Cash Management

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Introduction

CASH IS KING. It is the lifeblood of any business. Cash is used to pay bills, purchase office supplies, obtain raw materials for manufacturing and pay employees. Without cash a business will not exist. Without cash, a business (or person) can be forced into bankruptcy where the creditors can gain control of the company's assets, if not the company itself. Cash is the lubricant which keeps businesses running smoothly. Poor cash management is the cause of a significant number of corporate bankruptcies. Recently, a large photography supply store filed for bankruptcy protection. A look at the balance sheet showed plenty of assets, but very little cash. Sadly for the company but lucky for the buyers, the company's assets were purchased for pennies on the dollar. Unfortunately, this story is all too common. Companies and individuals outspend their cash requirements and suddenly are no longer able to meet the cash requirements of their business. Cash Management is a group of policies and techniques to assure a business has the funds to continue to operate and be prepared for whatever the future may bring.

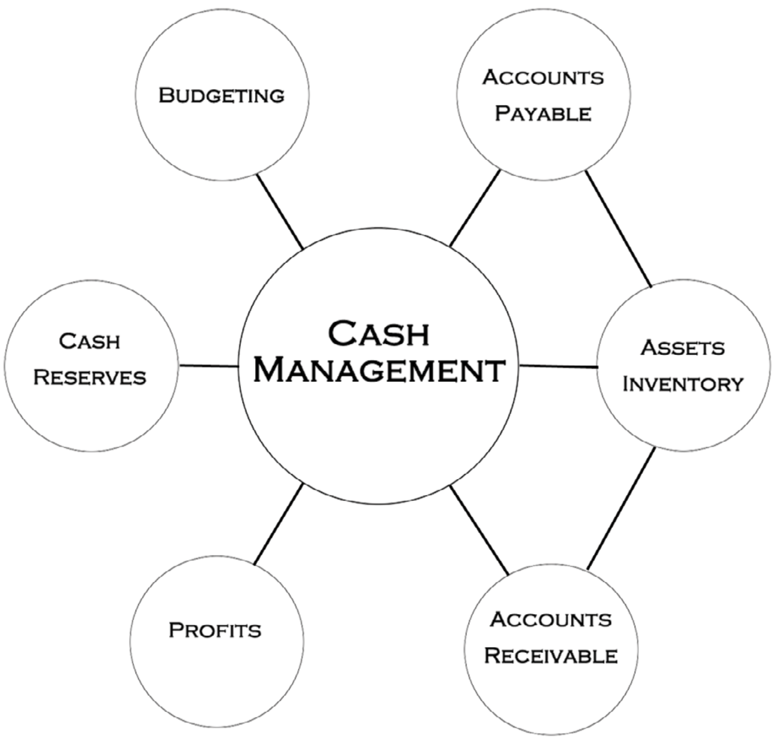

Figure 1: Cash Management

This book will look at how cash flows through a business, the uses of cash and how to assure cash is available when needed. Cash management includes: Accounts Payable, Account Receivable, Budgeting and more.

1 The Basics

CASH IS KING. No person or business can exist in today's modern society without cash. In the modern digital world, cash no longer means physical the money in your pocket. Cash refers to available funds to pay bills, purchase services or buy products. Cash is the method by which you pay yourself, your employees and your taxes. It is the money in your checking or savings accounts. Cash can also be considered to be a short term asset which can be converted into liquid funds within thirty days. Some types of short term assets which can be converted into cash are: accounts receivable, mature savings bonds, some stocks or a check. Assets which are not typically considered liquid assets are: real estate, an airplane or other heavy machinery which can take a long time to sell.

The easiest way to start to understand cash management is to start with a simple cash flow system and build up the complexity. One of the simplest and easiest cash flows to understand is that of the average working person, let's call her Ann. Ann has a job where she gets paid every other week, an apartment to live in and a car she uses for transportation. In this example, Ann does not have any credit cards. She shops for food, clothes and goes out with friends. A couple of times a year, Ann will take a vacation. All of these activities cause a cash flow to occur. When Ann does not have enough cash, she can't buy groceries, clothes or pay her rent. Making sure Ann has enough cash available to pay for everything is cash management.

Ann's paycheck is her income, revenue or inflow of cash. When the cash is not immediately needed to pay for something, it is put into a reserve commonly known as a checking or savings account. As her reserve grows, her savings increase. Counteracting the inflow are her expenses. These include: rent, car payments, telephone bills and the like. All of these require an outflow of cash or a reduction in the cash available on hand. The first way to visualize Ann's cash flow is to use a ledger showing her income and expenses.

Date	Item	Amount	Balance
Starting Balance			$1,626.32
August 1, 2014	Rent Due	($1,200.00)	$426.32
August 2, 2014	Groceries	($73.56)	$352.76
August 5, 2014	Car Payment	($325.11)	$27.65
August 8, 2014	Payday	$880.00	$907.65
August 9, 2014	Groceries	($56.37)	$851.28
August 15, 2014	Phone/Internet	($153.95)	$697.33
August 16, 2014	Groceries	($68.36)	$628.97
August 22, 2014	Payday	$880.00	$1,508.97
August 23, 2014	Groceries	($64.89)	$1,444.08
August 24, 2014	Clothes	($194.36)	$1,249.72
August 30, 2014	Groceries	($52.14)	$1,197.58
Ending Balance			$1,197.58

Figure 2: Ledger

This ledger is great for showing the cash entering and exiting Ann's bank accounts. Each month you can see how Ann get paid and where she spends her money. However, there is a BIG problem with this method. Can you see it?

The major shortcoming with using a monthly ledger for cash management is the inability to anticipate future problems. In the example above, Ann ends the month with a balance of $1,197.58. This will not be enough cash to pay her monthly rent payment. In addition, if Ann wants to take a vacation, there is no money being set aside to fund her vacation. The ledger displays previous cash flows but does not forecast future cash flows. It is the ability to foresee future cash needs and plan for them which differentiates cash flow from cash management. Cash management uses projected budget with income and expenses to determine not only how much cash will be needed to cover expenses but also if enough cash will be available to meet all expense obligations.

Now let's look at Bob. Bob owns a house, a car with payments and other miscellaneous bills. Bob's employer pays him twice a month on the 15th and the 30th (or the last day of February). It would not matter if Bob was paid once a month or every week. The excel spreadsheet he uses allows him to determine how much cash he should have available at any given time. As Bob built his budget he realized his income and many expenses were fixed from month to month. For instance, his mortgage payment or phone bill would change once a year. Meanwhile there were some variable expenses like his electric bill that would change from month to month.

