End of Financial Year Cash Flow Modelling
21/06/2023

CCH Learning:

Hello everybody and welcome to today's webinar, End of Financial Year Cash Flow Modelling. My name is Susannah Gynther from Wolters Kluwer CCH Learning and I will be your moderator for today.

A few quick pointers before we get started. You'll find the PowerPoint slide in the handout section on the GoTo Webinar panel. If you are looking for the extra handout, you will have to get that from the CCH Learning platform as unfortunately we can't upload it to GoTo Webinar, but please go there and have a look. If you're having sound problems, please check your settings. Maybe try toggling between audio and phone. And just a reminder that within 24 to 48 hours, a notification for the e-learning recording will be emailed to you. You can ask questions at any point during the presentation by sending them through the questions box. I will collate those questions and ask them at the Q&A session towards the end of the presentation.

CCH Learning also offers a subscription service, which many people have termed Netflix for professionals. It provides members with access to our entire library of recordings as well as live webinars for a competitive flat fee. That's for over 500 hours of content. For CPD purposes, your viewing is logged automatically.

Your presenter today is Lance Rubin, CEO and founder of Model Citizn. Lance has two decades of corporate experience across professional services, investment and commercial banking prior to founding Model Citizn. He has a wealth of financial modelling experience across financial and professional services having worked at two of the big four accounting firms, PwC and KPMG, as well as Investec Bank, Corporate Finance and Advisory, and National Australia Bank. Model Citizn helps all businesses and organizations to make informed and purposeful decisions with insight by better managing cash flow and their Excel and Power BI environments. Lance is the author of the CA ANZ Study Guide on Financial Modelling and has run workshops across Australia and New Zealand on data analytics and data visualization using Power BI on behalf of ACCA and CA ANZ.

I will now pass you over to Lance to commence today's presentation.

Lance Rubin:

Thanks, Susannah, and really appreciate everyone. I know it's a very, very busy time of year preparing for everyone's tax returns compliance, and I guess that's the perfect opportunity to really leverage an activity like cash flow modelling. So this session is really going to help you think about not just the model but also the business. We're going to go through some definitions. We are going to cover a lot of ground, but really this is about thinking about we are doing all this work. Is there an opportunity to leverage that work that we do when we are completing our tax returns? And the short answer is absolutely there is.

So what we are going to cover is really firstly the definition and some of the foundations, and I want you to think of these four areas. Think of backward-looking, think of forward-looking, think of looking around you, and think of looking deep. And I'll cover all of those and you'll see what I mean by all of those four areas because when it comes to understanding cash flow, it's not just one thing, it's many things. It's the most important thing of course is cash, but there's so many different things that can impact it. So what we are going to look at is financial and management accounting and reporting. Financial forecasting. There's many different ways that you can forecast. There's financial analysis. So how does that differ to forecasting? There's industry knowledge. There's

mathematics and logic that we need to design for the model. And of course you can't escape technology. We need to think about what are the technology solutions. So we'll cover a little bit about that.

So the first thing is your financial and management accounting. Now this is very much in the compliance world, particularly for financial accounting. So we need to give accurate and up-to-date information because that's what we're going to use for our modelling. So if we don't have the baseline information accurate, that'll really make it difficult for us to provide any insight in terms of cash flow modelling. So it's a strong foundation in financial and management accounting that will help us keep track of information, ratios, and other statements that'll really help us understand a business from a financial perspective but also from a business perspective.

So that's looking back very much in terms of the backward looking. What we then look at is forward looking in terms of forecasting. So one of the easiest way to forecast is just a run rate analysis, but we need to be a bit more smarter in terms of how do we make better decisions. We've got to think about drivers. We've got to look at the past, understand what's relevant, and pick those drivers out and use those to forecast.

Understanding different techniques. So time series analysis is really looking at information over time, whether that's growth rates or whether it's particular trends in particular months and seasonality. So time series analysis is really useful in terms of then forecasting based on the time series. Regression analysis is a statistical method where you're trying to look at different variables and how they relate to each other and using some of those variables to predict the future. Very statistical based, but of course a lot of programs and a lot of applications use some of those methods.

Sensitivity analysis is where you're looking at how sensitive particular numbers are. You've got a particular driver or you've got a particular factor. Maybe interest rate I guess at the moment would be one of the most sensitive factors in terms of particularly if you've got debt in a particular business would be quite sensitive.

And then scenario planning, where we're starting to look at more than just one variable. We're looking at a scenario, we're looking at multiple elements to that. And that's important to really understand because things don't change in isolation. What happens when we make many different changes at the same time, thinking about scenarios when we are looking forward is of course important.

So a key part of backward looking is really to understand and analyse the data and the trends. So we can't look forward until we actually analyse the data. So analysis tends to be very backward looking. And we use the analysis to really understand what's happening. And if we do that more regularly, we've got a better understanding. But when we're doing our taxing compliance for year-end and the tax preparation, we're getting a lot more deeper. We're getting a lot more closer to the numbers that we probably don't do throughout the year. So it's actually a great way. We're looking at checking with a certain expenses are deductible, we are looking at the way that the accounting works, we're looking at compliance in terms of the ATO and potential audits. All of these things, we are doing all of that with a particular compliance-focus lens. We could also do that with some financial analysis and management as well, which would really help us understand ratios and trends to really help us become more adept at forecasting and understanding variances is critical.

So we've got to look inside, but we've also got to look around. We've also got to look at what's industry benchmarking or what's information that's available externally. Now, that can be valuable in certain areas when you're looking at particular assumptions around growth. What is typical in terms of conversion rates or what is typical in terms of a particular marketing campaign and how successful that could be in particular channels? So looking around is really important. Having deep understanding of the industry at large. Is the industry going through some changes? That is also a very important factor to consider, not just what's happening in the company. We've got to sort of look much broader around, even globally in some cases.

