Financial Sustainability Webinar 1

# Cash Flow and Working Capital

Presented by Tim Flowers, Insight First

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## Financial Sustainability: Cash Flow and Working Capital

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This webinar was recorded in June 2018.

This webinar was produced during NDIS roll out under the title ‘NDIS Transition and Cash’. It originally focused on supporting service providers to understand cash flow for the purpose of funding their organisation’s NDIS transition.

The content of this webinar, however, will help with cash flow management and working capital for many other projects and purposes.

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## Disclaimer

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## Setting the scene…

Well, ladies and gentlemen, welcome to our very first “NDIS Simply” session. I’m Tim Flowers, and before we actually commence I’d like to acknowledge the traditional owners of the land on which we meet today, the Wurundjeri, and their elders past and present.

Today we’ll be working through a topic close to all of our hearts – Cash! In the next 15 minutes we’ll be talking through a couple of these questions: But ultimately what’s the headline? How much cash do we have? How much cash do we need to make a healthy NDIS transition? And how can I, as a frontline leader in my organisation, make much of a difference?

They’re the key questions that we’ve already been through. We will be working through some examples, so don’t panic yet. This won’t be as boring as it sounds…

In terms of resources for today’s session, you should have access to the webinar to rewatch at your leisure, an NDIS simply briefing sheet, and a series of worked examples in an Excel file will be available, and some other simple models will also be provided for you to experiment with.

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## Setting the scene: Grace’s example

My 17 year old came to me recently with a problem. She wants to be more independent and for her that means she wants to buy a car. Most of you have bought a car over time so you should be able to relate…

So what are the key things that we talked about? We talked about her current savings. We talked about how she can save from her current job, how much she can save a year if she was to get a new higher paying job, how much she’d need to pay to keep a car on the road and how much she thought she wanted to spend on the car. We also talked about how long she was intending to save for the car…

As an accountant I of course went to the Excel spreadsheet, and here’s how we modelled our conversation.

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So as you can see, Grace’s change is in fact to gain independence by buying and using a car.

What are the key things that we looked at? We looked at her savings. We looked at her savings as they are now, in a series of scenarios. We looked at her debts - so how much she owes, in a series of scenarios. We looked at current savings potential assessments, in terms of how much she earns and how much she spends, and therefore, what she has left.

We then looked at how much of an impact owning a car might have on her capacity to generate different types of income, and the additional costs that running a car may actually cause, one way or another. We also looked at how much a car may cost her over a period of time. And then we worked out how many years that it might take for her to actually repay the car over time, as you can see here in the spreadsheet.

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## Setting the scene: Grace’s example

So, what’s the summary of the conversation that I had with my 17 year old? Very small changes in my daughter’s behaviour created really significant differences in terms of her repayment outcomes.

A few of you are sitting there going “Man, I must be on the wrong webinar! What is Tim talking about? He’s talking about buying a car, not about NDIS.” Well, here’s how this actually applies to the NDIS.

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## Setting the scene: Applied to NDIS

Ultimately, we want to change. We want to transition well to an NDIS. The questions, the thought levers, the decision levers that we went through with Grace are actually very similar to the decision levers that you’ll go through in making a healthy transition into an NDIS.

Ultimately to lead through an NDIS you may need to understand: How much cash you actually have available to make the transition, how much cash you’re likely to need to make a healthy transition, how much cash our current support business actually generates, how that changes under an NDIS, and what your options are one way or another.

Another thing that you really need to understand at some point in this process is how your actions can contribute to the cash that we have left, and the flexibility and health of our transition, one way or another.

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## What is cash (working capital)?

So, what is cash? What is working capital?

Working capital is simply a finance term that’s talking about your cash position. Put simply, it’s “the cash that an organisation owns less the cash that they owe” at any given period.

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## How much “cash” do we have?

So how does this look in your organisation?

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The first thing that I’d like you to do is flick to some of the examples that we’ve included in our Excel spreadsheet. And I’ll do that right now.

So Staying Afloat is our example company and here’s their financial information. Staying Afloat has financial information present here at 30 June 2018 and we’ve simply put that material in as you can see here. Familiarise yourself with their financial position and their performance.