	Dec-13	Jan-14	Feb-14
Starting Balance	53.63	(111.59)	184.23
Mid-Month Payday	1,600.75	1,621.55	1,621.55
Mid Month $ Available	1,654.38	1,509.96	1,805.78
Mid-Month Expenses	1,231.07	780.00	780.00
Mid-Month Changes	0.00	(400.00)	0.00
Mid Month Balance	423.31	329.96	1,025.78
Month End Payday	1,600.75	1,621.55	1,621.55
Month End $ Available	2,024.06	1,951.51	2,647.33
Month End Expenses	2,135.65	1,767.28	1,767.28
Month End Changes	0.00	0.00	0.00
Ending Balance	**(111.59)**	**184.23**	**880.05**

MID MONTH PRO. EXP.	Dec-13	Jan-14	Feb-14
Cash	300.00	300.00	300.00
Credit Card Payment	350.00	350.00	350.00
Electric Bill	70.00	70.00	70.00
Cel Phone	10.00	10.00	10.00
Car Insurance	0.00	0.00	0.00
Gas Bill	50.00	50.00	50.00
Projected Expenses	1,231.07	780.00	780.00

MID MONTH ACT. EXP.	Dec-13	Jan-14	Feb-14
Cash	300.00	150.00	300.00
Credit Card Payment	350.00	900.00	350.00
Electric Bill	70.00	70.00	70.00
Cel Phone	10.00	10.00	10.00
Car Insurance	0.00	0.00	0.00
Gas Bill	50.00	50.00	50.00
	0.00	0.00	0.00
Actual Expenses	1,231.07	1,180.00	780.00

MONTH END PRO. EXP.	Dec-13	Jan-14	Feb-14
CASH	300.00	300.00	300.00
Mortgage	1,311.21	1,311.21	1,311.21
Car Loan	295.00	295.00	295.00
Doctors/Co-Pay	10.00	10.00	10.00
Water Bill	40.00	40.00	40.00
Home Phone	50.00	50.00	50.00
Cable TV	51.07	51.07	51.07
Daily Newspaper	10.00	10.00	10.00
Projected Expenses	2,135.65	1,767.28	1,767.28

MONTH END ACT. EXP.	Dec-13	Jan-14	Feb-14
CASH	300.00	300.00	300.00
Mortgage	1,311.21	1,311.21	1,311.21
Car Loan	295.00	295.00	295.00
Doctors/Co-Pay	50.00	10.00	10.00
Water Bill	40.00	40.00	40.00
Home Phone	50.00	50.00	50.00
Cable TV	51.07	51.07	51.07
Daily Newspaper	10.00	10.00	10.00
Actual Expenses	2,135.65	1,767.28	1,767.28

Figure 3: Sample Budget Showing Projected vs. Actual Expenses

Please note this spreadsheet shows only three months and has been rearranged to fit on the page. By looking at the budget, Bob can easily see he has a problem at the end of December and beginning of January. He will be short by $111.59. Seeing a potential problem, Bob has many options. He can: borrow some money, use his credit card, work overtime, delay paying a bill or reduce his discretionary spending. No matter what he chooses, the ability to forecast his cash requirements has permitted Bob to anticipate and avert a crisis. In a later chapter we'll discuss building a budget and using it to manage your cash.

Cash management allows a person or company to anticipate their cash needs for any day of the month. By knowing when and how much cash will be required, the company can plan for their cash needs and avoid potential problems. Cash shortfalls will be anticipated while there is enough time to determine the best solution to the problem.

1 – Questions and Exercises

What is the difference between a cash flow and cash management?

Explain why cash is so important

What happens when there is insufficient cash available to pay creditors?

What is the problem with using a ledger for cash management?

What are the advantages of using a budget/spreadsheet for cash management?

2 Creating a Budget

If you don't know where you are or where you are going, you'll never make any progress. Just as a map shows you your starting point, ending point and the route to get there, a budget shows you how much cash you are starting with, how much you expect to have at the end of the period and all the points along the way. An accurate budget is a vital component of any cash management system. But how do you construct a budget? There are plenty of software packages available which will create a budget. However, you need to be careful as some of them call themselves budget software when in reality they are just spending trackers. A real budget software package will allow you to predict cash requirements at any point in time.

While there are plenty of budget software packages available, in order to fully appreciate the budget process, we'll manually create a budget using a spreadsheet. The steps are fairly simple:

Gather all of your income/paychecks in one place
Collect all of your expenses and sort them by vendor or payee.

Determine your budget period and sub-periods. Some companies will use a 13 period year with each period consisting of 4 weeks. Meanwhile, a typical household will use a month divided into either halves or weeks. This is due to the frequency in which paychecks are received and bills are paid. Finally, there are some companies with such sophisticated cash management systems they actually break their months down by the day! No matter what monthly division you choose, it should be small enough to capture all the cash flows yet not be so burdensome that it will quickly be abandoned. For instance, if you pay your bills twice a month then you don't need to use a daily or weekly sub-period. Typically, most people pay their bills right after they receive their paychecks. Therefore, the frequency of revenue receipts (i.e. paychecks) will normally determine the monthly budget sub-period.

Across the top of the spreadsheet, starting in the second column, show the ending date of your sub-periods. Most spreadsheets will automatically complete a series for you,

	1/15/2014	1/31/2014	2/15/2014	2/28/2014	3/15/2014	3/31/2014

The second row will show the beginning cash balance for the period.

	1/15/2014	1/31/2014	2/15/2014	2/28/2014	3/15/2014	3/31/2014
Beginning Balance	$ 603.59					

List all the income sources for the period starting in the 3rd row. For a household, this would typically be your paychecks. For a business, this will be the accounts receivable. There should be one row for each customer or income source (paycheck).

	1/15/2014	1/31/2014	2/15/2014	2/28/2014	3/15/2014	3/31/2014
Beginning Balance	$ 603.59					
Paycheck	$ 1,545.95					

Calculate the cash on hand by adding the beginning balance to the income.

	1/15/2014	1/31/2014	2/15/2014	2/28/2014	3/15/2014	3/31/2014
Beginning Balance	$ 603.59					
Paycheck	$ 1,545.95					
Cash On-Hand	$ 2,149.54					

List all your vendors, one to a row. Enter in the bills under the sub-period in which the bill will be paid.

	1/15/2014	1/31/2014	2/15/2014	2/28/2014	3/15/2014	3/31/2014
Beginning Balance	$ 603.59					
Paycheck	$ 1,545.95	$ 1,545.95				
Cash On-Hand	$ 2,149.54					
Cable TV		$ 101.50				
Internet		$ 51.68				
Mortgage	$ 2,106.59					
Cel Phone		$ 132.36				
Water		$ 32.96				
Electric		$ 143.97				
Nat. Gas		$ 47.00				

Calculate your total expenses for the period.

	1/15/2014	1/31/2014	2/15/2014	2/28/2014	3/15/2014	3/31/2014
Beginning Balance	$ 603.59					
Paycheck	$ 1,545.95	$ 1,545.95				
Cash On-Hand	$ 2,149.54					
Cable TV		$ 101.50				
Internet		$ 51.68				
Mortgage	$ 2,106.59					
Cel Phone		$ 132.36				
Water		$ 32.96				
Electric		$ 143.97				
Nat. Gas		$ 47.00				
Total Expenses	$ 2,106.59	$ 509.47				

Determine the cash available at the end of the period by subtracting the expenses from the available cash. This will also be the beginning balance for the next period.