And really to understand the underlying key business drivers is a really important part because certain industries have particular drivers that are relevant for that industry. So SaaS businesses and technology, very much a driver is about, "How many people? What are the impressions? How many people are coming to our website? What's the conversion rate? What's the cost of acquisition? What's the lifetime value? LTV? CAC?" Those are really particular metrics that are in the SaaS world. But there may be very different worlds to the manufacturing like on time and full measures in terms of delivery. So these are important things we need to understand as an industry.

Then we apply that in a much more deeper fashion when we are trying to build the model. So now we understand... Let's say for example in the SaaS world, we need to understand data and look more deeper in terms of the information that we have and the logic we are going to build. So by going deep, we're actually looking into the maths, we are looking at the statistics. We're looking to understand how we shape and use that information and apply that in a model and build the logic. So we have to understand these data techniques and information, but we also have to understand the industry and apply that in designing the logic, in designing the model that we're going to be using.

So you'll notice the word analytics and analysis and modelling. It often comes up. This can be quite confusing in many cases. And so I often like to share this in terms of an understanding that analysis, particularly predictive analytics and looking forward uses a lot of data. So that may actually be relevant and useful particularly when you're using statistical methods. If you are using statistical methods and predictive analytics, you do need a lot of data and you need a lot of good data as well because you feed garbage in, you're going to get garbage out.

So analytics is really about deep and narrow focus on particular areas, whereas financial modelling and cash flow modelling in particular is much broader. So now we are looking at days in debtors and working capital and revenue and expenses and maybe payroll and FTE and growth plans and debt and funding. So you can see that financial modelling is much, much broader and it's quite shallow. We're not going down to a transaction level necessarily, but there's a great benefit in combining these two. So we might do some predictive analytics around our sales, but then use the rest of the financial model to predict cash flow in terms of, "Okay, we've got sales, but what is the average days in debtors and how do we model that from a cash flow perspective?" So that's also important. So combining these two can be quite powerful.

So the velocity of decision making is important. I mentioned earlier around sensitivities, scenarios. Understanding what's the velocity, how many scenarios, how many sensitivities. And if there's a high degree of variability, then you might even want to think about something called simulations. It's also referred to as multicolour simulation. Not use that often and probably not well understood, and part of the reason is really most people can't comprehend more than just a base upside and downside case, so three. So simulations allows us to create much more uncertainty because that's the world that we live in. There's a lot of uncertainty related to particular variables. Let's randomize that. So by creating randomness in a model, you're simulating that you can do thousands, millions, hundreds of thousands of simulations. And that just allows us to understand the outcome of those changes of a lot higher random inputs.

So simulations can be quite useful in certain key areas, but definitely we want us to understand the velocity of the decision making. We want to understand how we make those changes and how does that affect certain key decisions. It's quite well known what interest rates are going to go up by, 25 or 50 basis points, hopefully just 25, and how many rate rises we're going to have. You can have two or three. But if you've got a very high degree of variability, you sometimes want something else to be more automated in terms of how you make those decisions.

The last part of this is the technology. I guess this is where often we get into a little bit of hot water. Technology absolutely plays a critical part of this. And in most cases, people are using Excel. Excel is a really great tool, but we need to use tools that are appropriate for the situation. Sometimes some of these non Excel web-based tools are just as good because it's nice and easy and we pull that information. So it's horses for courses. We need to understand the complexity. If we have a high degree of complexity and the logic that we have to build needs to change quite a lot, then we're probably better in Excel because we can then make those particular changes and design the logic that we need.

If we don't need that and we just want to a basic run rate or growth rate basis, then of course we can use other applications that streamline and automate that. So we are not having to manually manage our Excel workbooks. And of course there's a bunch of add-ins as well that allows you to do that, but still inside Excel. So understanding how the tool supports your modelling process, your analysis process as well and your analytics is equally important. So technology is much more than just solving one thing. It's actually looking at the entire process and what works.

For us, we use these two technologies, Excel and Power BI. They solve different problems. Excel, and I'm going to show you an example of this workbook and that's what Susannah was referring to earlier. If you go onto the platform, you can download this Excel workbook. It has all the sort of attributes of a really highly automated, easy to use, click a few buttons and pull the data in and run some scenarios, but you're still in Excel so you can make some changes. But of course, Excel starts to fall apart when the data becomes a lot bigger. And so Power BI is another example of where we would use something at much greater. So if we want to look at a cash flow statement over much more granular data, then I guess we would use something that could scale that a lot more. So Excel and Power BI, both in the Microsoft stack, very powerful.

And as I said, there are a plethora of other cash flow modelling and reporting tools that are outside of the Microsoft stack and they are useful as well. They have their purpose, but their purpose tends to be quite narrow. They tend tends to be certain key areas where you don't have necessarily the full transparency of the logic. You don't have full control of the logic. And of course, that's the one area that these two tools are far better in terms of transparency and usability.

Then we want to think about not just the technology, but what is the type of model that we are going to be building. In many cases, it's just a transactional model or cash flow model or what we often refer to as a 1-way model. That's cash flow only or profit and loss only. So if you're just looking at one element of that, then of course that's a 1-way model. There's a 2-way model where we're starting to include the income statement, maybe some balance sheet items or the P&L and the balance sheet. That certainly can be useful. And in this case, obviously it would be more cash flow based with a P&L potentially or elements of the balance sheet. But of course cash flow models have to have cash in it.

