the gap between the time you pay and the time you get paid?
- Do you produce, and then regularly review, a cashflow forecast to ensure that everything is under control and there is nothing waiting to surprise you?
- Do you have standard payment terms in place and a policy within your organisation saying that they cannot be changed unless properly authorised?
- Is the payment due date clearly shown on all invoices?
- Do you have a strategy in place for dealing with requests from customers who suddenly and unilaterally demand a longer time in which to pay?
- Do you include your right to make late payment and interest charges on your contracts and invoices?

FIVE TOP TIPS

1. Set out and agree payment terms in advance and in writing. It's better to know what to expect than to leave things to chance and wonder why the money hasn't arrived later.

2. Watch out for any wording in documents from your customer that changes the agreed payment terms. If you accept their order, you might also be accepting their changed payment terms. If their documents contain terms that are different to yours and you fail to challenge them, their terms will take precedence.

3. Whenever you write about payment terms, and on your invoices, include the words: 'We will exercise our statutory right to claim interest (at 8% over the Bank of England base rate) and compensation for debt recovery costs under the Late Payment legislation if we are not paid according to our agreed credit terms'. Even if you don't intend to do so, it can be a useful deterrent against late payment.

4. Raising a further invoice for interest and late payment charges is an excellent way of gaining your customer's attention and raising the profile of your outstanding invoices.

5. If your customer unilaterally tells you they are going to take longer to pay in future, you will have to decide how important their orders are to your business. If they're claiming the extended payment terms for invoices already raised, you should demand payment under the previously agreed terms for goods or services previously supplied.

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3. Invoicing

If you don't raise an invoice, you won't get paid. Invoicing should not be seen as a back-office administrative nuisance. Rather, it is a vital first-step in achieving healthy cashflow.

Can you answer yes to all these questions?

- Do you raise an invoice immediately after you have supplied the goods or service?
- Do you make sure that everything the customer requires appears on the invoice?
- Do you have an effective accounting system and have you considered using dedicated accounting software?
- Do you have a process for investigating and resolving disputed invoices immediately after the query is raised?
- Do you log the details of disputes so you can fix any avoidable root causes?
- Do you keep documentation relating to disputes as evidence in case the problem escalates?
- Do you keep a record of the customers that dispute invoices so you can spot any who do so regularly as a way of avoiding prompt payment?
- Do you ensure your sales invoices are fully compliant with HMRC requirement for VAT if you are VAT registered? See HMRC VAT invoices
- Do you clearly indicate any reference the payer must quote so you can identify the payment?

FIVE TOP TIPS

1. The sooner you ask, the sooner you can get paid; send by first class post or, better still, by email.
2. Get invoices right first time; raising credit notes and reissuing invoices takes up resources and time better spent elsewhere. It also changes the payment due date.
3. Ask customers what they need on the invoice in order to approve it simply and quickly. Include at least the following:
   - Your full name and address
   - Your VAT registration number
   - Invoice date
   - Correct customer name
   - Correct customer address
   - Delivery address (if different)
   - Delivery date and method
   - Customer purchase order number
   - A clear description of the goods or service supplied
   - Accurate quantities, prices, discounts and total amount due
   - Payment terms and due date
   - How payment should be made with bank details (including sort-code and account number from bank statement)
   - Invoice number or other reference to be quoted by payer
   - Payment terms and due date bank statement and the reference to be quoted if payment is by direct credit.
4. Include the words: 'We will exercise our statutory right to claim interest (at 8% over the Bank of England base rate) and compensation for debt recovery costs under the Late Payment legislation if we are not paid according to our agreed credit terms' on every invoice, and print your terms and conditions on the back.
5. Have a system for resolving disputed invoices promptly, especially if a customer is using a small query to withhold.

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4. Treating suppliers fairly

Cash￿ow keeps business in business and if you don't pay your suppliers on time you risk damaging their business or – worse – causing, or contributing to, their failure. You want your invoices paid on time, and you should do the same. It's not just good business practice and ethical behaviour; it's also a demonstration of corporate social responsibility.