	1/15/2014	1/31/2014	2/15/2014	2/28/2014	3/15/2014	3/31/2014
Beginning Balance	$ 603.59	$ 42.95	$ 1,079.43			
Paycheck	$ 1,545.95	$ 1,545.95				
Cash On-Hand	$ 2,149.54	$ 1,588.90				
Cable TV		$ 101.50				
Internet		$ 51.68				
Mortgage	$ 2,106.59					
Cel Phone		$ 132.36				
Water		$ 32.96				
Electric		$ 143.97				
Nat. Gas		$ 47.00				
Total Expenses	$ 2,106.59	$ 509.47				
Ending Balance	$ 42.95	$ 1,079.43				

To determine future months, an estimate will need to be utilized in order to complete the annual budget. Use all of your knowledge concerning your income and expenses to fill out the spread sheet as much as possible. Many bills will be the same from month to month. These include cable TV, internet and phone bills. There are other bills which are based on usage, these are gas, electric and water. Finally, if you receive a salary, your paycheck will be constant. Paychecks for those who receive a commission or hourly workers' will vary. But once again use your best estimate. Just remember it is better to underestimate your revenues and overestimate your expenses. By using these conservative estimates, any corrections you make will be for your benefit as revenue will increase and expenses will be decreased.

	1/15/2014	1/31/2014	2/15/2014	2/28/2014	3/15/2014	3/31/2014
Beginning Balance	$ 603.59	$ 42.95	$ 1,079.43	$ 518.79	$ 1,548.81	$ 988.17
Paycheck	$ 1,545.95	$ 1,545.95	$ 1,545.95	$ 1,545.95	$ 1,545.95	$ 1,545.95
Cash On-Hand	$ 2,149.54	$ 1,588.90	$ 2,625.38	$ 2,064.74	$ 3,094.76	$ 2,534.12
Cable TV		$ 101.50		$ 101.50		$ 101.50
Internet		$ 51.68		$ 51.68		$ 51.68
Mortgage	$ 2,106.59		$ 2,106.59		$ 2,106.59	
Cel Phone		$ 132.36		$ 132.36		$ 132.36
Water		$ 32.96		$ 39.42		$ 32.96
Electric		$ 143.97		$ 143.97		$ 143.97
Nat. Gas		$ 47.00		$ 47.00		$ 47.00
Total Expenses	$ 2,106.59	$ 509.47	$ 2,106.59	$ 515.93	$ 2,106.59	$ 509.47
Ending Balance	$ 42.95	$ 1,079.43	$ 518.79	$ 1,548.81	$ 988.17	$ 2,024.65

As new bills and paychecks arrive, replace your estimate with the actual income or expense. The nice thing about using a spreadsheet is that as soon as you update a cell, all the other cells will automatically update too. This will allow you to immediately see if a potential problem was created.

2 – Questions and Exercises

Create your own household budget on a spreadsheet.

3 Monthly Reconciliations

At the end of every month, your bank will issue a statement for each account you have. This statement serves many purposes and is integral in any effective cash management system. Believe it or not, there are people in this world who believe, "If I have checks in my checkbook, I have money in my account." The only way to know exactly how much money you have in a given account is to keep accurate records and reconcile your bank accounts on a monthly basis.

All bank statement have similar information. They include the account number, account information, month's starting balance, ending balance, deposits and withdrawals. Your bank statement is the first line of defense against fraud. Any unrecognized or unauthorized withdrawal must be investigated and protested to your bank. You have specific rights that if not enforced will drastically adversely impact your liability for these fraudulent transactions.

ABC Bank

Lively Linguists Toastmasters Club
Unit 1-2, Block A
TI Tower
Speakers Avenue
205904

Account Number: 5141 3436 28

Statement Date: 30 Sept 2013

Date	Transaction Description	Debit (Withdrawal)	Credit (Deposit)	Balance
	Balance from Last Statement			**1374.03**
04/09	Deposit Cash		200.00	1574.03
05/09	Cheque Deposit via Machine 876 533		108.00	1682.03
06/09	Inward Clearing Cheque 4329 320	180.00		1502.03
10/09	Inward Clearing Cheque 4329 319	98.90		1403.13
19/09	Deposit Cash		300.00	1703.13
23/09	Inward Clearing Cheque 4329 321	146.35		1556.78
20/09	Inward Clearing Cheque 4329 322	180.00		1376.78
27/09	Cash Deposit via Machine		108.00	1484.78
30/09	Inward Clearing Cheque 4329 323	175.00		1309.78
30/09	Bank charge	1.50		1308.28
	Closing Balance			**1308.28**

Thank you for banking with ABC Bank.

Figure 4: Sample Bank Statement

Most accounting software will assist the user in reconciling the account. Reconciliation is the act of verifying each transaction the bank has recorded on the account statement with your copy of the account transactions. For instance in Quickbooks, the user only has to enter the ending balance, statement date, interest, fees and then mark the cleared transactions. As the transactions are cleared, Quickbooks will update the unreconciled amount. When all transactions on the statement have been cleared and the unreconciled amount is $0, the process is complete. If there is an unreconciled amount, research must be conducted to determine why there is a balance. This can be due to unrecorded fees, interest, mistakenly recorded transactions or even a bank error. No matter the cause, the problem should be found and corrected before the month can be closed. Manually reconciling an account is not difficult.

1. Record all transactions in your account register which are on the bank statement and not in your account register. These include fees, interest, auto deposits, auto withdrawals, etc.
2. Start with the ending balance on the account statement
3. Add all the deposits which are not on the account statement
4. Subtract all deposits which are not on the account statement
5. This total should match the ending balance in your account register.

All checking, savings, credit card and loan accounts must be reconciled every month to assure no problems have occurred during the past month. The account reconciliation is the first step in the monthly closing process. The next step in the process is to update the budget with the most current revenue and expense information. From there, the budget should be reviewed to assure cash will be available to meet the following periods' needs.

3 – Questions and Exercises

Why is monthly reconciliation important?

What information can you find on an account statement?

What is the process to reconcile an account?

What do you do after the accounts are reconciled?

4 Accounts Receivable

Like a person, a business is a legal entity and has cash flows. Unlike a person, the business' cash flows are irregular. That is to say, customer purchases or payments are not predictably periodic or regularly occurring. Nor are the company's purchases of raw materials and payment to vendors. This creates a greater unpredictability to the ebb and flow of cash within a business. However, there are some steps which can be taken to smooth out the cash receipts.

Years ago when I opened my photography studio, I learned from other photography studio owners that weddings created cash flow problems for them. Here in Chicago, a majority of the weddings occur between May and November. Most studios would take a retainer (about $500) when the wedding was booked. A second payment was due a couple of weeks before the wedding. The final payment was due when the wedding album was completed. From a cash flow perspective there are some problems with this approach. First, with most weddings occurring in the summer months, that's when most of the income was received. Conversely, this meant the wedding photographer had very little cash receipts during the winter months. Yet the photographer would still incur expenses during those off-peak times. Next, even though the newlyweds had committed to purchasing an album, there were times when the album was never delivered and the photographer lost money. Finally, sometimes when the photographer went to collect the second payment, just weeks before the wedding, they'd discover, for one reason or another, the couple no longer wanted the photographer's services. At such short notice there was little opportunity to rebook the day and would result in thousands of dollars of lost revenue.