But the other one is a 3-way model, which is of course your standardized income statement, balance sheet and cash flow integrated more complex but more robust. Our balance sheet makes sure that the forecast cash flows are correct. So if we don't have a balanced balance sheet in a 3-way model and we don't have that reliance on our cash flow. It's so important to have that. And a 4-way is where we start to bring in the sources and uses of funds. So we start to think about how do we take the cash flow, how do we make it really simple for someone to understand.

Remember, in the end we're producing this for a client. Clients are not going to get their heads around balance sheets. Or even the cash flow statement can be quite confusing because it's operating, investing, and financing. Whereas sources and uses, what is the cash coming in from? What is the source? And how am I using it? What are the uses? So the sources and uses is that fourth statement. It's not a mandatory statement, but it's often used to simplify understanding of cash flow in terms of and out. So that can definitely be used and added on to some of

those things. It's almost like it's going back to the 1-way, which is why the arrow goes back to 1-way because you're trying to just sort of cash in, cash out. Your 1-way cash flow is cash in, cash out. Nice and simple. The 4-way takes all of the complexities of that 3-way and puts it into a nice easy in and out cash in, cash out, which can be quite powerful.

Very important when starting a financial model or any sort of analysis is really to understand why are we doing it, what's the main purpose. So Simon Sinek's Golden Circle, if you haven't seen there's a great YouTube clip on it. The why, the how, and the what. Why are we doing this? What is the cash flow decision we need to make? And then what are the key things that we need to focus on? If we don't have that really clear, then whatever we are going to build or how we are going to build it is going to miss the mark. So I use this as a target because it's about nailing that bullseye, absolutely understanding what's the purpose.

And then we can look at how do we do it. So we are using best practice, we're using scenario analysis or sensitivities or simulations. Or maybe we are using certain technologies. We need to think about how we're going to approach that from a process perspective. And then what are we going to produce in the end, thinking about, "Are we going to produce the 4 or 3-way? Is it a 4-way? Is it just a transactional level model?" So we just want to look at invoicing and look at our debtors and our day-to-days and add in a factor of collections. So if you haven't seen, I did do a webinar on accounts receivable modelling. There was some good feedback there. So if you want to look at particularly modelling a very narrow transactional level focus, then that would be a good one to look at.

So understanding those concepts is critical. Once you understand the why and the how and what, then you need to think about, well what is it that'd be putting into this model? What are the assumptions? What is the data? What are the key outputs and dashboards? And what are the sort of appendices or things that we need to think about in terms of the chart of account structure and other key structural elements? So I'm not going to go through every single item here, but it's fair to say that all of these will have an impact on cash. So we need to really make sure we understand how does the data map to the chart of accounts. It's probably one area that I've noticed that is really lacking, is a really good solid chart of accounts to enable us to do good cash flow modelling.

So we definitely want to look at the mapping and transformation. We want to look at the historical data. We spoke about that in terms of the analysis, in terms of understanding trends. Obviously the time series in terms of are we doing a monthly model, a daily model, a weekly model, all important. And of course then we have all our logic around all these different areas. And then the outputs. The outputs are important. That's where clients are not necessarily going to go digging deep. Some will, but most won't. And they'll want you to give a nice little dashboard, an output, or a scenario manager that they can change things. And so I'm going to show you an example shortly around an example of a model where we've got some nice dashboards that are easy to use and also you can play with some scenarios. So that's important.

Managing risk in cash flow modelling is important. When you start to build a team around providing the service, we need to make sure we start adopting some best practice approaches. So I use an acronym called FAST. If you haven't seen it, Flexible, Appropriate, Structured and Transparent. Again, I'm not going to read everything on the slide, but it's important to really think about how do we make the model flexible to cater for different things, whether it's different scenarios or just the way in which the business is going to change.

Now what's appropriate for one company is not necessarily appropriate for another. So there's some degree of reusability, but ultimately we need to tailor the cash flow model to the particular client, especially if you've got a different industry. So certain industries will have consistent metrics but other industries won't. And of course as accountants, we're working across many different industries. So that's important to tailor that. Make sure it's well structured. If you don't have a good foundation of how the model's built, just like a house of cards, it'll just all come crashing down. So we really need to have that.

And the transparency is important. I think that's where some of these other tools, whilst good and structured and easy to use and flexible, they don't always have the transparency. And of course being able to understand the logic, understand the calculations is important. Particularly if we get a question from a client in a particular number, we want to be able to articulate that and dig behind it to see how it's calculated. Some of the tools, you just can't. Their logic is embedded within the software. It's not available like you have in Excel.

So we have our first question, Susannah. There's a lot that I ran through just then in terms of the basics, but I really want to ask the audience this around the forecasting methods. So yeah, maybe you want to take it away.

CCH Learning:

Thank you very much, Lance. So which of the following financial forecasting methods involves analysing past data and applying a statistical method to identify trends and patterns that can be used to predict future performance based on relationships with variables? Is it A, regression and analysis? B, scenario planning? C, time series analysis? Or D, sensitivity analysis?

I'm just going to launch the poll. And if you could please, put a click in the radio button next to the answer that you think is correct, that would be great. Just a reminder of course if you do have any questions, please put them into the questions pane and we will get to those questions in the Q&A session at the end of the presentation.

It's great to see everybody voting, so I'll just give you about 10 more seconds to get your votes in and then we'll close the vote. Okay, get those last minute votes in because I am going to close the vote. I'm going to close it now. And let's have a look at what people thought.

Okay, so 46% said C, time series analysis, 23% said D, sensitivity analysis, and 15% for B, and 15% for A. Thank you very much. Lance?