Their financial position is their current assets, what they own versus their current liabilities, what they owe. Their financial performance is their profit and loss statement. So what they earn, and what they spend leading to a net profit, one way or another.

So once you’ve familiarised yourself with their financial position and performance what I want you to do is to grab your own organisation’s financial information. What I want you to do, is I want you to pop it into the “my information” tab, right here. So, this is simple. Anything that’s in green is fair game. You can input stuff as you go. So “My Org” 30 June 2018 and you can plug in the details as we go, et cetera. None of it’s difficult. If you need a hand, reach out to your accounts team because they will be able to help you with this process.

So as you can see, if we go back to the Staying Afloat example, we take the cash, we take receivables, we take the other assets, we take the payables, the provisions, and the current borrowings and we effectively say they are what forms our working capital, or our cash base. You can see that over here in the “Working Capital” column. We exclude property, plant, and equipment, because to turn this into cash we would have to sell it, and we exclude long term borrowings, because ultimately they don’t have to be paid back in the short term to our financial institutions.

So if you have a look at Staying Afloat’s position they’ve got total assets that are liquid in nature of 750,000 and total relevant liabilities of 500,000. This means that Staying Afloat has 250,000 in available working capital, as you see here. How does this position look to you? If, as noted down here you can see that they are also making 191,500 in profitability over time.

Then what I’d like you to do is flick back to your information, and you can go to the “Your Scenario” sheet here and you can simply see how the information that I’ve typed in, my information, is actually flowing through here. You’ll note property, plant, and equipment is excluded and it’s already giving you a working capital calculation.

So my question to you after you put your own information in is how did your position look to you? Do you think you’ve got enough cash available to you to make the NDIS transition well, in this particular case?

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## How much “cash” do we have?

So to get a bit of a feel for how cash actually flows through an NDIS support organisation…

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## NDIS cashflow cycle

…the other thing we probably should do is reimagine, or have a bit of a view of how the cash cycle actually works in an NDIS support provider.

Typically the cycle looks like this: Employees will deliver supports to participants. The organisation promptly bills the NDIA for these supports. NDIA will pay for those supports that have actually been delivered. The cash will then be paid to suppliers and to payroll and the cycle repeats itself over time.

Obviously one of the things that you need to understand, is that if you don’t claim on time, if you don’t do this step in time, then the cycle can become quite concerning quite quickly. Obviously you also can’t spend cash that you haven’t received yet, so being able to understand this cycle will actually help you think about the decisions that you make and how they impact on available cash in the NDIS transition.

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## How much cash may we need?

So, how much cash might may we need to actually make a healthy NDIS transition?

And the answer of course is, “it depends”. Our simple example in the Excel spreadsheets gets you to think about three separate project types in the transition to NDIS, and they are: people costs, infrastructure costs, and enterprise discipline costs of transitioning to an NDIS. The key projects that we will work through in terms of people costs are on this slide.

The pre-transition planning and preparation, for a small organisation, we believe should take order of magnitude between two and three weeks, and for a larger organisation obviously that grows greatly. The implementing of new tracking systems likewise, the entry of participants into a Customer Relationship Management system, and the commencement of NDIA billing process are obviously all key tasks that we need to understand, and we need to execute.

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Again, if you look at the worked example for Staying Afloat and you have a look at the staff costs that we have estimated, this is the technique that we’ve used.

We’ve got available cash of 250,000, we’ve estimated the costs of staff cost transition as follows. So for the planning and preparation, we’re requiring a senior member of staff who’s paid about $43 an hour. We’re estimating six weeks of full time work which costs about $12,000 as you can see here, for a total of 40,300.

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## How much cash may we need?

The key infrastructure costs in transitioning to an NDIS are actually significant as well and they may not necessarily be as easy to identify and calculate.

They include the enterprise management software and inculturation, time and attendance system implementation, support model design and testing, recruiting, and marketing and brand development work.

