

WHITE PAPER

MANAGING CASH FLOW IN A PROFESSIONAL PRACTICE DURING ECONOMIC DOWNTURN

By Randy Paulkiens, CPA/ABV, DABFA

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Don't Manage By Headline; Manage by Economics

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The information contained in this document represents the current view of **WithumSmith+Brown, P.C.** on the issues discussed as of the date of publication.

This white paper will inform the reader on how to streamline cash flows and reduce receivables. It will also provide a long-term perspective on the nation's current fiscal slump.

The paper will cover the following key points:

- Accepting credit cards and offering discounts for quicker payments ... (better to get \$0.98 today than \$1.00 later!)
- The benefits of billing out your WIP promptly and regularly...(as opposed to letting it sit, as many practices do)
- Tips on collections ...(Don't be afraid to use a collection attorney!)
- Keeping a Long Term view when it relates to quality staff
- Do Not Panic ...(which should be rule #1)

This white paper is for informational purposes only. It is advised that you discuss your business's individual needs with a Certified Public Accountant to assess how your business must respond to changing market conditions within your industry.



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OVERVIEW

It seems that it is impossible to read any newspaper, any magazine, watch TV, or read any finance column - whether online or in-print - without finding significant amounts of negative information regarding the economy. In fact, I have seen headlines of a story be modified from portraying doom and gloom in the morning, to stating that the same gloomy theory holds no traction by the end of the business day.

In truth, it is hard to argue (and I am not) that the economy is not in as good of shape as it was only one or two years ago. Gas prices are at historic highs, even adjusting for inflation; unemployment is creeping up; there is a credit crisis; the stock market is down from its historic highs of October. The list can -- and does -- go on. In fact, you can probably spend hours waxing about how bad things are and provide headline data to support your contention.

I could also point out that while unemployment is higher than it was recently, it is by historic terms still very low. And although the headlines state such things as "fell by the highest amount since x-year", it refers to the worst data in the last 20 years. Clearly much of the above issues will have an effect on business and it is important to separate the *facts* from the *hype*.

The public - and we all are a part of the public - is heavily influenced by the media. If we are constantly told things are bad, we will eventually believe they are bad. Our clients and customers will also believe things are bad and will begin to cut back and perhaps overreact or over-correct. Unfortunately, one of the first things to be cut back on is payments to vendors.

SORTING ECONOMICS FAST FROM FICTION

The press has been particularly focused on labeling the current state of the economy and many politicians either want to use the "R" word or avoid using the "R" word at all costs.

The "R" word, of course, is Recession. The mere mention of it can galvanize people and send shock waves through the soul. But, before we touch upon the current economic status, let's define what a recession is.

While there is no "official" agreed upon definition to a recession, the most common definition is two consecutive quarters of negative GDP growth. Thus, you cannot know if you are actually in a recession until at least six months after it began. Nor can you know when it is over -- until you start having consistent expansion.

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According to the current economic data, we have not had negative GDP growth for even one quarter, never mind two quarters!

As of the date of this article, the Federal Reserve is meeting to assess the current economic situation. However, we as business owners however must make decisions today to manage our business--and we cannot wait until someone tells us what happened.

Most of the reports I read tend to indicate that we will have slightly negative GDP growth for the first quarter of 2008 and possibly into the second quarter 2008. Actual growth for the first quarter 2008 was .6%. Thus, we cannot assign the classic definition of a recession until at least September 2008.

Most reports indicate that economic growth is expected to resume in the third quarter 2008 - and continue into the future. Therefore, at the date of this article we may already be halfway through the theoretical recession, according to the news.

What's the main rule for business owners to follow in times like these?

Don't manage by headlines -- manage by economics. In short...

DO NOT PANIC.

**QUICKER PAYMENTS, BETTER FLOW:
ACCEPTING CREDIT CARDS AND
OFFERING DISCOUNTS**

One would not expect to walk into a supermarket and walk out with a cart full of food with a wave and a vague promise to pay. Neither should our clients.

Not all practices have the capability of accepting credit card payments. Most, if not all of us, readily use credit cards for everyday convenience, then hopefully pay the charges off promptly. But, there is a real opportunity here for professional practices, too, by accepting credit cards for accounts receivable payments.

Despite the economy, the credit card companies are still very willing to extend credit to anyone and everyone who is willing to pay the interest costs.

Therefore, starting your clients out sooner rather than later on a credit card payment plan will reduce your accounts receivable and take you out of the business of "lending" money. (Really, do you collect those service charges you seek?). Also, receiving 98 cents today may be well worth not waiting six

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months or a year for a dollar. How much is the interest charge on your firm's credit lines? Even if the credit lines are 6 percent a 2 percent 2 accept credit card payments, only amounts to 4 months of outstanding accounts receivable.

Similar to accepting credit card payments, offering to take 95% within two weeks --or by the end of the month-- can also be effective. Everyone likes to get a discount and take advantage. Again, you have less money initially but compared to the normal collection cycle and the cost of capital you may actually be better off on a net basis.