Can you answer yes to all these questions?

- Do you agree payment terms with your suppliers before you place an order?
- Do you pay bills on or before the due date?
- Do you tell your supplier immediately if you have a query with their invoice so that they can resolve the problem and still be paid on time?
- Do you let your suppliers know immediately if anything is going to prevent payment by the day they expect it?
- Do you make sure your suppliers know what information and detail you require on their invoices to enable you to approve and pay them promptly?
- Do you check in advance where and how your supplier needs to be paid?

FIVE TOP TIPS

1. Make sure payments due are in your cashflow forecast so they don't catch you by surprise.
2. Talk to suppliers early if you have a problem preventing prompt payment.
3. Paying promptly:
   - earns your business respect
   - may allow you to negotiate better deals or agree a prompt payment discount
   - helps you avoid late payment or interest charges
   - ensures supplies don't get stopped
   - improves your trading relationships
   - makes you a more valued customer.
4. Give your key customers a copy of this guide.
5. Treat your suppliers as you want your customers to treat you.

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5. Credit insurance

The fact that a business is here today and is creditworthy does not mean that it will be tomorrow, next week or next year – or in fact that it will still be in business. If a customer becomes insolvent and cannot pay money that is due to your business it can be catastrophic, especially if the amount involved is large. Insurance companies and brokers offer credit insurance to meet the specific needs of clients, industry sectors and specific transactions to protect against non-payment by your customers and their insolvency. Good credit insurers can often provide detailed information on prospective customers, and can sometimes provide access to cheaper business financing.

Can you answer yes to all these questions?

- Are you confident that your most important customers are not at risk of failure?
- If the 'riskiness' of a customer rises, do you have sufficient controls and monitoring in place to ensure you see it happening?
- Can your business take on all the risk itself and still achieve the level of turnover you want with each of your customers?
- Are you happy with the amount of detailed information you can gather on your potential and existing customers?
- Can your business afford the risk of expanding into new and unknown markets?
- Can your business achieve sufficient and profitable growth while taking all the risk itself?
- Does your business have all the necessary credit management expertise in-house?
- Have you worked out the impact of late or non-payment by major customers on your business, and how you would survive it?

FIVE TOP TIPS

1. If your business would be more comfortable trading with protection against bad debts or, in certain circumstances, late or non-payment, then credit insurance is worth considering.
2. Credit insurance can give you a stronger balance sheet and (because the risk of bad debts is reduced) it can make finance through traditional overdraft, factoring, or invoice discounting more readily available (possibly at a cheaper rate).
3. Credit insurers have access to more up-to-date and detailed information than is readily and publicly available. This can open up larger credit lines or more flexible payment terms allowing your business to grow its profitable sales.
4. There are a number of credit insurers and insurance brokers, who offer a variety of insurance products. It's always worth shopping around for the most suitable type of policy and best rates, just as it is for any other insurance product.
5. Credit insurers can be a real asset in helping you introduce good credit management practice into your business.

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6. Factoring and financing options

Most businesses extend credit to their customers and extending credit requires finance. Unless a business has the cashflow to support the difference in timing between the cash it collects and the cash it has to pay out, it can be in trouble. Managing cashflow effectively means staying on top of finance and ensuring funds are available when they are needed.

Can you answer yes to all these questions?

- Do you have sufficient cash reserves to meet commitments and pay suppliers on time?
- Are you getting longer payment terms from your suppliers than you're giving to your customers?
- Do you have finance facilities in place that will grow with your business (factoring and invoice discounting are designed to do just this)
- Is the product or service you supply so vital that you can dictate payment terms?
- Is the level of your bank overdraft or short-term finance sufficient?
- Do you monitor the creditworthiness of your customers?
- Do you have access to adequate credit management systems and skills?

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SIX TOP TIPS

1. Don't wait until things become critical. You need time to put arrangements in place and it's easier when you're not under too much pressure.