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So again, as you see here in the model, we’ve tried to make some estimates in terms of those potential costs. We’re saying that an enterprise management system may cost order of magnitude $50,000, the time and attendance system about 35 for Staying Afloat, support design testing and documentation, we’ve said will be done by a senior practitioner again, over about a six week period, and recruiting and marketing about $25,000 each, totalling 146,000.

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## How much cash may we need?

What other cash requirements might we have in terms of making the transition to an NDIS?

Enterprise discipline has become really important under an NDIS, and in our view enculturating them, making sure that they’re implemented properly, and making sure that everyone’s on the same page in terms of these key enterprise disciplines becomes really important, and it genuinely does cost something.

So in Staying Afloat’s case what you’ll actually see is that the key enterprise discipline projects have been estimated here.

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So plan commencement date, coinciding with delivery date is being done by the administration staff member, who’s being paid $33 an hour at approximately one week of work overtime, because ultimately Staying Afloat is a relatively small organisation. And we’ve also noted, for example, the billable rate analysis project. So this is how many hours is a client-facing staff member providing purchased support versus how much are we paying them in wages. That is taking a senior staff member, again, approximately two weeks of time to get up and running. Our view is that the overall cost for Staying Afloat totals about 22,000 overall.

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# How much cash may we need?

One of the other variables that you’ll need to think about very carefully in terms of your NDIS transition and how much cash you are going to need is when you need to make your transition to NDIS.

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## When do we need to transition?

Now most people will know when NDIS is coming to their area, but if you don’t know, look it up on the NDIA website.

In short, it’s important to understand in terms of your cash position, and how it impacts transition that the more time you have before transition the more staged and steady your process, your change process can actually be. The shorter the transition period the more your options for healthy transition may be limited and the more expensive they may become.

Okay, so how much can we save before NDIS transition becomes a really important topic for us in terms of figuring out what we’ve got to spend and where it’s going to come from?

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## How much can we save before NDIS transition?

As in Grace’s example, how much you can save before embarking on the NDIS transition makes a big difference to your flexibility in the process.

In the Staying Alive [sic] example, effectively we looked at the period that DHHS funding will actually persist. We’ll have a look at the current revenue projection based on previous financial outcomes.

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DHHS-funded operations in Staying Afloat’s case will persist through to 31 October, and so effectively in this model we have said four months’ worth of DHHS funding. We are assuming the July CPI increase of 2.5% is coming through. We’ve looked at how much support margin we are actually making in the current format of the business and we’ve discounted that slightly, and we’ve then added back some non-cash items, like depreciation, and we have said before NDIS transition we think we can save a further 125, 126,000 before NDIS transition, which obviously is going to help in terms of flexibility.

So let’s put this all together. We’ll estimate cash left after transition by taking our opening working capital up here, so that’s the capital that we calculated right at the beginning of the session for Staying Afloat, and we’ll take away the key project costs for NDIS transition, being staff costs, being the infrastructure and discipline.

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## How much can we save before NDIS transition?

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## How much cash will we have left after transition?

We’ll then add the pre-transition free cash flow that we had calculated out of our DHHS support, and that will leave us with the cash that we should have on hand to commence our NDIS transition, one way or another. So this is how we put it together.

It’s always a good idea to do some scenarios before we actually commence on a transition process, because we don’t always get some of our guesses right. The risk adjusted numbers on the right hand side here are simply Staying Alive [sic] director’s way of saying, “If we don’t manage this process carefully, what might these costs be and how much risk does that add to our potential transition?”

So if, for example, the infrastructure cost blows out from our estimate of 146,000 to 200, that may mean that we may end up with as little as $5,000 left after making the transition to an NDIS. That’s certainly not something that we would necessarily be comfortable with.

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## How will claiming cycle impact cash?

It’s also important to understand that very small changes to claiming behaviour may have a really significant impact on your business, particularly if the NDIS business that you deliver ends up growing over time.

So here’s a brief example from Staying Afloat to demonstrate the annual impact of claiming in the month after support delivery rather than in the month of support delivery. Clearly deferring your NDIA claim even as little as a month may have a really significant cash flow impact on your business.

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## How will support margin and support volume impact cash?

It’s also potentially important to understand the impact that support margins and volume may have on you and those around you. Let’s get to the basic concepts.

