Improve Days Sales Outstanding With Three Achievable Tricks

Justin Binik-Thomas
University of Cincinnati
Indiana Wesleyan University

Contracting can be tricky. It is easy for an organization to get behind in its financial processes and complete the work before obtaining a payment — or worse, before even a signed contract is in hand. Work before written acceptance is a substantial risk to the company and may result in disapproved work, unplanned discounting, and delayed payments. The business would be wise to consider a clear set of expectations, including periodic financial packages, a preapproval document for scope changes, and clear delegated authority for the team regarding work ahead, approvals, and contracting. Clear, proactive communication and positive relationship management are crucial to mitigating the risk.

Keywords: cashflow, contracts, days sales outstanding, DSO, financial packet, risk mitigation, risk cycle

INTRODUCTION

Finances can be taboo in the workplace, just like friends and family. Taboo or not, the responsibility of proper financial management in any company falls to the Finance and Contracting departments to ensure the contractual agreements are fair and equitable to both parties. The payments should be as cash neutral as possible, paid approximately equal to the work performed (Baker, 2017). A related measurement within the finance department is days outstanding sales, measuring the days from work served to paid (Barron, 2010). The expectation is to manage in as few days as possible, generally in the 30 to 60-day range, depending on the industry.

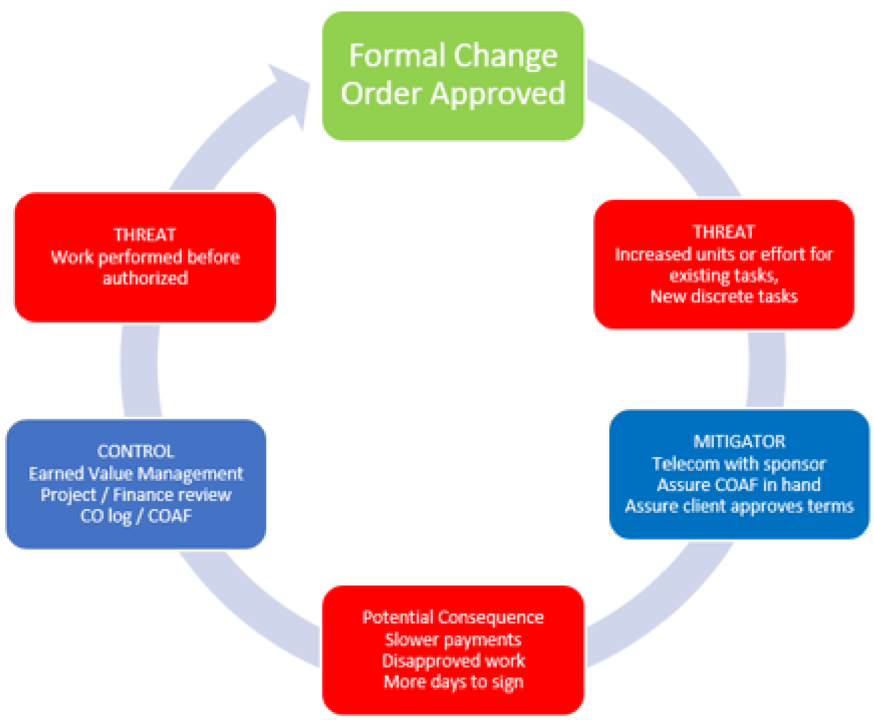
There are changes from time to time to the study expectations; if the modifications require a change of delegation or price, they are incorporated formally into the contract file to protect each party. Some of these changes almost certainly adjust the effort necessary to perform the activities and the price. If the work is urgent, it may need to happen before a contract, thus resulting in the need for additional full-time equivalent (FTE) allocated to the program. This addition would then potentially impact headcount and legally delegated authority. A company working without written permission is a significant financial and legal risk. Proactive communications regarding the financial packages, such as completed units and projections, may mitigate the risk, as changes shouldn't surprise. Further, written approval will clearly show auditors and regulatory bodies the modification to delegated work.