Lance Rubin:

Thank you. I know this was a tricky one. When I put it together, I thought, "Oh, it can be confusing" because we are looking at time series, we're looking at sensitivities, but this particular giveaway is statistical method. So regression analysis is the answer because it uses specific statistical methods and it identifies trends and patterns, in particular relationships of variables. So scenario planning, there's a bunch of things in there in terms of time series analysis. They're all part of doing forecasting methods, but the giveaway here is the statistical method. You can do scenario planning, time series and sensitivities without doing statistics. So that was really the clincher there. I know it's a bit finicky, but ultimately, regression analysis does enable us to do quite powerful statistical modelling, which again is probably... I don't do a lot of it, but in some cases that is used. So that's probably where people are not as familiar with regression analysis.

So linking this to the cash flow modelling for your year-end tax process. So I think this is the key. We've got to think about, "We have these tools, we have these technologies, we want to do this work, but how do we link it?" So we've really got to think about we are doing all this work for the compliance as I said, for compliance for tax regulations. We are doing a lot of that analysis work. So we just need to extend it a little bit, go beyond just checking if an expense is deductible or understanding certain things, just looking at, "Well what if we changed the way certain expenses were incurred? Or maybe we can look at different scenarios." So I think it's important that there's a huge correlation between the reliability of the information that we're working on from a tax perspective is as essential for cash flow and forecasting and financial record keeping.

So this is where we can really bring these two together. So by integrating the process and looking at our year-end tax process, we can start to pull little threads across into cash flow modelling. So, "No, we need to understand holistically the business." Well, in many cases you need to do that anyway from a tax perspective in terms of if there's a tax loss, what is the business going to do about future performance? And is the tax loss going to be recoverable? Or do we want to manage the tax in a way that of course is compliant but manage that tax position? Now we need to understand what the business is trying to achieve. So again, there's another thread that we can use to understanding strategy and looking forward. So optimizing your tax position is a huge benefit from a cash flow modelling perspective. Improving cash flow management in terms of when we are incurring certain costs and the deductibility, whether it's CapEx or OpEx and how certain things are incurred. And ultimately, it's about looking at financial performance and how we can link these two together.

So when we start to think about this... And we need to think of, of course you can't do something unless you pitch it to your client and what is the benefit for them. So I think the benefit for them is they're already spending time and cost, relating you preparing the end of your tax returns. There's additional work that can be done at this point. I guess this is where there's a huge opportunity to convince the client that, no, there is value in terms of going a little bit further, a little bit wider than just the financial records, but looking into some of the business drivers and identifying areas of where cash flow be improved through reduction of certain expenses or increasing of certain revenues. Now, we wouldn't typically do that from a tax perspective because we're now looking at the future. We tend to be looking just back.

So when you think back to the back, forward, wide, and deep, thinking about those elements are important when you're trying to pitch to the client of, "Well, why would you do more work?" Well, the benefit of that is you can look beyond just what has happened but into what is going to happen, what's likely to happen. No one can predict the future, 100%, but at least you can use some of these techniques. And so by using that, you can use it for cash flow modelling and insight to help them develop better and accurate forecasts. If you're starting from scratch and you've never done one, of course there's a lot of variability in forecasting. But as we get better, it's about starting that journey.

So by pitching it to the client, we're not just going to do it at the year-end. You might start doing cash flow and modelling at the year-end because you're doing all that work, but you might suggest to them that doing it on a more regular basis, whether it's a quarterly basis around the same time as you're doing your BAS returns if you're a quarterly filer of your BAS, understanding those times are also a great time for you to look at cash flow modelling.

So emphasize the potential cost savings that this could be achieved by integrating these activities. You're already doing the work. So doing a little bit extra could actually add a lot of value. So there will be potential cost savings in terms of doing it outside of when you're doing your compliance year-end tax returns because then you've got to go back into do all the analysis. You already have the bonnet open, you're already in the engine, you're already digging around and looking at stuff, then why don't we leverage that activity? And that's the benefit of doing it around the tax year-end. And so this is where we can really add a lot of value in terms of conducting that work at the same time and really bringing those together.

So we've spoken about pitching it to the clients, but there's a lot in here around your business model. So if your business is set up as largely compliance-focused, then how do we design our business in terms of offerings? So it's all good to pitch it to the client and sell it. Now we have to deliver it. So what are the elements that we need to think about from a business model design perspective? So now, expertise. We clearly need to have experts in understanding how to build models, understanding the business. What technology? We've spoken about that briefly. What processes are we going to have to put in place? If we're going to be looking at the year-end results and we're going to start to pull these threads that could use for cash flow modelling, then what does that process look like? What is the data that we are going to be using and how do we manage that? Because that's an

important aspect as well. Client engagement. We spoke about quality control. And of course pricing strategy, which we'll go to in a sec.

So the experts that we need to hire or think about is really cash flow modelling capabilities, understanding financial analysis, accounting skills are critical. So we have to have a team that understand cash, understand the relationship between accounting and cash and tax, and all of these elements are important. We have to provide some form of training or professional development because it's not something that is typically covered in university in terms of understanding cash flow modelling. Yes, there's forecasting and budgeting, but cash flow modelling is quite niche and quite specific, just focused on cash. And of course, sharing and collaborating and understanding people's challenges in this space, particularly if we are moving towards offering this, we need to think about how do we support people.

Technology. As I spoke about earlier, there's lots of different software that you can use. How do you configure it? How do you make sure that it's a fit for purpose? And all of those things I guess are important. And so there's definitely a plethora of information, almost too much. So there's definitely areas where we can think about how do we focus and how do we measure the right technology. And there's a method of that that we probably won't have time to go into detail on that front.

