

"Dear Gabby"

A New way of Thinking about Cash-flow

By

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"Dear Gabby"

(That would be me.)

"You mentioned a Report that I haven't seen in my 22 years of owning this business called the Statement of Cash-flows. My accountant was hoping for a little guidance on what you think I should see in that report. Are there any other key reports you'd like to share?" (Signed: Clueless in California.)

Dear Clueless:

Pin your shoulders back! Stand-up straight, extend your right hand and point a (nice) finger vigorously at your accountant! Then mumble something on your way out of his/her office in a huff for effect. God I love that effect! If you lived closer, I'd do it for you! Scratch that. I'd pay you to do it for you.

Account**ANTS**....errrr! Don't let their amortized; self-depreciating, fantasy-football worlds fool you. The day one of them can calculate the *PV* (Present Value) of the last beer in the cooler, they have standing. You sign the *real* checks and if your numbers guy doesn't know why a Statement of Cash-flows is critical to you now more than ever, take away his mechanical pencil!

Now that I've gotten that off my chest... let's take it from the top!

Dear California:

You're not alone.

Most folks have never seen a Statement of Cash-flows on their agency unless an Evaluator stuffs it into their 40-page Stock Evaluation. And, it's a well documented fact (as seen on NOVA) that Surety Producers are the only stockholders who find a Statement of Cash-flows a great read. The problem is, a once a year look-see isn't helpful. Strike that. It's useless.

You need a simple, homemade report and it will change your life!

The basic premise of a cash report is simple. Your P&L is a combination of the real and imaginary. Your cash report is cash. Cash-in...cash-out.

Since this is potentially an accounting article, let me distance my analogies just a touch from GAAP.

For anyone who's held the handle on the toilet, delicately balancing the meniscus of the water level in hopes that it will all flush-out under the weight of liquidity..., it's like that. That's your cash report. Cash spends. Cash has needs. Cash is cyclical, seasonal and fickle. Cash is king, queen and you're a Prince if you have enough on 12-31. You're a Joker if you don't. Your P&L has no idea how much cash checked-in and checked-out each month in your Hotel California... You, however...need to know. If you don't, well...could be royally flushed!

Your monthly Income Statement (heretofore known by the unwashed as the "P&L") is the most important two pieces of paper (sans Branch breakouts) you get each month. If the P&L comes slowly, then shoot the cook who's cooking the books! There is zero excuse to wait 3-weeks after the month-end close for that "first-run" report. El Zippo! The very next day (unless there's a Star Wars Convention in town) your Accountant, Controller, CPA, or bookkeeper should have emailed you an updated cash-flow report on a 12-month rolling basis. That report can get-out faster than your P&L. Copies of "Excel for Dummies" is available if your number's guy whines.

The problem with a Profit & Loss statement, courtesy of Applied/AMS/Nexsure/ (whatever), is that it's a three-legged dog without the monthly cash-flow report. It's "almost" a full dog, which is nice (actually great), but it's a hobbled report. That dog, that report, can't hunt. And, I'm just amazed at how the vast majority of owners never get this report, because this report is important.

So, let's call my report something different.

"Rolling 12-month Cash-flow Projections"

Cash flitters and spurts and then gushes thru your account in fairly predictable, asymmetric, lean and fat months sort 'a ways. Contractors work, then they don't. Your firm has huge months and lean ones. It's a tricky skill to balance your contingency money (Q1) against the "flushing" of cash in December (typically). Today, getting adequate working lines of credit (if needed) are lick pulling ticks. There's just no good way.

"Biff" in accounting amortized expenses over 12 years. Revenue "this", "installment that", "normalizing", "deferred", and least we forget "posted" commissions that won't grace your Bank for another 90-days..., if you're lucky. It's all the backwash of a P&L. You need more than the P&L to sleep nights.

The cash report lists the actual cash you've received from your major categories...Commissions & Fees, Finance Agreements, Contingents and Employee Benefits, and the pop machine. The report lists your cash obligations by month to include a payment to Old Joe, your Benefit Plan down payment, When E&O premiums are due, estimated tax payments (under Safe Harbor or otherwise), Your software and renewal, the month "raises" hit", a vested interest payment to a

new Producer, a Cap-Ex timing for computers in month six, and a sprucing-up project in the women's bathroom next fall.

This report is updated each month. As September comes around, your P&C manager noodles on how the contingencies for next year will look (IBNR's notwithstanding!). Your accountant will/should model your Producer True-ups, their stock payments (paid-in capital...i.e.: cash), and your contributions to 401(k) type plans. It's all designed to answer the question: "Got cash?" It's designed to stop you from doing some things and, if not, to plan them differently in deference to the cash account.

