Growth Rock News

November 2008

A manager's guide for building durable businesses with rock solid controls

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Financial Crisis Puts Focus on Working Capital Management

Tough economic times never last, only tough companies do. And to survive during these times, growing companies are keeping a close watch on cash flow. This is not the time to be adventurous. Rather, companies are keeping a close tab on expenses and focusing on monitoring receivables, inventory and accounts payable, working capital accounts of the company.

Why is working capital the heart and soul of a company's operations? It's because working capital functions like a lever that controls the inflow and outflow of cash and is a key driver of operating cash flow. Working capital management is really about managing cash flow, the success of which depends largely on accounting controls.

On the cash inflow side, having strong credit management, billing and collections processes are key to improving cash inflow. It all starts with procedures to set up new customer accounts. For new customers, companies should establish clear credit policies and have procedures to evaluate credit worthiness of new customers by reviewing the following:

1) Recent financial statements
2) Vendor and bank references
3) Credit reports by Dun & Bradstreet or other third-party credit agencies

Uncertain times require greater due diligence when accepting new customers. When in doubt, companies should have customers pay upfront. Once a new customer has been accepted, it is critical that the customer information be set up correctly in the accounting system. The customer record should be complete as much as possible, including the proper name, accounting contact, mailing address, credit terms, credit limit, telephone and email contact. Too often, data is entered incorrectly or incompletely without proper documentation. Errors cause invoices to be sent to the wrong location. Having proper controls and spending a little time up front can make all the difference in the world to avoid bad debts and cash flow problems down the road.

For existing customers, it is critical to stay on top of accounts receivables by having procedures to monitor aging. Procedures should be in place whereby customer statements are sent monthly followed up with phone calls by an accounting staff. Additionally, companies should examine their billing procedures to make sure customers are billed promptly and accurately. Billing errors or missing documentation (such as shipping documents or purchase

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Do You Know What's in Your Vendor Masterfile?

As the year-end approaches, accounting departments are getting ready to send out a mountain of forms, including W-2's and 1099s. It's also the time of year to look at the vendor masterfile and see what all is inside. For many companies, the vendor masterfile is a black hole that is used to process invoices and checks. Few companies pay serious attention to this important area. Yet managing the vendor masterfile is key to establishing disbursement controls and guarding against fraudulent payments. Common problems include:

"*For many companies, the vendor masterfile is a black hole...*"

1. Duplicate vendor records
2. Incomplete or incorrect vendor information
3. Fictitious vendor records

All three problems result because there are poor controls over the vendor masterfile data. In the world of QuickBooks, many companies create vendors "on the fly" by entering just enough information to complete a task and no more. As a result, the vendor masterfile becomes a behemoth over time with duplicate and incomplete vendor records cropping up like weeds. Too often, vendors are set up without approval and documentation.

Vendor management should be more rigorous. Before payments are made to vendors, a new vendor setup form and a W-9 form should be used to document new vendors. Having a new vendor setup form and a W-9 form is a key control to document approval, establish legitimacy of vendors and provide a way to capture all relevant information to process payments correctly. It is here that duplicate or unauthorized vendors can be caught before they are entered into the accounting system. Some of the key information that should be entered include the vendor name, mailing address, accounting contact, payment terms, tax ID, whether or not the vendor is a 1099 vendor, phone and email address. Taking time to provide complete information for each vendor will save time, improve efficiencies and avoid mistakes.

In addition to having good setup procedures for new vendors, a review of the vendor masterfile should be done at least annually. As part of the review, the vendor masterfile should be reviewed for the following:

1. <u>Duplicate vendors</u> - Where possible, combine duplicate vendor records into one record.
2. <u>Incorrect address</u> - Verify address information against a recent vendor statement.
3. <u>Missing W-9 form</u> - Verify that a signed W-9 form is on file.
4. <u>Incomplete records</u> - Verify completeness of record by filling in for missing fields, such as tax id, accounting contact, phone, etc.
5. <u>Inactive vendors</u> - Deactivate vendors with no activity during the last 12 months.

Besides basic controls, proper vendor file management will help establish good trade credit with vendors and optimize cash flow. For example, a company that incorrectly sets up a vendor with net 30 terms as due upon receipt will end up paying the vendor too early. Likewise, a company that sets up a vendor with net 10 days terms as net 30 days will end up making delinquent payments that can damage a company's trade credit, particularly if the vendor reports data to third party agencies, such as Dun & Bradstreet. Being late with payments by a few days can result in a poor credit score. Moreover, if a vendor offers a cash discount for early payment, such as 2% in 10 days, net 30 due, and the vendor is set up as due on receipt, the company will end up paying too much too soon.