Customer	January	February	March	April	May	June	July	August
1						$ 2,500.00		
2							$ 2,500.00	
3								$ 2,500.00
4					$ 2,500.00			
5					$ 2,500.00			
6						$ 2,500.00		
7	$ 500.00							$ 2,500.00
8	$ 500.00						$ 2,500.00	
Total	$ 1,000.00	$ -	$ -	$ -	$ 5,000.00	$ 5,000.00	$ 5,000.00	$ 5,000.00

Figure 5: Traditional Wedding Studio Cash Receipts

In the example above you can see the first six customers paid their retainer fees before the first of the year. From January until April, two clients provided only $1000 of cash for the studio to operate. In fact, there is no income in February, March or April. However, once the wedding season starts, the studio is receiving $5000 per month from these customers. Wouldn't it be better to average out this cash flow to about $3000 per month? What would happen to the photographer if one of these clients cancelled at the last moment without making their final two payments?

Good cash management procedures and policy solve all of these problems. Rather than use the tradition payment schedule outlined above, my studio scheduled regular payments from the time the client booked their wedding until a month before the wedding assuring the whole wedding package was paid in full by the time of the event. This evened out our cash flow by spreading out the client's payments to us. To make it simple, all payments were due on either the 1st or the 15th of the month. We were no longer concerned with clients who didn't order their album as they had already paid us. Another advantage of this system was the incentive for clients to keep in touch with the studio. Using the new payment system, we were notified much earlier than under the traditional payment system should a problem arise or our services would no longer be required. This allowed us to attempt to rebook the date and if we were successful, we'd refund a portion of the monies previously paid to us. Believe it or not, our clients liked having regular payments because it allowed them to better manage their wedding funds.

Event/Couple	1-Jan	15-Jan	1-Feb	15-Feb	1-Mar	15-Mar	1-Apr	15-Apr
Robert Bar Mitzvah		250		250				
Carol/Connor	350		350		350		350	
Hope/Steve		525				525		
Noreen/Joe	400							
Jennifer/Gary					450			
JoAnne/Scott				345				350
Barb/Byron				495				495
	750	775	350	1090	800	525	350	845
		1525		1440		1325		1195

Figure 6: Expected Client Payments

Fortunately, most business owners are able to set the payment terms their customers need to follow. For instance, a retail establishment is able to specify cash, check or credit card. Unless the customer is purchasing a big ticket item (ie. Car, Appliances, etc.), the business owner will not extend credit. But they may provide lay away or credit through a third party like a bank. Meanwhile, some Business to Business (B2B) companies will negotiate terms with their customers. Those terms might be balance due within 10, 15 or thirty days. When the product or service is on-going, the B2B provider will allow for monthly payments rather than collecting full payment upfront.

As you can imagine, any time a vendor collects payments over time there is some risk the customer will not pay as expected. The smart business owner works diligently to reduce their bad debts. As a photography studio owner, collecting payment in advance, my bad debt allowance was close to zero. For if I didn't receive full payment, we were not obligated to show up for the event. In practice, we never exercised that option. However, we would refuse to release any photos until full payment was received. Since newlyweds were excited to see their wedding photos, we didn't have to wait long for full payment.

Withholding your products or services is not the only way to induce the desired behavior. There are some vendors who will provide a discount for early payment. The earlier the payment, the greater the discount. For instance, if the customer pays their bill within 10 days, the customer will receive a 10% discount. If the payment arrives within 20 days, the discount might be 5% and there is no discount for payment at 30 days.

While some providers will provide a reward for early payment, others will inflict a penalty for late payment as an inducement for prompt payment. Typically that penalty is interest on the outstanding balance. The problem with a penalty is the customer must agree to the penalty before the product or service is provided. The vendor cannot arbitrarily add a penalty for late payment. Generally, the rule is the other party must be notified of any potential harm they may incur prior to entering the business relationship. Some localities have specific laws which address this matter. In most areas, the vendor is not allowed to charge more than 25% interest as this is considered loan sharking. If you do decide to use a penalty to induce prompt payment, I urge you to consult with a local lawyer to fully understand your responsibilities and legality of your assessed penalties.

Sometimes a debt goes bad. Despite all efforts by the business to collect the outstanding balance, the customer will not or cannot pay. In this situation, the business must have policies in place to deal with the bad debt. Many companies will sell the bad debt to a collection agency for a small fraction of the debt owed. In the alternative, the company can hire a collection agency to collect the bad debt. In either case, the company is forced to write off some bad debt. The bad debt is an expense which flows straight to the bottom line and reduces the company's profit. In a company with poor cash management techniques, the failure of one client to provide payment could cause the business to be unable to pay their vendors. Like a row of dominos, one company after another falls.

A couple of years ago, General Motors (GM) faced a serious cash flow crisis which would have forced them into bankruptcy. Had GM filed for bankruptcy protection, they would not have paid any of the their vendors. Those vendors, in turn, would not have been able to pay their vendors. This scenario would have repeated itself multiple iterations and affected hundreds if not thousands of businesses. GM was too big to be allowed to fail. For if GM had failed, there would have been countless smaller companies failing too.

One way to deal with bad debt is to actually budget for it. During the budget process, there will be an expense line item called, "Allowance for Bad Debt." When creating a line item for bad debt, the business should look at historical or industry data to determine the proper percentage to allocate for bad debt. In some industries it may be close to 0% and in others it could be as high as 10% of sales. Whatever number is used, a company's bad debt needs to be carefully managed. To reduce their exposure to a bad debt, if a specific customer balance becomes too far overdue, the company must take action, such as stopping shipments to that customer,. It is sheer foolishness to continue shipping product or providing services, thus incurring more debt, to a customer who is not paying their invoices.

Account aging is one way a business can monitor customers' debts. You may have seen an aging report at the bottom of an invoice you have received showing the age of your debt to the vendor. Most accounting/invoicing systems will produce a report which shows every customer's debt in relation to how old the debt is. These reports will show debts that are less than 30, 30–59, 60–89 and 90+ days old. Any debt which is over 90 days old is at risk of becoming a bad debt. The 90+ day mark is the point at which many companies initiate their debt collection policy. This may start with a phone call or letter to the debtor. Escalating actions according to a predetermined time-line will follow culminating with sending the account to collections and ceasing to do business with the debtor.

