



VERITAS

Know Your DSO

A Veritas Inside Guide

Truth | Tenacity | Teamwork

Calculating DSO

DSO, “days sales outstanding”, is a standard month end KPI (key performance indicator) for credit managers. It effectively calculates the number of days it takes to turn sales into cash.

Businesses can calculate profit margins based on the sale price and credit terms offered. Payments received after the due date consequently reduce the profit and this directly affects the performance of the business.

What is it used for?

As a measure of credit control performance, the lower the DSO figure the better the credit control team is performing. It is therefore set as a target for the credit control team to bring the actual DSO to as close as they can to the best possible DSO calculation.

DSO can also be used in the budget process e.g. when applied to the sales budget, it will calculate the forecast debtor and cash receipts budgets.

DSO is not affected by sales volumes (more sales produce more debtors) but it is influenced by the credit period and extended payment terms. The longer the credit and payment terms, the higher the DSO figure. Therefore, the average DSO for a sales ledger offering net monthly terms (30 days) could be 45 days whereas, if the credit terms are 60 days, the average DSO would increase to 75 days.

High levels of cash sales or invoices paid within the same month that they are raised, will also distort the DSO figure. This is because they will reduce the current month sales ledger balance if those sales are included in the total monthly sales used for the calculation.

How to calculate DSO

There are a number of ways to calculate DSO, the most common of which are shown below.

Countback Method

This is the best method of calculating DSO because the latest sales figures, which are most closely related to the sales ledger balances, are used in the calculation.

The current month sales are deducted from the month end sales ledger balance. If this does not clear the sales ledger balance in full, previous months sales are deducted.

For each full month sales deducted, the number of days in that month is added to the DSO calculation.

When the sales figure exceeds the balance of the sales ledger value, the number of days represented by the remainder is calculated by multiplying it by the number of days in the month divided by the total sales for the month as shown in the calculation below.

| | | |
|--------------------------------|-------------------|---------|
| Sales Ledger Balance - June 30 | 1,450,000.00 | 30 days |
| June Sales | <u>650,000.00</u> | |
| | 800,000.00 | |
| May Sales | <u>490,000.00</u> | 31 days |
| | 310,000.00 | |
| April Sales = £600,000 | 310,000.00 | 16 days |

No. of days in April x Balance/April Sales
 $30 \times 310,000/600,000$

DSO = 76.7

Aged Debt Method

This method is often used by credit managers as it combines the total credit taken with the age of the debt.

Debtor balance aged by month

Daily sales by month

The sales ledger balance is aged by month and the average daily sales are calculated for each month. The aged balances are then divided by the daily sales figure to give a monthly DSO. These are then added to give a total DSO.

| Value in £000s | June | May | April | March | February | January | Total |
|----------------|----------|----------|----------|----------|----------|----------|-------------------|
| Days in month | 30 | 31 | 30 | 31 | 28 | 31 | 181 |
| Total sales | £650,000 | £490,000 | £600,000 | £550,000 | £510,000 | £620,000 | £3,420,000 |
| Sales per day | £22,000 | £16,000 | £20,000 | £18,000 | £18,000 | £20,000 | £114,000 |
| Debtors | £640,000 | £375,000 | £295,000 | £85,000 | £30,000 | £25,000 | £1,450,000 |
| Debt Days | 29.54 | 23.72 | 14.75 | 4.79 | 1.65 | 1.25 | 75.7 |

DSO = 75.7

Quarterly Averaging Method

This method of calculating DSO is less accurate because it uses average sales figures against an actual sales ledger balance.

$$\frac{\text{Debtors x days in last 3 months}}{\text{Sales last 3 months}}$$

| | | |
|--------------------------------|---------------|---------|
| Sales Ledger Balance - June 30 | £1,450,000.00 | |
| Sales – last 3 months | | |
| June Sales | £650,000.00 | 30 days |
| May Sales | £490,000.00 | 31 days |
| April Sales = £600,000 | £600,000.00 | 30 days |
| | £1,740,000.00 | 91 days |

DSO = 76

Annual Average Method

This method is even less accurate than the quarterly averaging method because the data used is for the whole year. This means that debtors and sales figures are both evened out over a 12 month period.

$$\frac{\text{Year End debtors}}{\text{Annual sales}} \quad \times 365$$

| | | |
|------------------|---------------|-------|
| Year end debtors | £1,450,000.00 | x 365 |
| Annual sales | £7,200,000.00 | |

DSO = 74 days

An alternative. Moving Annual Average (MAA) DSO is also used by some companies. This method uses the average sales ledger balance and monthly sales for the previous 12 months.

$$\frac{\text{Average month end debtors (last 12 months)}}{\text{Average monthly sales (last 12 months)}} \quad \times 365$$

Best Possible DSO Method

This method is used to calculate the best possible time taken to convert sales to cash. It helps to distinguish between the delays in payment resulting from extended payment terms and delinquent debts by using only current receivables.

The DSO calculation should be close to your sales terms.

$$\frac{\text{Current receivables}}{\text{Total Credit sales for the period}} \quad \times \text{Days in the month}$$

Based on a sales ledger balance of £650,000 (June month end), total sales for last 3 months (April to June) of £1,740,000 and 91 days.

$$\frac{£650,000}{£1,740,000} \quad \times 91$$

Best Possible DSO = 34

It pays to know your DSO

By focusing on tangible key performance metrics, including DSO, you can bring measurable benefit to your organisation, driving improvement performance through regular, consistent and effective analysis.



VERITAS



Contact Us

Call

Please call our team and talk confidentially and informally to one of our expert advisers about your requirements and objectives.

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Alternatively, email us at

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Meet & Plan

Built from years of working closely with businesses, our unique planning process will ask the key questions to chart where you are now, your desired destination, and your route to getting there.

All discussions are in complete confidence and without obligation.

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