Primary Discussion

An organization must ensure the least risk, and most income is recoverable. Many organizational development tools are applicable, such as a bowtie risk assessment and a cause, effect, and consequence pathway. The resulting data is often disseminated to the larger organization in a Contract Risk Cycle (see

Figure 1) to illustrate the value of proactive risk and financial management. The situation of more units at the same price, more units at a different price, and the addition of brand-new units represent the critical reasons for controllable cashflow that a contract amendment can manage. The organization should have an internal system, such as earned value management, to identify units completed and project units to complete. Anytime there is a change in project requirements, communication with the client must occur before completing work, allowing them to accept or reject the project modification. If accepted and acknowledged in writing, the extra work can continue. If not approved, the study flow may require modification to stay within the original budget, modify the complexity, or perform the work in-house (no longer outsourced). These communications occur through finance packages and preapproval forms implemented through explicitly delegated authority. These recommendations — finance packages, preapproval, and delegated authority - are outlined below.

FIGURE 1
CONTRACT RISK CYCLE



Created by Justin Binik-Thomas, All Rights Reserved

Consistent Finance Packages

The company should provide periodic updates on the study's financial position, including units performed and units projected — the analysis can show as percent complete or trend lines, depending on the type of activity covered. Suppose the organizational efforts exceed the units authorized. In that case, the client needs to decide the next steps utilizing the finance package (e.g., approve more units, adjust the ask to scope, or take some services in-house to compensate). The Contract Risk Cycle (Figure 1) equates to 'change in units' same price' and 'change in units new price.' The final possibility in this scenario is a brand-new task or activity (not previously contracted), as noted in the risk assessment, which may require negotiation before updating the program contract.

Signed Preapproval for New Work

If the client decides to change the number of units performed, they must agree to the changes in writing. An ideal agreement format is a contract; however, some items must happen relatively quickly. Using a standardized approval form to memorialize the agreement is valuable in those cases. The standardized approval form may or may not present as a billable form (billable preferred) but assures the alignment of parties on the change and the price before working, thus resulting in fewer surprises at the contract step. The standardized form may also distinguish between staffing and expenses, allowing the no-profit components to be billable immediately (e.g., taxi trip, bank fee, vendor support). In addition to the above points, another benefit to using the standardized form is that the company may prioritize what goes into the changes to streamline discussions, that is, all the items agreed upon and perhaps the related material (e.g., nothing under a preapproved threshold such as $100 or 5%). A quicker contract signature results in improved cashflow and an improved reduction in the days sales outstanding.

Clear Delegated Authority

Once making a go-forward decision to enter into a change in the contract, it is vital to be clear on what decisions each party is authorized to make after the preapprovals. Further, there is value in understanding where to go for deviations ahead of time. There are constructive collaborations between the frontline personnel, the contracts team, and the sales team. The clear delegation of authority within the organization is also essential because it is imperative to maintain constructive relationships with internal and external customers. Providing transparency in the process and presentation for the reviewers on both sides of the deal yields a quicker turnaround. If needed, it helps all parties work toward a binding agreement for billing, revenue, and headcount. No process is foolproof or firm, but authority bands are required to ensure all parties work harmoniously towards a common goal of clear contracting and on-time and on-budget work.

CONCLUSION

Much success or failure is rooted in trust and transparency, like many interactions in life, business, and pleasure. Effective financial management assures no surprises to the efforts, approving increases to units before the performance, and the payment terms are as neutral as possible, so there aren’t extensive checks in either direction. The days sales outstanding measurement tracks the combination of drivers, from the day performing to the day paid for work. Proactive communication, relationship management, and straightforward contracting—all business basics—are the most effective tools to mitigate risk.

ACKNOWLEDGEMENTS

The author would like to acknowledge peer reviews from Mr. Mark Mann and Mr. Michael Perez for their feedback and validation of the materials. Further, Ms. Heather Squire and Ms. Jen Vance have been invaluable in ensuring the material is readable and relatable to consumers in other business areas. Furthermore, Dr. Debbie Philpott for her technical and academic support.

REFERENCES

Baker, G. (2017). A beginner’s guide to cashflow management. *NZ Business*, *31*(10), 20–24.

Barron, J. (2010). Measuring your metrics. *Business Credit*, *112*(9), 22–25.

Binik-Thomas, J. (2022). *Risk mitigation within a contract research organization*. Wesleyan Holiness Digital Library. Retrieved from https://www.whdl.org/en/browse/resources/15506