key business drivers

2 Risk Management

Starting your own business takes guts and determination. Generally owners of startups and fast growing businesses are comfortable with a degree of risk and embrace challenges as they arise. And this is a good attitude to have, as business owners are exposed to many risks. However, while some risks can be managed by implementing appropriate business controls, it's becoming increasingly important for businesses to implement additional safeguards.

Risk management safeguards

As part of sound risk management, DFK recommends business operators consider the following safeguards:

- Asset protection and estate planning
- Managing liquidity risk
- Insurance

Asset Protection and estate planning

In today's increasingly litigious and volatile business environment, it's becoming more and more important for individuals to consider asset protection. Asset protection is typically achieved by correctly structuring your business and investments. Too often entrepreneurs establish a business structure and then years down the track, find the structure to be inflexible and tax ineffective.

Assets can also be protected by formalising agreements with legal contracts. This provides a legal avenue when disputes arise and gives you better grounds for appeal, compared with a 'handshake deal'. One agreement we recommend unrelated business owners consider is a buy-sell agreement. This is a contract between the principals of a business where the principals agree to sell their interest in the business to the other principals if a triggering event occurs. General triggering events include the death or total permanent disability of one of the principals. The main benefits of a buy-sell are that the remaining principals have certainty regarding the ownership structure of the business and the family of the deceased receives a negotiated value for the business interest, rather than inheriting a business interest which will either have to be sold or managed.

While no one goes into business expecting to have a disagreement with their co-owners, disputes can arise. For this reason, shareholder/partnership agreements are also recommended. Such agreements legally establish the conduct and duties of each party, and provide grounds for legal action when one party has not satisfied their duties.

Estate planning is typically a difficult and emotional area for people to consider, however, early estate planning has many benefits. Estate planning covers creating a will and dealing with how you want your personal assets to be distributed upon your passing, as well as ensuring your superannuation is distributed in accordance with your wishes, and that your business interests are dealt with appropriately. While many people delay considering these issues until later in life, it's important to have estate planning strategies in place in case unforeseen circumstances occur.

Quick Tips

Asset Protection

- Get your business structure right from the beginning. It can be very expensive to change it later down the track.
- Having a will provides clarity for family and expedites the finalising of your estate.

Managing liquidity risk

- The old idiom that 'cash is king' applies here. Businesses that have better cash flow management are typically more stable and therefore tend to be more profitable.
- When preparing a cash flow statement, remember profit does not equal cash flow. Your cash flow needs to fund other items such as capital outlays, tax payments and loan repayments
- If your ratio of debt to total funds is above 60%, you are considered to be highly geared and therefore exposed to greater liquidity risks.

Risk management process

- Where possible, insurance should cover an unlimited timeframe and not be limited to a particular date.
- If you're acquiring professional indemnity insurance, ensure that the policy covers the work of your employees.
- In an increasingly complex taxation environment, businesses are considering Tax Audit Insurance (TAI)to protect against professional fees involved in responding to an audit, review or investigation by the ATO.

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LEADING ACCOUNTANTS AND BUSINESS ADVISERS

2 Risk Management

Liquidity risk

Liquidity risk is broadly defined as the risk that a business will be unable to meet its financial commitments. This is a highly regulated area with serious penalties being levied to directors that are found to be trading whilst insolvent.

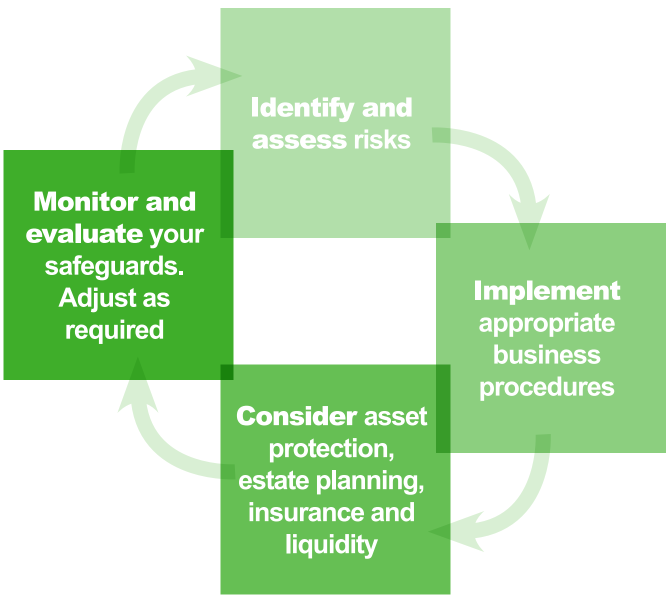
Managing liquidity risk

Managing liquidity risk is not just a director's duty, it is also good business practice. To minimise liquidity risk, it's important that operators prepare cash flow forecasts. We recommend that these be prepared at least monthly and for at least one year in advance. A longer time frame may be appropriate for businesses with long-term contracts, high volatility or large anticipated capital expenditure. Paramount to preparing a cash flow forecast is comparing the forecasted results against actual performance. This enables you to obtain a more accurate understanding of your cash inflows and outflows, and better anticipate your future cash position. Other techniques for managing liquidity risk are to ensure that you have appropriate borrowing facilities in the event of unforeseen circumstances. We also encourage businesses to keep an adequate cash buffer and to carefully manage outstanding or slow paying debtors.

Protecting what matters

When considering whether to obtain insurance, it's important to firstly identify the risks your business faces and what really matters to you. While the basics such as theft, fire and vehicle insurance spring to mind, there are a multitude of other insurances that you might need. These include but are not limited to, insurance covering professional indemnity, public liability, key person, directors and officers liability, business interruption and machinery/equipment breakdown. Your needs will vary depending on the type of business you operate. Once these risks are considered, insurance providers or brokers can be approached. Ultimately, when deciding on a policy, it's important to ensure your insurance appropriately covers all risks, and that the amount of cover is sufficient.

Risk management process



Want help with risk management?

It's in your best interest to put sound risk management strategies in place before things could go wrong. A trusted DFK adviser can help you get the right foundations in place. If you're ready to make changes or simply want to discuss your options, call us on **1300 DFK ANZ**

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