Support margin simply measures how much you earn per NDIS-delivered hour against how much it costs you to deliver that hour of support. You can see it in the examples here. How much you earn for a bit of community inclusion support – 44.72 per client-facing hour – how much it’s costing you in this example - $52 – therefore you’re making a net support margin at a loss of $7.28 per hour.

In these examples, this is a leverage loss example, this is where we’re breaking even, and this is where we are going forward with real enterprise discipline. As you can see in these three examples, support margin may not be a problem when you remain quite small, because even if you’re making very large losses with a small amount of client-facing hours delivered, the overall cash impact is actually relatively small.

As the business grows, obviously the cash impact can become very important very quickly. So you can see some scenario-based thinking in Staying Afloat’s case all the way down the bottom, so in this example what we’ve said is the average support margin in the prior period, we made 5% in the prior period on our DHHS support. In this example we think that we are going to decrease our support margin so that we will be losing 5.4% overall per client-facing hour, and that the NDIS business will grow overall in terms of volume by 35%.

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According to these cash estimates up here, that gives us one year to make sure that we reform the business. If we change one of these variables to mean that we were losing only .5, obviously we would be breaking even and that gives us a lot more margin for error, one way or another, and so forth.

I know you hate homework, but it’s really important that if you’re going to make a healthy transition to an NDIS you make cash personal, so once you’ve understood the Staying Afloat example what I want you to do is to experiment with the My Transition scenario planner and check out how your organisation looks through the process. Then, importantly, I want you to reflect on how your decisions potentially change cash outcomes here.

How do I do that? Once I’ve put my information in here, both balance sheet and profit and loss that will populate your transition scenario, and again, anything in this sheet is there for your benefit, and anything in green can be used to estimate the cost of doing transition. What I’m expecting over time is that you will use this sheet to think through how much cash you actually have on hand, how much you’ll need to make the various different parts of the NDIS transition happen in healthy ways, and what your options are, one way or another.

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## How do my actions change outcomes?

It’s about this time in most sessions that the vast majority of my clients start complaining. They talk to me about stuff like, “I can’t change my cash position. I can’t change how much overhead we charge by our business. I can’t make NDIA pay the organisation on time, and I can’t change the NDIS price paid for our services.” They feel powerless.

I hear you, but there are also plenty of things that you can have genuine input into. There are plenty of ways that you can contribute to making this NDIS transition a really healthy one.

Good leadership at frontline level can change the cost and outcome of transition activities. It can change the design and outcomes of new infrastructure. It can minimise the difference between what’s actually being purchased and what’s being delivered. It can maximise the accuracy and timeliness of NDIA claiming. And most importantly it can also change the way that your team delivers support in the longer term to maximise client satisfaction and outcomes overall per dollar of their purchase.

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## What do I need to remember?

To do great leadership in this particular case you’re going to need to remember a couple of things, and in terms of the stuff that’s captured here there is a cheat sheet available to you that reminds you of the key things that you need to remember as leader and the key things that you need to do.

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## Next steps

What are the next steps that I would encourage you is, from my perspective, I appreciate that we’ve covered a lot of ground and that some of you are effectively going to tell me, “I signed up to make a difference. I didn’t sign up to make a profit. Tim, you’ve talked a lot about numbers. You haven’t talked a lot about human rights.” I’m here to tell you that making this transition in a really healthy way ultimately is the best way that you can support your clients in the short term.

So one of the next steps that I would encourage you is, first, do your homework. Understand where you’re at now in terms of the cash position of your organisation.

Second, think, plan, and act wisely in terms of identifying, specifying, implementing and reflecting on the key projects that you need to do as part of the NDIS transition. That is your job. That’s everybody’s job.

I would encourage you to invest in open communication. Ultimately to bring your team along here is really important. If they don’t understand that you are thinking about the client, about building an organisation that’s built to last, then that’s an opportunity lost both for you and them.

And I would encourage you to lead with clear thinking and discipline. I understand that you’re not all accountants. Ultimately your job is to make sure that your organisation is safe in terms of human rights, but also safe financially for continued support for your clients.

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