What's the process? How do we set up a process to do this in terms of developing, implementing and reviewing our models? So we have to think about that. Just like a process to complete a tax return, we have to collect information, we've got to validate, we've got to do some calculations and we've got to report or prepare or finalize. Very similar to cash flow modelling where we've got to design, develop, implement. I've got a nice little summary in terms of what that process looks like. We need to document it, we need to share it with our teams and we need to monitor that ongoing.

So the 5D business model is something that I created not too long ago around going through this process of understanding the discovery to work through that. Now, in many cases we have existing clients that discovery phase might not be needed to some degree, but we do need to think about beyond just the compliance focus and other areas. If you're going to spend a lot of time in discovery, definitely make sure that you're charging for it because you are adding value to the overall business and you're designing something that is going to be useful into the future. We need to define the problems. So we need to discover information to then define the problem. What is it that's impacting cash the most? Is it working capital? Most cases it is, it's managing your debtors and your creditors and your stock.

How do we design several pathways to find a solution to that? Is it changes in credit policy? Is it training? We've got to design that. Then we have to develop the solution. So the development of the solution may be a model, but it may be a new process, it may be some training. So how do we develop that so we educate our clients to manage that?

So this business model is not just about a financial model, it's actually about understanding the solution that meets the defined problem that we have. And I think that's the important thing to think about. And then how do we deliver that? How do we deliver the value add? We may be running a training session or maybe reviewing or doing certain things on a more regular basis. A great way to deliver this is more regular reviews of their cash flow on a quarterly or monthly basis. Or if they're really dire straights, we want to look at maybe more narrow. On a weekly basis, that might be useful. So these elements are important to understand in terms of the business model and how we set ourselves up to deliver this.

So when we are starting to think about this, we also need to think about pricing and scope. One of the areas that we often get ourselves into is scope creep. So this is just a longitudinal view of that business model discovery defined, is that some rough guidelines in terms of how long certain things would take. Now, most of the other elements are really predicated on the discovery phase. So you do discovery two to three weeks. Now, obviously to deliver a training course is vastly different from delivering a financial model to delivering a data solution with power apps and Power BI and doing all sorts of great stuff. So that's why a lot of that is hinged on the discovery phase to really understand we've got to make sure that we keep a scope and we manage that. And of course, we have to have pricing approval as we go through so that we can manage scope creep. It's one of the areas that is most challenging from a business perspective in terms of doing this work because we can burn so much time.

So there's risks as well. Like everything, like every business, like every service, we have to think about this. So what is the risk of certain things in terms of our clients and the risk for us as well? So the key thing for clients is they have a real risk in terms of interest rate at the moment. The cost and inflation is a real impact. Credit risk, of course. Balance sheet risk in terms of working capital is a big risk. Understanding the logic and the assumptions, there's risk in that. So we need to understand and think how do we validate some of our assumptions? Do we have a clear purpose?

The biggest risk is building a model without understanding the why of where we are going. It's very, very dangerous to just build a model because we think it's going to be valuable without understanding how's it going to be used, where's it going to be used, what is the time series that we are looking at. Is it short term, medium term or long term? Are we actually looking at our model and taking in actuals and adjusting and comparing? We want to make sure that whatever we are building, and in this case obviously focusing on a model is, is it accurate? Is it picking up the right things? And if it goes out of whack with what we expect, do we understand why? Do we understand why there's a variance?

One of the biggest challenges is assuming profit or EBITDA as cash. And that's one of the biggest questions that business owners often have is like, "Well, I'm making all this profit but my bank balance doesn't show it." So really trying to articulate that. Not always assuming that profit is cash. And of course, that's a risk. If we're showing big profits, it doesn't necessarily mean a lot of cash. And just remember there's a great saying by George Box, "All models are wrong. Some are useful. It's not the model. It's not the number. It's how we use it in decision making that's critical."

Data management is important in terms of collection, storage, and managing data. If you've got a cloud system like Xero, you've obviously got the financial information. But what if you are using information outside of the accounting system like HubSpot in a CRM or you are using Salesforce? So we do have to think about data management because if we are getting information into this model, how do we manage all of that? How do we manage that from a security perspective but also ease of access? And so we need to understand and design how are we going to source with the format and the quality standards that we need to adopt in data management.

And so we're starting to cross out a little bit into the IT space around data management, but it's an important thing to think about. We can't just ignore that. Of course we have to make sure the data's secure, but I think that's a given. As accountants, we know that our data that we use for clients is absolutely sacrosanct.

Client engagement. So how do we think about engaging with the client, the communications? How do we actually discuss these sort of options and these sort of things in terms of running the business marketing? How do we onboard a new client or how do we onboard an existing client that we've been supporting for a long time from a compliance perspective? But now we have to think about it from a cash flow and modelling perspective.

Giving them regular updates. How do we charge for time or value? Perhaps a bit of both. All of these things around what is the value that clients are going to get? Strategic decision making, scenario planning, valuations, debt covenants, procurement. These are actual areas where there is tangible value for them. If they want to sell their business, what is the value of their business? If they're a startup and they have a runway, when's that going to run out and how are they going to need to think about cash flow and the consumption and the cash burn rate on their balance sheet? So there's absolute value to present. It's a question of, how do we get that? How do we charge for that value?

Quality control. We have to have some form of peer review in terms of models. Quality standards. We spoke about FAST, the FAST acronym in terms of building. But we need to think about all of that because the last thing you want is starting to offer the service and the quality starts to drop off. And no, if you don't understand all those risks that we spoke about, that could also be problematic. So we need to think about how do we maintain the quality control of the models that we're producing and how do we make sure that we are evaluating that service on an ongoing basis.

So that's a lot. If you want to start this new area of cash flow modelling, there's lots to think about. There's a lots of different areas. So I'll put this question together because I think it can be overwhelming sometimes. So Susannah, do you want to put that up for participants to think about in terms of what do they focus on?