	Current	1 - 30	31 - 60	61 - 90	> 90	TOTAL
Customer 1	105.32	0.00	0.00	0.00	250.00	355.32
Customer 2	0.00	106.00	0.00	351.00	0.00	457.00
Customer 3	366.00	123.00	641.00	0.00	0.00	1,130.00
Customer 4	0.00	0.00	0.00	0.00	943.00	943.00
Customer 5	0.00	0.00	0.00	703.00	0.00	703.00
Customer 6	769.36	653.00	0.00	0.00	0.00	1,422.36
Customer 7	944.77	489.00	0.00	0.00	0.00	1,433.77
Customer 8	651.13	111.00	0.00	0.00	0.00	762.13
Customer 9	943.17	89.00	0.00	0.00	0.00	1,032.17
Customer 10	0.00	37.00	0.00	0.00	0.00	37.00
Customer 11	103.00	0.00	403.00	0.00	4.95	510.95
Customer 12	509.00	0.00	0.00	0.00	0.00	509.00
TOTAL	**4,391.75**	**1,608.00**	**1,044.00**	**1,054.00**	**1,197.95**	**9,295.70**

Figure 7: QuickBooks Summary Account Aging Report

A business can also mitigate their exposure to bad debts by selling their accounts receivable to another company specializing in payment processing. This is call "Factoring." The company which buys the accounts receivable considers the unpaid receivables as an asset. However, they do not pay full value. In some instance the factoring value can be as high as 10% which means the company only pays 90% of the value of the accounts receivable. One advantage of factoring your A/R is the ability to receive your cash immediately upon delivery of the product or service. The business does not have to wait for the customer to pay before they receive the funds. Another possible advantage is the company does not have to write off their bad debts. All the debts are included in the factored A/R purchased by the factoring company. However, you can see that factoring can be a costly way of obtaining your funds quickly. In fact, one company I worked with was factoring $4M per year in revenues. Even at 1% factoring, factoring their accounts receivable was costing the company 40,000 per year! This expense was the difference between breaking even or making a profit. As this was a family owned business, that was $40,000 per year which could be used for vacations, college education or even retirement. Factoring was a dangerous trap the company fell into and discovered they couldn't extricate themselves. It took careful cash management and an SBA loan in order to escape factoring cycle.

A company or business owner has the most control over their accounts receivable. The business is able to set the terms when payments are due and thus are able to decide when the cash will be available to them. Typically, the sooner you get the money, the better. However, there are some factors outside the control of the business. These factors include, their customers' behavior and industry norms. Despite these limitations, there are actions a business can take to provide incentives for prompt or early payment.

4 – Questions and Exercises

Explain the difference between a household's and business's cash flows

What can a business do to control their Accounts Receivable?

What inducements can a business use to provide for early/prompt payments?

What penalties can a business assess for late payment? What are the dangers?

Why is monitoring outstanding debts important?

What report is available to monitor debt?

What is an allowance for bad debt?

What is factoring?

What is the advantage of factoring?

Why is factoring dangerous?

Why is having an allowance for bad debt important?

5 Cash Handling

Most small and medium businesses have little need to handle cash. However, that does not hold true for businesses which deal directly with the public such as restaurants, retail or professional services. These businesses do have the need to handle cash on a regular basis. In order to assure the actual cash is properly protected, good cash handling techniques are required.

At no time during the day, should any cash be left unattended or unlocked where unauthorized personnel can easily steal the cash. At the beginning of the day, a trusted individual should count the starting cash and record it in a secured report. Throughout the day, any cash registers should be monitored to make sure they do not have too much cash in them at any one time. Any excess cash should be counted and moved to a secure location away from customer access. All cash movements need to be recorded. For instance, if a roll of quarters is removed from the safe and placed in the register, this movement is recorded. Excess cash moving from the register to the safe is likewise recorded. Meanwhile access to both the safe and the tills must be limited to only those who need access to process sales and then only at the time they are processing the sale or moving money. The register drawers or safe should not be open at any other time.

At the end of the day, all of the cash is counted by at least two people. They will determine how much cash is available on hand. The cash receipts are reconciled against the cash register tapes to determine how much cash should be on hand. Any discrepancies should be noted and investigated. Some discrepancies are normal and expected due to mistakes in providing change for purchases. Other problems are a result of employee dishonesty or pilfering the till.

Once the cash has been counted and reconciled, the day's bank deposit is completed. Depending on your arrangements with your bank, an armored car can pick up your deposit or you can drop it off at the bank. Some banks even have a night deposit which can be used when the bank is closed for the day. No matter what method used, the business, needs to record the deposit in the proper ledgers.

Part of good cash handling is counting everything at least once by two different people. This assures a counting error does not occur. This is still the rule when withdrawing money from the bank. The teller will count the funds and so should the employee receiving the money. Banks can and do make errors. One way to reduce the possibility you are the victim of being short changed is to double count the money in front of the teller. Don't be worried about offending the teller as they actually expect you to count your money in front of them. In addition, if you walk away from the teller window and discover an error, it is almost impossible to prove the error happened. However, if you count your money in front of the teller and find an error, there is no controversy about an error happening.

Proper cash handling is vital to assuring your cash stays safe and is properly accounted for through the day. Should a problem occur, your records will assist you in pinpointing the time of day when the problem happened and who might be responsible for the problem.

5 – Questions and Exercises

Why is cash handling important?

How many times should the cash be counted?

Who should access the cash?

When should the cash be accessed?

When should the bank deposit be made?

6 Accounts Payable

Just as an individual or business has income, they also have expenses. As previously mentioned in order to pay the bills due or Accounts Payable, cash is required. We've seen how to control your income. However, there is much less control over the timing of your expenses. Just a your business can determine when your Accounts Receivable are due, your vendor has the same control over your expenses. Understand your Accounts Payable is somebody else's Accounts Receivable and your Accounts Receivable is your customer's Accounts Payable.

Remembering cash is king, the general rule is to collect your debts as soon as possible and pay your invoices as late as possible. This will provide you with the maximum average daily balance in your bank accounts. Since many banks waive fees bases on an account's average daily balance, this is one way to avoid those bank fees. In addition, by collecting your money before paying your debts, your business should be able to pay your bills without resorting to using your line of credit. Every invoice a business receives must be evaluated to determine not only if it should be paid but when it should be paid.

Now you may question why an invoice should be verified for payment. Sadly, there are some nefarious individuals who will send businesses fraudulent invoices in hopes of receiving something for nothing. These invoices can appear to be from a business your company has no relationship with. Periodically, my studio would receive an invoice from Purple Directory Services of America[1] with a nice Yellow Pages logo in the corner. A close look at the fine print on the "invoice" showed this was a contract to start service with their company. They were hoping the "invoice" would be paid without scrutiny and a business relationship be established. The "invoice" was properly filed in the outgoing garbage.

Fraudulent invoices can also be from a company you regularly do business with but may not have received the product. Finally, it could be an honest mistake where something you did purchase was double or incorrectly invoiced. It is much harder to recover funds you have mistakenly paid than it is to hold onto your money. While fraud from outside sources is a threat, a bigger problem can be fraud from within. The fewer people involved in verifying invoice payments, the higher the risk of internal fraud. Internal fraud occurs when a trusted individual starts diverting company funds to themselves by writing checks against bogus invoices. A good control system will have at least two unrelated individuals review all payments.

I implemented one such method, known as Positive Pay, at a client's business after they had been defrauded for over $100,000. Positive Pay is setup with your bank. Each day a list of checks presented for payment at the bank is provided to the business. An officer of the business will review that list against a list of invoices and approve the checks for payment by the bank. Should a check not match an approved invoice, the company officer will not approve the check and the bank will deny the check's payment. For a business which actively monitors their invoices, Positive Pay will minimize the risk of paying fraudulent invoices and checks.