2. Factoring – the factor agrees to pay an agreed percentage of approved debts as soon as they receive a copy of the invoice; 80–85% is common. The balance, less charges, is paid when the customer pays and the factor will undertake all credit management and collections activity following an agreed credit policy. The advance is likely to be 'with recourse' (meaning that the factor will be able to reclaim its money from you if your customer does not pay) so the option of bad debt protection should be strongly considered.

3. Invoice discounting – immediate cash for up to 80–85% of the approved invoice value is available. However, responsibility for the sales ledger operation and credit management activity remains with the organisation and the service is normally undisclosed to its customers. Payments received are paid into a bank account administered by the invoice discounter, after which the company is credited with the balance, less charges. Again, this advance is likely to be 'with recourse' (meaning that the discounter will be able to reclaim its money from you if the customer does not pay) so the option of bad debt protection should be strongly considered.

4. Supplier finance – sometimes called 'reverse factoring', is an option if you are a regular supplier to a large organisation that has an appropriate arrangement in place. Invoices are paid immediately (and ahead of terms) when the buyer confirms it has approved the invoice for settlement. The buyer then repays the financier according to the original contract payment terms. This allows you to receive an immediate cash payment, less a discount that is based on the buyer's credit rating and is without recourse (meaning that money will not be reclaimed from you if your customer fails to pay).

5. Project bank accounts – ensure that the contractor and their supply chain receive promptly monies rightfully due through certified interim payments. The project bank account is set up in trust for the whole supply chain and is the medium through which payments are made. The project bank account makes payment on receipt of an instruction signed by both the project client and contractor, and the supply chain is notified of the day they will receive payment from the project bank account. Project bank accounts have trust status which prevents a receiver seizing the proceeds of the account in the event that the contractor goes into receivership.

6. Asset based lending–where funding is provided, secured against the property, plant, machinery, stock, or sometimes even the brand name, of a business.

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7. Chasing payment

When you get paid, the sale is complete. When a customer doesn't pay, they're hanging on to money that is rightfully yours and you should ask for it. You should have a routine system for following up non-payment that includes letter, email, and telephone, but be prepared to act more quickly if the amount is large or you are concerned about the customer.

Can you answer yes to all these questions?

- Did you agree the payment terms with the customer before you accepted their order?
- Are you sure the invoice is accurate and no dispute has been raised?
- Has the payment due date passed?
- Has the customer confirmed receipt of the invoice?
- Do you have proof of delivery for any goods delivered?
- Does the invoice say how and where payment should be made?
- Do you keep a record of all collection activity? It will be vital later if you have to engage a third party (see '*When all else fails*' guide in this series).

FIVE TOP TIPS

1. If the invoice is large, call the customer before the payment due date to make sure it has been received and there is no query; this is good customer service.
2. Make immediate contact when payment has not arrived, be assertive about what you expect and when you expect it, and make the consequences of non-payment clear. Follow up promises to make sure they're met.
3. If a customer persistently pays you late or makes excuses, check them out (see 'Knowing your customer' guide in this series) and consider whether you're prepared to continue supplying on credit terms. It may be better to lose an order, or even the customer, than supply goods, not get paid and suffer a bad debt (when that happens you lose the goods and the money you're due).
4. Be polite, professional and persistent. Do what you said you're going to do when you said you were going to do it.
5. Try to get customers to pay by electronic transfer or Direct Debit to avoid waiting for the cheque to arrive.

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8. When cash runs short

Cash keeps business in business. However healthy the order book and profit margin, if a business runs out of cash it won't be able to pay its suppliers, its wages, or its overheads and it will fail.

Can you answer yes to all these questions?

- Do you have sufficient cash or finance availability to meet commitments as they fall due?
- Are you confident that this will remain the case for the foreseeable future?
- Do you have, and update regularly, a cashflow forecast to ensure you stay within your financing facilities?
- Are your major customers paying you promptly and not putting you under pressure to extend payment terms?
- Is your product or service so vital to your customers that they will pay your invoices first if they have to choose who to pay?
- Are you sure that none of your customers are having financial difficulties that might make them pay you late, or not at all?
- Are you implementing good credit management practice? (see other guides in this series for advice and tips).