CCH Learning:

Thank you for that, Lance. So yes, what is the key element of the business model design for a cash flow modelling service? Is it A, developing a marketing plan to promote the service to potential clients? Is it B, creating a pricing structure that aligns with the value provided by the service? Is it C, establishing a team of professionals with expertise in cash flow modelling, financial analysis and accounting? Or is it D, implementing accounting software and other analytical tools to support the service delivery process?

So I'm going to launch that poll. And if you could please put a click in the radio button that best describes what you think is the answer, that would be great. And just a reminder that if you do have any questions, please put them into the questions pane and we will get to those questions in the Q&A session at the end of the presentation. I'll just give you a few more moments to get your votes in and then we'll close the vote.

All right, so I'm going to close the vote now if everybody's ready and let's have a look. Okay, so 50% said C, establishing a team of professionals. 25% said B, creating a pricing structure. And 25% said D, implementing accounting software. Back to you, Lance.

Lance Rubin:

Thanks Susannah. I love the answer there around developing the team, but I actually think yes that's an important ingredient, but I don't think it's the first key element. I think one of the hardest things is pricing and selling the value to clients. And so we can build the team, we can build the software, we can build the marketing plan, but if we don't know how to price this work and we don't know how to sell and pitch it, I think it's a little bit cart before the horse. I'd say that C is probably the very next thing. So if we do price it, we obviously need to develop the team and we might want to focus on that, but we need to get our pricing right. Otherwise, we'll go into an engagement and we'll burn the team and there's a risk with that.

So I think pricing is actually what I would say is the first key element. Because we are so used to charging for time, how do we charge for value? And it's a very much a mindset shift in terms of how do we price for value, which can be quite difficult and of course quite different for different clients who've got different complexities. So definitely the rest are really good. I do like the fact that majority say the expertise because I think that's where the current challenge is in most firms, is just the skills don't exist, and therefore that makes it harder to sell. So I think that's generally one of the challenges that people are facing. So got to have a price, got to be able to sell it. If we can't sell it, we're going to develop a team that just can't deliver the work, or we can't win the work in the first place.

So pricing, as I've just said, is really a mixture of art and science, particularly when you're thinking of value. So now how do we price this? Given that it's, as I said, one of the most important things to get clear in our head to start off with? Are we going to do hourly rate? Clients want transparency around hourly rate. Is it flat fee? Is it a set fee for a model? Or is it a combination? Now how do we compare to our competitors? If we just build the team and we can't realize how others are doing this or how others are pricing it, it's important. Pricing is a competitive landscape. Everyone's rushing. Obviously some people said go get technology first. I think the risk with that is you get technology and it doesn't do what it says on the TIN and you've now got to fall back to Excel. And that makes it very, very painful if you haven't set up the Excel skills and the Excel environment well enough.

So definitely think about pricing from a delivery perspective, a competitive perspective in terms of how people are charging for this. There's various models for that. Do you have an effective way to price that work? That's an important thing. If we don't have that, again, we're going to run into some challenges. And how many times we've tried this work? Because I'm sure accounting firms have tried to do a bit of cash flow modelling or advisory work and they've just priced it significantly lower compared to the effort. That's what I hear time and time again. "I tried it. I got burned. I'm not going to do it again." So the pricing actually makes it quite difficult to go into that space because of the overruns and the effort that's often involved because we missed price. So we are not thinking about the price relative to the value, but we're also not thinking about the price relative to the effort.

It's hard to understand the effort because we don't know what we are going into. But I'm going to give you an example of how you can actually break it down and give you that flexibility on price. So is it hourly rate? Is it fixed price? Maybe there's a retainer element in terms of ongoing updates of the model. And maybe it's a hybrid. I'd recommend hybrid is definitely the way to go. So for a discovery phase, you're going to go fixed price and you might have a wide budgetary guidance. So you say, "Okay, well, we're going to do discovery. We're going to look much more beyond just the compliance numbers. We're going to look at other information. And for that we are going to charge you 3 grand or 5 grand, whatever it is, a fixed fee. And then we are going to give you a budgetary guidance in terms of what the solution could be based on that. It could be anywhere between 10,000 or 50,000 or whatever that is."

And as part of the discovery phase, we then go narrow that down to a fixed price but never have a fixed price without a fixed scope. So scope creep, and that's where you start to adjust. So fixed fee, fixed scope, and then we start to charge for out of scope items. And that's where the hourly rate comes in. So this is where you can have that hybrid pricing model where we have fixed fee for discovery or what's also called a diagnostic. We have a range in terms of what the fee would be. Clients want transparency, so we'll give them that transparency. We'll lock in a price, but that price is locked in for a fixed scope.

So if we say, "We have to build a model, it's a 1-way cash flow model, it's going to cost us 2 grand. I know I can go get a cash flow model from using technology like Excel cloud or other technologies. I can do that. It's going to cost me $500 to do that with the time that the team's going to spend," and that's great. But if they want to change that or they want four or five versions of that, then it's outside of the scope. So fixed fee, fixed scope, three versions, that's it. And when we want to do more, then the clock starts ticking in terms of hourly rate. So we have to manage that uncertainty with the process relative to the pricing.

So I'm going to give you a quick example in the last few minutes that we've got of the session. So here is a cash flow model. By the way, this model is available for you. You're doing the end of financial year tax returns. A client wants to explore a new marketing and promotion plan. So the plan can yield anywhere between 122,000 and 1.1 million in additional revenue over the next 12 months. So that's a big, big range in terms of what that could earn. The cost of the campaign could be anywhere between 110,000, so kind of just almost break even with the revenue uplift to 250,000. And so they want to try and understand this variation. There's going to be some ancillary impacts on cash flow and direct and indirect expenses. Direct expenses being things like salary. They want to understand all of those things. They want to understand the impacts on overheads. And of course all of those they want to understand really easily in a nice easy to use dashboard.