Once an invoice has been verified and approved for payment, the next decision is to determine when the invoice should be paid. Just because an invoice has a due date does not mean the invoice has to be paid on that date. As you may provide discounts for early payment so might your vendors do the same. In addition, the penalties for late payment might actually be less than the opportunity cost of using that cash elsewhere. For instance, if you earn a return of 1.5% per month on your cash but the penalty for late payment is only 1%, per month then you actually lose .5% per month. In this case, the longer you wait to pay the invoice the more income you have. If you can delay a payment for three months, you will have earned an extra .5% per month compounded. While that might not be much money for a small business, for a major corporation dealing with millions of dollars, this can actually be a substantial sum.

Sometimes for a business in financial trouble, they have difficulty paying their accounts payable. In this situation, the business has to determine which invoices will take priority over other invoices. Suppliers of raw material, electricity and other necessities must take priority over payables which will have a much lower impact to the business. One such payable might be for cable TV service to the TV in the employee lunch room. Another one might be for advertising in a magazine which has already been published. A late payment will not result in the immediate loss of services but could cause the publisher to demand full payment for the next issue. These are when the tough decisions have to be made. The company's supply lines needed to keep the business functioning must be preserved at all costs.

6 – Questions and Exercises

Explain why a company does not have as much control over the timing of their expenses as they do for their income.

What is the general rule concerning cash management?

Why do invoices need to be verified before they are paid?

What is Positive Pay, how does it work and why is it used?

Why might a company wait until an invoice is 90 days old before paying it?

Why might a company pay an invoice immediately?

7 Other Sources of Cash

By now you see cash management is not a passive activity. Cash management is an active on-going process to assure the company remains solvent and the cash is being put toward the best use. So far we've discussed budgets, account payable and accounts receivable. But what happens when the unexpected occurs? You've commonly heard "a household should have 6 months of income saved for a rainy day." This savings can be used if somebody losses their job, becomes ill and can't work or some other emergency occurs. Cash reserves don't just happen. When I started my first job, my parents told me to put some money aside every paycheck to make sure I had cash reserves available for an emergency.

Businesses are no different from personal households. They need a cash reserve. The size of the cash reserve depends upon the business or industry. In some cases, the age of the business will influence the size of the cash reserves which are required. I once attended a local school board of education meeting. At the meeting, the board approved adding a couple of new buildings to the school district at an expense of millions of dollars. The new buildings were being financed by using the school district's cash reserves which impressed me the most and was an indication of how well the school district was managed. That meant there would not be any tax hikes or bonds issued to pay for the buildings. This was a sign of good planning, budgeting and cash management.

A business needs to maintain a cash reserve for many unexpected expenses. In this litigious age, they can be sued for no reason. Equipment can fail unexpectedly. A large customer order may suddenly arrive. Insurance may cover some of the litigation expense but it will not cover aging equipment or the need to make a large purchase of raw materials to cover an unanticipated large customer order. Sometimes, the cash is needed to expand the business. Without a cash reserve, the business has limited options to finance the purchase of raw materials or expansion. The cheapest cash you can obtain is from yourself.

Your cash reserve can be working for the benefit of the business. Rather than sitting in a low interest savings account, the cash reserve funds could be sitting in a higher yield account. However, there must be a balance between the higher yield and the availability of the funds. A 1 year treasury note has a higher yield than a 30 day note does. However, the 1 year treasury note cannot be converted into cash as readily as the 30 day note could be. You trade liquidity for higher yield. Every business is different and will need to tap into the cash reserves at various times. The ability of the company to obtain or pay for a short term loan until the cash reserve can be liquidated will determine the type of investment vehicle for the cash reserves.

There are times when for one reason or another, the cash reserve is not a good option to tap for some needed funds. In that case, the company may tap into their line of credit. A line of credit is an open loan previously arranged with the bank. This is exactly like a credit card account but with pre-negotiated interest rates. The line of credit can be used to purchase raw materials or expand the business. The line of credit typically needs to be paid off as soon as possible. Depending on the cash needed and the cost of that cash, the line of credit might be the best alternative.

One example of this type of loan is called a builder's loan. The builder has agreed to take a loan with a set limit which is secured by the house to be built. The builder will draw money from the loan account as raw materials are purchased and contractors are paid. While the house is being built, the builder makes interest only payments on the loan. When the house is completed and sold to a buyer, the loan is repaid. Any funds paid for the new house in excess of the loan amount become the builder's profit. In this manner, the builder is able to stretch their purchasing power beyond what their own cash reserves would normally allow by leveraging the bank loan. One by product of the housing crisis was the number of half completed and abandoned new housing projects. Of course this is a big problem for the banks because they foreclosed on half completed projects and had to find somebody to complete those projects before they could recover their investment in the loan.

A line of credit should be considered a short term bridge loan to cover a cash shortfall from the time an expense must be paid and when the income will be received. Using a line of credit for an extended period of time is like a revolving credit card where new purchases are replacing those that have been paid off. The line of credit should be a tool to assist in cash management and not a crutch to cover constant shortfalls. If the business has constant cash shortfalls, action needs to be taken to resolve this cash management issue. The business needs to either accelerate the accounts receivable, delay the accounts payable or some combination of both. But remember there could be a cost for delaying your accounts payable.

7 – Questions and Exercises

What is a cash reserve?

How do you determine how much of a cash reserve to have?

What can the cash reserve be used for?

What factors determine how long the cash reserves should be invested?

What is the liquidity vs. yield tradeoff?

What is a line of credit?

What is a line of credit used for?

When should a business avoid using their line of credit?

What are the advantages of having a cash reserve?

What should a business do if they are constantly using their line of credit?

8 Assets and Inventory

A walk though the halls of any business which has been around for several years or more will find unused assets, unneeded raw materials or old unsold inventory. All of these represent cash tied up in non-liquid assets. Asset and inventory management are important components of cash management. Operations management deals in great detail with assuring both raw materials and inventory are kept at appropriate levels. But to understand why this is important lets take a look at the production cycle in terms of cash management.

Raw material is purchased to create a product. Depending on how fast the raw material is used in production, the raw material can sit on the shelves or be used in the creation of a product. Normally within 30 days of the raw material being delivered, the supplier's invoice is due. Hypothetically, let's say the product is sold immediately after it is produced and it takes a week for production. The customer is invoiced for the product and has 30 days to pay. In a perfect world, where customers pay immediately and the product is shipped **before** the raw material invoice is received, the customer's payment will arrive before the vendor's invoice is due.