Seeing the world thru the eyes of cash-flow will change the way you run the firm, how you plan, and more importantly how you prioritize. Most importantly, it will affect the way and timing in which you administer compensation to the highly compensated. It will cross-check your ability to pay with your willingness to pay and, just perhaps, bring you to a compensation "draw" scheme that is based upon 80% run-rate, trued-up at six months (or a month where you have lots of cash), and at the end of the year. It's one of the reasons I moved Producer annual reviews to April rather than yearend. We were awash in cash then. (We changed our installment debt structure too.)

It will help you see "ownership", distributions, dividends, and re-investment *timing* in a way that may help you do things you want, but feared before.

The Statement of Cash-flows isn't an accountant's report. It's a Board Report. It lists the ebb and flow of the life's-blood of the firm...cash. It will reveal who you are. It will focus your attention on a few critical things that no other report can do. And, this will litmus test your accountant. It's not hard to blend your budget against historical cash and expenses, and then list the true costs and expenses by month as they occur.

The P&L is my Bible. It tells me everything about operations. But it cannot tell you the following:

- ✓ How much cash do we have to pay Sub-S Corp taxes?
- ✓ Do we need to tap our working line in August?
- ✓ Should we hold some distributions back until owners see how the cash position looks in 90-days?
- ✓ If we take this excess cash, can we pay-down/off Old Joe's note if he gives us a discount?
- ✓ Why are we paying our E&O in full in the worst month we have for cash?
- ✓ Why don't we pre-pay our September sales outing in March (cash-rich) and get a discount?
- ✓ Why don't we offer put-shares to Producers who have grown their books and under-drawn rather than burn-up our cash?
- ✓ How's that new Accounts Receivable procedure working?
- ✓ Why do we pay 100% run-rate compensation to Producers before their true-up?
- ✓ How does moving our Calamity Casualty Personal Lines business to Safeco affect our cash-flow?

- ✓ Is there a way we can change our 401(k) contributions to a month other than December?
- ✓ Maybe we could buy Old Joe a lunch and amend his debt payment (stock payment) from December to October of each year. That way we don't have to borrow the money.
- ✓ How is the growth in fee-based revenue going to affect our cash position?

You get the point.

Part Two: Useful Accounting Reports

1. Income Statement: A.K.A. P&L
2. Rolling 12-month Cash Flow Report
3. Net Book Growth Report Per production Team YTD
4. Draw-versus-Reality Report Per Producer
5. Accounts Receivable Report: By account, By Producer Team (I focus on the team rather than the Producer in this report). The Producer almost always has no idea what, why or when and can play only a last-call role usually. Receivables don't just tell you the obvious. They tell you which team invoices badly, processes endorsements, audits, renewals, etc poorly. A/R's tell you more about operational issues than you can imagine. They tell you about the quality of the Producer, potential for E&O, bad Debt, inaccurate renewal summaries, and dysfunctions.

And, since I know Bob in Accounting just gave you a strange look after reading this article...this one's for you Bob! (See next Page.)

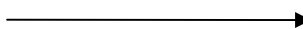


James Bond & Surety Agency: Cash Flow Forecast

Cash Categories

Jan-09 Go 2 years

Prior Period Cash on Hand

0 

Income From Operations

Direct Bill- All (Benefits + Personal L+ Comm'l
Agency Billed: cash in the door (ALL)
Funds transferred from Branch Operations
Cash available...

General & Administrative Expense

Salaries, 401(k) & Payroll Tax
Capital Expenditures
Sales & Administrative Expenses
Total General Disbursements

Cash left after Operational expenses:...

Other Cash

Payments to Treasury- Stockbuyers/Stockholders
Note Receivable from sale of book to ABC Agency
Contingent Income & Benefits Over-rides
Total Other Cash

Other Cash Expenses

Bonuses
Tax Advance
Producer draw true-up at Main Street Location
Producer draw true-up from Branches (name each)
Holiday bonuses (cash)
Bonus pool for salaried employees
Lease Obligations
Note Payables – List each here
Account Purchase to other Agency
401(k) required or excess contributions
Pre-payment of E&O & Insurance Non-Health
Sales Awards and prizes/trips paid
Company banquet
Corporate Taxes
Total Other Disbursements



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Other Cash to Monitor

CREDIT LINES

Draw from working lines/loans
Cash loans from Officers
Repayments on loans and working lines
Accumulated Balance Working Lines/Loans

Ending Cash on Hand – Estimate
Ending Cash on Hand – Actual

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