So here are a bunch of assumptions that we've got. They're going to need to raise some capital. So there's some equity coming in. So what we can see here is information around the equity. There's an uplift in income. There's different variations on that. There's some direct costs of the promotion. There's 125,000, 110,000, and of course we have 250,000. So all of these are going to be put into a nice easy to use scenario manager base, best, and worst case. And ultimately we are going to sensitize and change how long and the amounts that these particular line items in the financials are going to be impacted.

So client can give you this table and you need to understand and now model all of these things. So when you're starting to think about the process, think about what is it in particular we want to look at, what are the scenarios, and how does that play out. This is an example of what that would be. So I'm going to jump now quickly to the Excel workings. Here we have our scenario manager. That's the scenario manager, the screens that you just saw there where we've got our base case, our best case, and our worst case. And we can start to make some changes into each of these scenarios. And then produce a dashboard which allows us to compare the enterprise value, the gross margins across those cases. So we've got base case, best case and worst case.

And we can look at a particular company. In this case, it's just looking at the Australian entity. We can also look at different time periods of the impact on the cash. Opening cash, movements in cash and closing. I can look at each of those individually and I can look at the margin. So our base case is 2.7%. Our worst case is -71%. So we can start to look at the scenarios in terms of what impact it has, but maybe you want to look at that side by side. So same sort of situation, we can look at each of these impacts side by side in terms of those different use cases, revenue, expenses, movements in cash and balance sheet. All of those will have an impact.

So what we can do is we can put some of those scenarios, we can grab the data from the reporting system and start to use that and understand the conversation around what we might suggest as a way forward. So whether we go with that particular marketing campaign or we decide to do other things or we start to lock in some revenue, all of those aspects... Sorry, I will show you the forecast cash flow scenario as well, which is in the slides. See here, you can look at your forecast cash flows for those different scenarios right there by clicking this button. So here, we have our cash flow. And depending on what we put in will depend on how some of those expenses will flow through into the model.

So understanding all of that and using that is an important part. So looking at things side by side or looking at the impacts on margins and valuation, that's all useful. So a final question, which of the following core skills needed in the team? So back to everyone wanted to understand, I guess, the team skills and expertise, what would you say would be the core skills needed to provide cash flow and modelling services? So Susannah, if we just jump to the final question?

CCH Learning:

Yes, certainly, Lance. So which of the following are core skills needed in a team that provides cash flow modelling services? Is it A, marketing and sales expertise? B, project management skills? C, accounting and financial reporting knowledge? Or D, programming and software development experience?

So I will just launch that poll. And if you could please put a click into the radio button next to the answer that you think is correct, that would be great. And just a reminder that if you do have any questions, please put them into the questions pane and we will get to those questions very shortly in our Q&A session at the end of the presentation.

All right, I can see that everybody's voting, so I'll just give you about 10 more seconds to get your votes in and then we'll close the vote. Okay, I'll just close that vote and let's have a little look at the answer. Okay, so 69% said C, accounting and financial reporting knowledge. 15% said A, marketing and sales expertise. 8% said B, project management skills. And 8% said D, programming and software development experience. Back to you, Lance.

Lance Rubin:

Great. Thanks, Susannah. And it's great. 69% of you were correct. You can't do any of this without a core knowledge in accounting and financial reporting. So really well done. Not to say that the others are not important, but I think this is the core skill.

And so, in thinking about the team that we have today, whether we need to think about expanding their skills in accounting and financial reporting, but you'd assume that most accountants working in the teams doing compliance work would have a reasonable knowledge in the space. So I think the answer by 69% is absolutely right. I think marketing and sales expertise are important as we said, but I don't think that's the core skill. If we can't deliver it, then I guess we're going to have a bit of a challenge. Project management is important. And programming and software development, if you're going to build your own solution, sure, but I think you'd probably want to look at leveraging what... There's a plethora of technologies out in the market, but if you are building inside Excel or Power BI, then of course you can do some development of your own using some of the native programming languages there. So I think it's definitely an area of great interest.

So next steps, I guess for me, thinking about what you've heard today and do you have the expertise in your current firm. And if not, how do we go get it? There's a range of things that Model Citizn's working with CCH Learning in terms of developing more content around the space that you of course can use. But of course sometimes you want face-to-face. Do you have a defined process? In most cases, I've found that there isn't. So maybe thinking about some of the processes and some of the design that we've got. And pricing. I find pricing is certainly an area where we need to reflect on and think about how do we price for this work.

Investigate the modelling workbook, take notes, look at the structure, just think about how do we design it so that it's nice and easy to use, it's appropriate, it's structured, and of course it's transparent. I know some of those formulas are quite large, but you can use ChatGPT to define and explain some formulas, which we did recently on a meetup, which can be quite powerful.

So attempt a few methods using the live use case and certainly similar formulas. You might even want to use it for particular clients. You don't need to have any subscription. You can just use the Excel workbook, delete the data that's there and reuse it. If you need to, if you want to have a more automated solution, of course you can reach out. But this is more about understanding how would I present this to clients in terms of the outputs of a scenario, which is quite useful. So Susannah, over to you.

CCH Learning:

Thank you very much for that, Lance. We will be spending the next few minutes taking questions, so please, just a reminder to please type them into the questions pane.