FIVE TOP TIPS

1. Plan your cashflow requirements carefully allowing for differences in the payment terms you receive from your suppliers and those you give to your customers. Regularly update cashflow forecasts to ensure you stay within your financing facilities
2. Monitor stringently against the plan so that you spot any variance as early as possible.
3. If you think you might have a cashflow problem, talk to your bank or financier immediately. They might be able to help and the earlier you speak to them, the more options there will be.
4. If you can't pay a supplier on the due date, talk to them as soon as you know you cannot do so. Again, the earlier you talk to them, the more flexibility they'll be able to show and the more likely they are to be able to accommodate an extension to payment arrangements.
5. Remember, early communication is key – if you avoid talking to suppliers, your bank and other parties, you might find supplies or finance have been withdrawn or legal action has started and things will quickly escalate. There were over 70 corporate failures every working day between May and July 2008, many of these through lack of cash; you need to make sure your business doesn't become a statistic.

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9. When all else fails

Sometimes, you just can't get paid. You've done all the right things and the money has still not arrived. The longer the debt remains unpaid, the more likely it is to turn into a bad debt and bad debts damage your business. Legal action is always an option but there are others you should also consider.

- Are your invoice(s) raised in exactly the right name? (see '*Knowing your customer*' guide in this series)
- Do your invoice(s) have all the information required by the customer?
- Has the customer confirmed receipt of the invoice(s)?
- Are you sure there are no queries?
- Do you have proof of delivery if the debt relates to goods supplied, or a signed order for services?
- Do you believe the customer has the funds to pay you?
- Has the customer promised to pay OR are they refusing to talk to you at all?
- Is the debt straightforward?
- Do you have a record of all your collection activity to date?

If the answer to all these questions is yes, it's probably time to move to the next stage and consider the following.

- Taking legal action either yourself or using a solicitor – commencing legal action yourself is relatively easy but takes time and effort (see *HMCS Money Claim Online* run by HM Court Service). Using a solicitor will save you effort but cost you more if the debt and costs aren't recovered. For debts in Scotland see *Small claims in the sheriff court*.
- Using a debt collection agency to act for you. They will often work on a no recovery no fee basis, collecting debts is their specialist area, and most will escalate action through their own legal partners if it becomes necessary. You should be aware that the percentage commission can be substantial if they succeed, especially if the debt is large (see *CSA Members* to find agencies who belong to the Credit Services Association and follow its code of practice).
- Issuing a statutory demand that you can follow up 21 days later with a bankruptcy (individual) or winding up (company) petition, as long as the debt is at least £750, (see *Insolvency Service Statutory Demand* to download a *Statutory Demand (Form 4.1)*. You need to bear in mind that, if the customer fails to pay, their insolvency may follow and you are then even less likely to recover the debt. (see '*When your customer goes bust*' guide in this series).

FIVE TOP TIPS

1. Make sure the invoice details are accurate before you consider taking further action.
2. Always write and advise your customer that you will be exercising your statutory right to claim interest (at 8% over the Bank of England base rate) and compensation for debt recovery costs under the Late Payment legislation and that you will be taking further action – this might be enough to prompt them to pay.
3. If you can't get paid for the outstanding debt, don't let it grow. Stop supplying any further goods or services. If your product or service is important to your customer, it might be just the lever you need to get payment.
4. Always consider the commercial reality – if the customer is insolvent or has no available funds, further action is unlikely to help, and consider the costs of any action against the size of the debt.
5. Check out any solicitor or agency before you instruct them; make sure they belong to their appropriate trade association or professional body and check that their background and expertise matches your needs.

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10. When your customer goes bust

Inevitably, businesses fail and – when one of your customers goes bust – it hurts. There is little you can do except wait to hear the outcome. The general outcome is that the debtor's assets are divided among its creditors and the insolvent debtor is released from the burden of its debts. Once most formal insolvency processes are underway, you cannot start or continue any action to recover your debt.