And, let's not forget the fact you will not need to follow constantly on the accounts receivable balance. This practice can allow you to focus more time on building and servicing existing business than collecting from them.

The number of hours we can devote to work is relatively finite therefore focusing on what is revenue generating (albeit slightly discounted). Generating and servicing business is usually more productive and rewarding if you can reduce your time spent on collections.

Inquire with Banks and other financial institutions about their programs to finance

litigation. Some institutions have programs for helping clients fund litigation. It may be in your best interest to understand those programs, so you can refer your clients to them if appropriate.

If you do not take the time, you can put your client at a disadvantage as they are fighting against a better financed adversary. Or worse, you can lose the opportunity entirely.

BILL YOUR WORK IN PROCESS PROMPTLY

Clearly preparing your bills is a time consuming --and rather thankless job. I don't know of many people who actually *enjoy* the process. While billing is certainly better than following up on collections (asking for money), it still is not the most exciting thing under the sun.

But the outcome is simple: If you do not bill it you will not be paid.

Your rent does not wait until you get around to writing the check. Your staff does not appreciate their paychecks being delayed. Similarly, if you hold Work-in-Process Amounts, it does not even get on your clients' radar for payment. You incurred the costs -- so why not work to recognize (and collect) the

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revenue? Clearly, there are times when sending a bill does not make sense – the time charges are too low or a fixed fee project is not at a billable stage, for example. But, these instances should be the exception rather than the rule.

Prompt billing will speed up your payment for that time charge. Also, by virtue of the client seeing the billing, they may develop more realistic positions. Your client may realize how much effort you are investing on a daily basis. For example, if you wait 3 months to bill phone calls. How likely is it that your client is going to remember he or she called you every day for a week when something was wrong?

Do not be afraid to take action on collections by using an attorney. Calling your clients personally can be an effective way to spur them on in getting those invoices paid; it is easier to ignore letters in the mail than the friendly, familiar voice over the phone. If after a considerable amount of time this continued effort remains ineffective, do not be afraid to take action on collections by using an attorney.

However, you must read carefully here... Since a notice of collection can be responded to by a claim for malpractice. If you are an attorney reading this you already know this. Other professional practices and service

organization should become acquainted with a collection attorney and refer them clients promptly. We also suggest that your engagement letter or engagement contract explicitly state that collection costs are in addition to your fee as well as allow for binding arbitration, etc.

YOUR FIRM'S LARGEST INVESTMENT IS IN ITS PEOPLE. DON'T "DAY TRADE" THAT AWAY.

Clearly, there are times when a staff member simply do not fit the organization for a variety of reasons. Once a it is realized that a person needs to go then it is in the best long term interests of the organization if not the individual (since they may also realize they are not working out) to part ways. This should occur during both good and bad economic times.

However, due to human nature, we tend not to want to hurt someone. When times are good we may carry someone who is not a going to make it. When times are bad, we may feel compelled to cut them immediately. The question is, have you done them a larger disservice by waiting until time are bad and the labor market softens to cut them loose. I think so. Thus, it is extremely important to

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continually review and modify your staff at all times.

But what do you do when you have quality staff and you are faced with a downturn? First, think long and hard before doing anything. That staff member may realize that a large client was lost and that they no longer are busy. You could let that staff member go but think of the damage that would do to your remaining staff in terms of loyalty.

Also remember, you have a lot of money (time) invested in that staff member. When times get better --and they always do-- how much will it cost? Think about lost capacity, time to hire a replacement, etc. to get you back to where you are today? Probably more than the staff savings during the current downturn.

Most prudent investment managers indicate that you should invest for the long term. Over the long term, well balanced portfolios are going to out perform the latest fad.

Net/Net? Don't Cut Quality Staff For Short Term Situations.

CONCLUSION

The beauty of capitalism is that it creates opportunities for all. It also corrects periodically – even though in the short term

those corrections can be painful. However, remaining calm while others around you are losing their heads is old yet sound advice.

There have been major recessions in the 1970s and early 1980s. There was a minor recession in 1991 to 1992 -- and again in 2000 to 2001. We may be in one already.

While each has its nuances, employment and growth have always returned. If you were to look at the newspapers from each of those periods, you would see convincing articles and literature that “this recession is different than the others and this one will be worse”. It is possible that the current recession will be worse but much if not most of the economists seem to believe (including the Federal Reserve) that growth will return this year or in the next could of months.

Today the stimulus checks are being printed and the deposits are being made. Also many people receive tax refunds in April and will probably be spending them. Many of the earnings report are indicating earnings that are meeting expectations or at worst earnings that are lower than last year but still are earnings as opposed to losses. Much of the financial sector has written off a lot of loans etc due to the new Fair Value Accounting issues. Many of the loans will perform in the

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future and the financial institutions do not make money by not lending it.

In other words, the world is not ending, going back to basics and thinking through the problem rather than simply reacting to it should allow you to make prudent decision and not create lasting damage.



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