And to give you some time to type those up. I will mention some of our upcoming webinars. There we go. So coming up, we're looking at establishing and managing healthy workplace boundaries. Next week we're looking at tax effect accounting and financial modelling. We also have our monthly tax technical update for June 2023. We're also going to be looking at the salary packaging of electric vehicles. In a couple of weeks, we will be looking at keeping in-house investments, all you need to know, and also reflections on FBT 2023 and the need for reform. If you're interested in any of those, please head to our website at wolterskluwer.cchlearning.com.au. Have a look and see if they would be right for you.

So let's have a look at our questions. Okay, so I have a question from Philip. Philip was asking, "How does cash flow modelling differ from other financial forecasting techniques such as budgeting and financial planning?"

Lance Rubin:

Thanks, Philip. That's a really, really good question. I think we often get these confused. Often, budgeting is focused on a profit basis. Financial planning as well can be quite focused at profits. And of course profit is not cash. So I think this is where we often get ourselves into a bit of hot water where the purpose of doing a forecast is looking at profitability. But sometimes later down the track we say, "Oh yeah, but how does that impact my cash?" And unless we've built the model to focus on cash, it won't necessarily focus on cash. So when you start to then retrofit a budget model or a planning model to focus on cash, well then you've got to then start to stitch in all of the working capital elements and the timing of all those things, and that's quite difficult and different.

So that's why when we go back to Simon Sinek's Golden Circle, why are we doing what we are doing? And what I've found is in budgeting and forecasting and planning, it's more focused on tax or profit or balance sheet. It's not necessarily focused on cash. I think that's the big difference here. This is about focusing primarily on the most important resource in any company, and that's cash. So we've got to focus on those things, particularly around cash has got so many different levers and drivers that can be impacting it from a debt equity tax. There's many, many different streams that flow into this one big river called cash. And we've got to think about that in terms of what we look at. We've got to make sure that if we are going to go on the path of budgeting and planning, that we think about cash as well, because we often don't and then we have to come back. So it's similar but quite different in terms of its focal point.

CCH Learning:

Thank you very much for that, Lance. And there you go, Philip. I hope that helps you when you are trying to walk out your own cash flow versus financial and other for forecasting. I also have a question from Sarah. Sarah was asking, "What are some of the challenges of cash flow modelling?"

Lance Rubin:

Sarah has a great question and I think some of those questions I was asking as well in the polls, because I think the challenges do vary based on the firm and I think they are varied also based on the client base. One of the biggest areas of challenges is probably the complexity and variability of the cash flow information and the data. So I think one of the things that make it very difficult for people to adopt cash flow modelling or cash flow advisory is that variability and the complexity.

Certain things are really easy to model in terms of a cash flow perspective, like, "I'm doing a marketing campaign. This is my revenue. These are the expenses. They're going to happen in these months." That tends to be quite easy. But when we start to think about, "Well, actually I'm going to bring on new staff. Some of that staff are going to be our IT developers, some of that's going to be capitalized, I then going to have to amortize that. Then there's depreciation or there's [inaudible 01:01:47] associated with that CapEx asset, maybe there's some R&D claiming." So very quickly it can start to get pretty complex. And to be honest, you don't know that and neither does the client know that until you start. And it's only once you start, you're kind of already entrenched in the process and you kind of feel like you have to finish it.

So the uncertainty that that brings up and the variability of what can impact is so wide that it can make it extremely complex. So making sure that we've got accurate data, we've got up-to-date information, we understand your proper discovery. And this is where I find most people just do the discovery for free as a way to win the work. That is the worst thing you can do because you want to rush it, you want to win it, and then you win it and then you lift up the Pandora's box or you open the Pandora's box and suddenly all these things jump out and you're like, "Holy, I didn't know all of this. I didn't know all of this in their business." Because a compliance-focused lens is very much on the compliance numbers, not so much on the business. And I think that's the biggest challenge is the unknowns, the known unknowns and then the unknown unknowns, right?

It's the stuff that you know don't know, but then there's also stuff you don't know, you don't know it. And that could be quite tricky. So definitely think about that in terms of understanding and approaching this work. And that's probably why a lot of people steer away from it because we don't know how to manage that complexity, that uncertainty. And hopefully through today you've got a business model, you've got an approach of how you might tackle that variability. So you go in, you do a discovery, you raise all the rocks, you look underneath all of them, you open all the boxes and you say, "Okay, well what's in here?"

It's kind of like doing a spring-cleaning, which is a great time of year to do it. When you're doing your tax return, you start to look at all the nooks and crannies, but you start to look a little bit broader than what you would from a compliance perspective. And then you start to think about, "Well, how would I then approach that? How do I build the process around it? And how do I make sure, if there's a Pandora jumping out of the box and there's something that's really scary, how do I make sure that I charge for it because it's going to hurt me? So how do I make sure that I can charge for these unknown unknowns?" And that's the challenge. That's the scoping discussion that I mentioned before around making sure we have the flex, we have a hybrid pricing model. We have to have that ability to charge for that complexity.

CCH Learning:

Thank you very much for that, Lance. So there you go, Sarah. Lots of challenges, but I'm sure that you'll be able to sort them out.

Well, that does bring us to the end of our questions for today. So in terms of next steps, I would like to remind you all to please take a moment to provide your feedback when exiting. We have asked you a couple of questions about today's webinar, so it's really important for us to hear your opinions. It's also a reminder that within 24 to 48 hours you will be enrolled into the e-learning recording, which can be watched multiple times and have access to the PowerPoint, transcript, any other supporting documentation, which in this case of course is that Excel model and a CPD certificate.

I'd very much like to thank Lance for the session today, and to you, the audience for joining us. We hope to see you back online for another CCH Learning Webinar very soon. Enjoy the rest of your day. Thank you very much.

Lance Rubin:

Thanks all. See you.