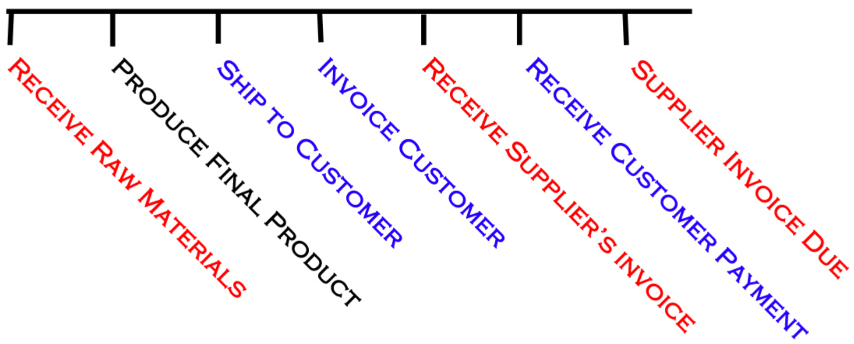

Figure 8: Perfect World Timeline

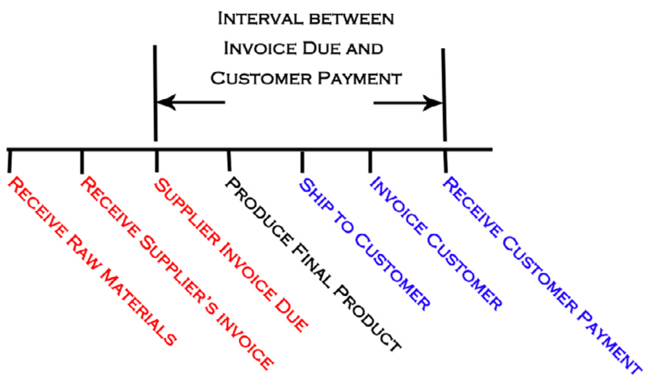

Figure 9: Reality Timeline

However, we don't live in a perfect world. Many times the supplier's invoice arrives immediately upon delivery or the raw material sits in the warehouse waiting to be used. In the case where the customer does not pay promptly, the raw material sits on the self or the finished product sits in the warehouse, the interval between when the supplier's invoice is due and the customer payment is received grows larger. In some cases, this could even be a year or more. This is one reason why my photography studio insisted on full payment before any products were ordered. This way I had the cash to pay my suppliers before I ordered the product from them. In addition, I could wait until the client's check cleared the bank to make sure I didn't have to collect on a bad check. Rather than have a delay between the time I owed the supplier and the time the customer paid, I already had the cash in had.

Unfortunately, many businesses do not have the ability to charge their customer before they place an order with their supplier. This is one reason why some companies get in trouble using their line of credit or turn to factoring. One way to solve the inventory problem is to turn to a just in time production and delivery of products. This will reduce the time from material purchase to product delivery and reduce the time a float is needed. This is also one of the reasons why it is hard for a company to increase capacity despite having the orders in hand. The orders are there, but the payment for the product is not. To increase production to meet the demand, the company will need to borrow the funds or obtain additional capital to finance the expansion. There are many text books which go into minute details of how to manage inventories. For now, it suffices to know how inventory management affects cash management.

Asset management deals with managing the long term assets of the business. There are many factors which determine if an asset should be purchased or leased. It is best to speak with your accountant before acquiring any major asset to determine if purchase or leasing is the best alternative in your situation. One advantage of leasing is the ability to return the item immediately upon finishing any uses for that item. Meanwhile, a purchased asset is yours until it is disposed of. A purchased asset provides less liquidity than a leased asset. It also makes it harder to upgrade to the newest version of the machine in question. However, once an item is fully paid for, there are no expenses other than maintenance or repairs. Sometimes it makes sense to break a company into two portions. One portion owns the assets and leases them to the side of the company which provides the services. This is the common structure in the airline industry. A holding company actually owns the airplane and leases the airplane to the operating side which is responsible for the carriage of passengers. I have also seen this arrangement with construction companies.

8 – Questions and Exercises

Why is carrying a large inventory is bad for cash management?

What does excess inventory represent?

How does Just In Time manufacturing reduce cash management problems?

Why would a company like to ship the product before the vendor's invoice arrives?

Why does a custom order company want cash payment before starting production on the product?

Why problems occur when the company suddenly grows or obtains a large order?

What do unused assets represent and what should be done with them?

Why do some companies have two sub companies?

9 Cash Flow Statement

As mentioned before, if you don't know where you are starting from, you will not know how to get where you are going. But just as important is being able to check your progress along the way. On a journey, we look at landmarks and compare them to the map. When we get lost, we stop, look around and plot a new course to get us to our destination. Fortunately, accountants have provided us with two reports which provide the business owner or manger the information they need to determine if the business is on course. These statements are the Balance Sheet and the Cash Flow Statement. Sometime the Cash Flow Statement is referred to as the Statement of Cash Flows. Regardless of what it is called, it provides the same information. There is a great deal of information available in these two statements. For a deeper understanding please refer to material on Managerial Accounting. The Cash Flow Statement is divided into three sections. They are:

Financing Activities

Operating Activities

Investing Activities

Financing Activities are those which are related to obtaining funds to run the company. This typically includes any long term borrowing and cash flows related to stock in the company. When stock is sold by the company, funds are received. Cash is paid out when the company issues a dividend or buys back the stock.

Operating Activities are those which are directly related to running the business, purchasing raw materials, paying invoices, producing the product or service, delivering it to the customer, collecting the payments due and the wages associated with those activities.

Investing Activities are related to any investments the company makes with the cash reserves. This can be real estate, long-term treasury notes or any other investment.

While it is nice to see a positive cash flow from Financing and Investment Activities, that is not where the business should obtain the bulk of the profit. That should come from the Operating activities. That is why it is so important to isolate the three distinct cash flows to determine the actual source of funds the company uses. Not generating funds via Operations signals a major problem for a company and the company will not stay in business for long.

The Balance Sheet is the other tool accountants provide to understand the health of a business. A Balance Sheet is divided into two sections: Assets and Liabilities. A company's assets must equal the liabilities. That's why it is called a Balance Sheet. The Assets and Liabilities must balance! Both sections of the Balance Sheet are broken down by short and long term. Therefore, you'll see: Short-term Assets, Long-term Assets, Short-term Liabilities and Long-term Liabilities. There are all sorts of rations which accounts use to determine the health of a company. These ratios will vary depending upon the company's industry. Construction companies will differ from retail companies which will differ from service companies. All of these companies have differing cash flows which will also be reflected in the balance sheet. A business owner needs to understand the expected Balance Sheet ratios for their particular industry.

9 – Questions and Exercises

What is a Statement of Cash Flows?

What does a Cash Flow Statement Show?

What are the three sections of a Cash Flow Statement?

What is included in each section?

Why are there three distinct sections of the Statement of Cash Flows?

Why is the Operations section of the statement so important?

What is a Balance Sheet?

Why is it called a Balance Sheet?

What are the sections of the Balance Sheet?

10 Profit Management

Benjamin Franklin said, "If you fail to plan, you are planning to fail." In much the same manner if you fail to plan for profit, you will fail to profit. For a small or medium business owner, it is easy to forget to "pay yourself." Sure you may receive a salary but the point of owning a company is not only to pay yourself but also to profit from your efforts and those of your employees. A publically traded company which failed to turn a profit would soon find itself with a low stock price and few people willing to invest in the company. Eventually, that company would find itself as a takeover target as some investor decides they can make the company profitable or the assets are better off being sold off.

Yet many small business owners fail to think about profit. They are happy as long as they are breaking even. That is a bad attitude to have. Just as you need to have a cash reserve, you need to make sure the business owners are receiving a profit payment. The most common method is to take all the excess cash at the end of a period, typically a quarter, and take those funds as a profit. However, there is a problem with this method. This method fails to account for future cash needs. Nor does it set aside funds specifically for profit. While the business is waiting for the quarter to end, those funds could wind up being used for a low priority discretionary expense.