Types of insolvency

It helps to understand the main types of insolvency (for more detailed information see www.insolvency.gov.uk). Bankruptcy can only apply to individuals (including sole traders and individual members of a partnership). Bankruptcy petitions may be presented to the court by the individual, by creditors who are owed £750 or more, or by the supervisor of an individual voluntary arrangement. A bankruptcy order is made by the court.

Individual Voluntary Arrangement (IVA)

An individual comes to an arrangement with creditors to pay his/her debts in full or in part over time as an alternative to bankruptcy. The arrangement is set up by a licensed Insolvency Practitioner who will put it to a meeting of creditors. If the proposal is accepted at the meeting, the agreement reached with the creditors will be legally binding. An Interim Order is sometimes issued by a court and will immediately protect the debtor from any legal action by creditors.

Company Voluntary Arrangement

A company comes to an arrangement with its creditors to pay the debts in full or in part over time. A CVA begins with the company (or its adviser) drafting a formal proposal at a Creditors' Meeting to pay part or all of the debts. If the proposal is accepted by the creditors, the arrangement will become legally binding and the directors will retain control of the company.

Compulsory Liquidation

Compulsory liquidation is the winding up of a company or a partnership by a court order (a winding up order). A petition is normally presented to the court by a creditor stating that he or she is owed a sum of money by the company and that the company cannot pay. The Official Receiver becomes liquidator when the order is made but an Insolvency Practitioner will be appointed to take over if the company has significant assets. The liquidator's role is to realise the company's assets, pay all the fees and charges arising from the liquidation, and pay the creditors as far as funds allow in a strict order of priority.

Creditors' Voluntary Liquidation

In a creditors' voluntary liquidation the shareholders pass a resolution to wind the company up without the need for a court order. A Creditors' Meeting is held to nominate the appointment of a liquidator and consider a statement of affairs. Creditors can appoint a committee to work with the liquidator, whose role is to realise the company's assets, pay all the fees and charges arising from the liquidation, and pay the creditors as far as funds allow in a strict order of priority.

Administration

Administration applies to limited companies and partnerships and is intended to get the company out of trouble and trading again if possible. Administrators can be appointed to a company that is unable, or is likely to become unable, to pay its debts. They can be appointed by the courts (on application from a creditor, directors or partners), the holder of a qualifying floating charge over the assets of the business, or the company or its directors. An administrator's primary goal is to rescue the company as a going concern. If this isn't possible, the administrator will try to get a better result for the creditors than would be possible if the company was wound up. If neither of these is possible, the administrator will sell the company's property to make at least a partial payment to one or more secured or preferential creditors, such as employees or the bank.

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MANAGING CASHFLOW GUIDES

10. When your customer goes bust (continued)

FIVE TOP TIPS

1. You should be contacted automatically by the official receiver or insolvency practitioner if they know that you are a creditor.

2. If you believe an individual may be subject to insolvency proceedings and you have not heard, search the Individual Insolvency Register.

3. If you believe a company may be subject to insolvency proceedings and you have not heard, use the Companies House WebCheck service.

4. If you think your customer is bankrupt or the subject of a compulsory liquidation, contact the insolvency enquiry line – 0845 602 9848 or email insolvency.enquiryline@insolvency.gsi.gov.uk

5. If in doubt, contact the official receiver or insolvency practitioner to make sure they have details of your debt. Also, contact them if you have any information about the assets or the conduct of an individual or company.

USEFUL CONTACTS

Institute of Credit Management
For tips on getting paid and advice on best practice in credit management, tel: 01780 722911
email: tech@icm.org.uk / www.creditmanagement.org.uk

Business Link
For further information and advice on starting up, running and growing a business, tel: 01845 600 9006
www.businesslink.gov.uk

THE GUIDES IN THIS SERIES

All these guides are available from the **ACCA website**.

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