"*...the vendor masterfile becomes a behemoth over time with duplicate and incomplete vendor records cropping up like weeds.*"

Simple mistakes can add up in a big way and can be avoided by having a few controls in place.

—GRN (11/08)

Simple, Low Cost Tools To Strengthen Controls

Small companies are ever challenged to find cost-effective ways to implement internal controls in their business. Managers and owners recognize the need to establish controls not only to support growth, but also to comply with a host of laws and regulations, including Sarbanes-Oxley. The full costs can be astronomical for a business that's conserving every dollar to help fund its growth. Establishing good controls, however, does not have to break the bank. There are a few old-fashioned control tools that have withstood the test of time. Best of all, they are easy to implement and inexpensive.

The first tool is the accounting form. Accounting forms have been around since ancient Mesopotamia nearly 6,000 years ago when Sumerians used clay tablets to record accounting transactions. Forms are useful to organize and simplify information so that a transaction can be entered accurately and efficiently. Forms serve as the foundation of any records retention policy. Good forms have the following characteristics:

1) Sequentially prenumbered
2) Multi-part (minimum 2-part)
3) Place for management approval and account coding

Another overlooked control tool is the trusted rubber stamp. In the old days, virtually every accounting department owned a set of office rubber stamps. Rubber stamps are fast disappearing in a world of high tech wizardry and virtual reality. Rubber stamps remain an invaluable documentation tool to provide a link between the control form and the underlying accounting transaction in the accounting system. Stamps help answer basic questions about the status of an accounting transaction, including: 1) Has the transaction been entered, paid or reconciled? 2) How was the transaction coded or entered? 3) On what date and posting period was the transaction entered? 4) Who entered the transaction?

For controls purposes, stamps should have the following features:

1) Automatic date stamping
2) Space for notations about a transaction: G/L account, post period, amount and author
3) Ruggedness to handle high volume transactions
4) Permanent ink that cannot be altered

"Accounting forms have been around since ancient Mesopotamia nearly 6,000 years ago..."

Stamps strengthen the audit trail by providing a permanent record of the notations made on the control form when the transaction was originally recorded. Today's accounting software makes it too easy to change or delete a transaction. Without the original documentation and the stamping notation, it is difficult to figure out what was originally entered.

Back-to-the-basics control tools are usually the simplest and most cost-effective ways to improve internal controls. It seems that with all the technology available, people are moving away from paper based documentation. From a controls standpoint, original hard copies are preferable. When used together, prenumbered, multi-part forms and rubber stamps are a sure bet to improve accuracy, increase efficiencies and reduce fraud. Best of all, these tools never go out of style and won't break the bank.

—GRN (11/08)

Photos: Antique rubber stamps and stand (top) and modern day rubber stamp (bottom)

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orders) can dramatically slow the collections process and give customers reasons not to pay. As a precaution, customer invoices should be independently verified by someone other than the person who prepares the invoice.

On the outflow side, companies should redouble efforts to improve purchasing, inventory and accounts payable controls. Conserving cash should be paramount and any unnecessary investment in inventory should be avoided if possible. Having proper inventory and sales forecasting is important, as well as controls over inventory stock. Knowing what is in stock and how much is critical in keeping stock levels as low as possible to conserve cash while still accommodating customer orders. Procedures for issuing purchase orders, receiving inventory and processing accounts payable are important as well. There should be proper controls to match purchase orders with receiving reports and vendor invoices before invoices are paid. Mistakes in purchasing, receiving and accounts payable can be costly. Once the purchase order or check is out the door, there is little that a company can do. Also, it is important to stay current with all payables. Letting payables slide into delinquency for cash flow purposes is not a good idea, as it can damage the company's trade credit. Maintaining good supplier relationship is important, and having open and clear communications is key to keeping accounts in good standing with vendors.

For fast growing companies, it is even more critical to monitor cash flow. Management often have amnesia when planning for growth. They often forget that growth consumes cash. During recessionary periods, companies should re-visit their growth plans and assess what should be the optimal growth rate in light of the economy. It may be necessary to slow down the growth rate to improve cash flow. Having rigorous cash forecasting and reporting processes is important. During these times, it is incumbent for companies to review and strengthen accounting controls. Having proper controls in place will help companies handle negative shocks and position companies to capitalize quickly when the economy improves.

—GRN (11/08)

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