A better method is to actually create an expense line item in the budget for profit disbursement to the owners. I don't recommend a predetermined or set amount of profit to be disbursed every quarter. Rather a flexible budget should be used to allow a percentage of sales, net profit or some other amount to be used as the monthly profit. The profit can be disbursed either monthly, quarterly or annually. If the profit is paid either quarterly or monthly, an accrual account should be used to hold the profit until it is paid. This way, the cash representing the profit will be available when the profit payout is made.

In the United States, the Internal Revenue Service has rules about how much profit can be taken in relation to the amount of salary a business owner it paid. In general, the rule is the business owner must first be paid a salary comparable to others individuals doing the same job in the same geographical area before they can take a profit payment. This is to assure the proper payroll taxes are paid by the individual. For instance, if a business owner took no salary but $10000 per month as profit, the IRS would consider this as tax avoidance. However, if the business owner paid themselves a salary of $6000 per month and took the rest as profit, the IRS would look to see what other small business CEOs' salary were in the same industry. If the salary was comparable there would not be a problem. As with anything dealing with taxes, the smart business owner will consult with their local accountant to determine the proper ratio for salary and profit disbursements.

10 – Questions and Exercises

What is profit management?

Why is profit management important?

What is wrong with just using excess cash to pay a periodic profit?

Why should there be a profit accrual or budget line item for profit?

Why does the IRS regulate profit payments in relation to owner's wages?

11 Fraud

For as long as business has existed there have been people who want something for nothing. There are all sorts of fraud a company must protect themselves against. Why you might ask is this a cash management issue? Simply put, when a company is a victim of fraud, an asset has been stolen by false pretenses. This loss becomes a charge against the profit of the company. There are two types of fraud: internal and external. I've already discussed one type of fraud, the invalid invoice. However, there are many more for the business owner to beware. Just as each industry has their own cash flow characteristics, each industry will also have typical types of fraud for the business owner to know about. Knowledge is the best protection. Once you know about how a scam works, you can institute policies to protect your company against those scams.

Years ago, one morning a new photographer whom I was mentoring excitedly called. She had received an inquiry for an out of town wedding taking place in a couple of months. The person wanted to hire her without meeting because they were out of the country. The prospective client wanted to know the total bill and would forward my friend the funds for the wedding. When the funds arrived, they check was for more than the bill. An e-mail followed stating the "accountant" had overpaid my friend and would she forward the excess funds to the "event planner?" My friend was all set to send out a check for several thousand dollars to the event planner until I stopped her. Fortunately she had not cashed the check so we returned it to the "client." That was the last she heard from this "client." In this case, I'm sure the check she received was counterfeit. Her bank would not discover this until after her overpayment refund check had cleared. I explained to my friend, my studio has a policy that no funds (if any) are refunded until ninety days after the check is deposited. If somebody wants me to be their banker, that's fine, BUT they have to wait until the funds are free and clear.

A dress shop owner I know, explained to me, there are ladies out there who will buy a dress a few days before a big party, homecoming or prom. They will wear it to the big event. After the event, the woman will return to the shop to return the dress. To combat this type of fraud, my friend will only issue merchandise credit. Other dress shops will not take a dress back if the tags are missing. Restaurateurs will commonly tell you about the customer who ate their meal only to complain about it. This customer is expecting a free meal. As you can see, no matter your industry, there are customers who will attempt to take advantage of the business. That's why you need written policies to protect you against external fraud.

Internal fraud is another matter. This can be anything from an employee taking money from the till, to stealing assets. Many retailers will check their employees' coats and bags as they leave the store. Casinos have cash rooms with clear tables and special clothes for the money counters. Once again, policies and operating procedures protect the company against typical internal theft and fraud. If you are not familiar with the problems of your industry there are many resources available to assist you. You can consult with your peers. There are industry trade groups which typically have best practices and lots of advice to give the business owner. Finally, there are outside consultants who know not only your industry but, others as well. These consultants are able to take best practices from one industry and adapt it to another. No matter what you decide, make sure your hard earned assets are protected from those who will attempt to trick you into giving them something for nothing.

12 Concluding Remarks

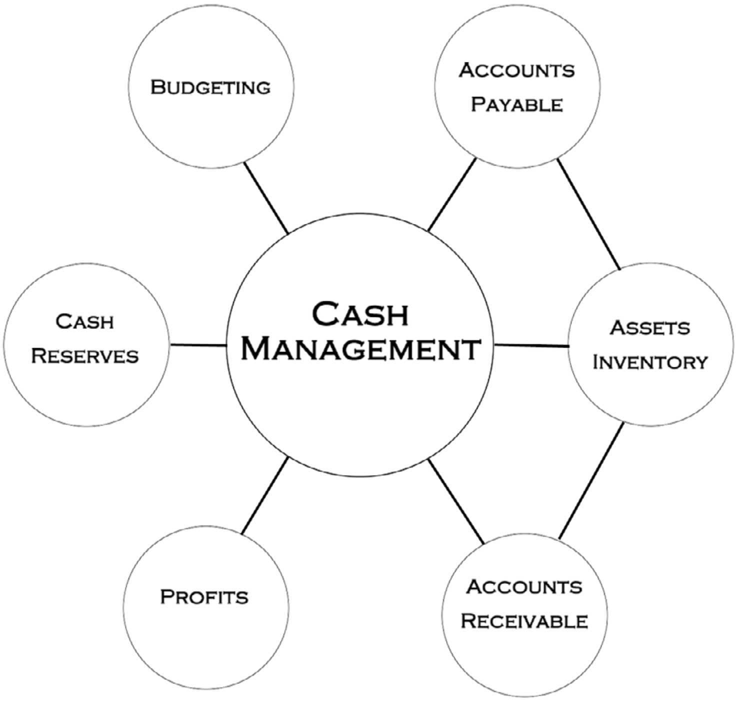

Figure 10: Cash Management

Cash management is a complicated subject at the heart of every viable business. A good number of viable business fail because they fail to properly manage their cash. Likewise, there are a great number of business which could be more profitable if they paid more attention to cash management. Cash management starts with a flexible budget. Every expense is classified as either variable or fixed. Based on the budget sales projections are completed along with expectation for cash reserves and profit. Budgets are also prepared for earning 60%–150% of the anticipated sales with 5% steps. The income and expenses are placed in the budget to allow forecasting of cash needs based on a variety of scenarios. Policies are put in place to manage the cash flow from accounts receivable and the cash flow for accounts payable. Inventory must be managed to prevent stock outs yet not tie up a large amount of cash in raw materials where it is not working for the company. In the end, a business exists to maximize their profit.

After the cash needs of the company are met, excess cash reserves need to be invested in accounts which provide a higher yield than an regular savings account yet provide a form of liquidity. Should additional funds be needed beyond the cash reserves, borrowing from a variety of sources is available. However, the business must make sure they are obtaining funds at the lowest cost to the company. Good cash management is a set of procedures and on-going activities to make sure the company stays solvent and can pay their bills, taxes and employees.

Endnotes

1. The event is real, however the company name is fictionalized.