7. Cash Management

It is very important to ensure that sufficient cash is available to meet obligations and to make sure that idle cash is appropriately invested to maximize the return to the company. One function of the company "treasurer" is to examine the cash flows of the business, and pinpoint anticipated periods of excess or deficit cash flows. A detailed cash budget is often maintained and updated on a regular basis. The cash budget is a major component of a cash planning system and represents the overall plan of activity that depicts cash inflows and outflows for a stated period of time. A future chapter provides an in-depth look at cash budgeting.

You may tend to associate cash shortages as a sign of weakness, and, indeed, that may be true. However, such is not always the case. A very successful company with a great product or service may be rapidly expanding via new business locations, added inventory levels, growing receivables, and so forth. All of these events give rise to the need for cash and can create a real crunch even though the business is fundamentally prospering. To sustain the growth, careful planning must occur.

7.1 Strategies to Enhance Cash Flows

As a business looks to improve cash management or add to the available cash supply, a number of options are available. Some of these solutions are "external" and some are "internal" in nature. External solutions include:

Issuing additional shares of stock -- This solution has a definite advantage, because it allows the company to obtain cash, without a fixed obligation to repay. As a result, this may seem like a sure-fire costless option. Unfortunately, the existing shareholders do incur a very real detriment, because the added share count dilutes their ownership proportions. In essence, it is akin to existing shareholders selling off part of the business; a solution that may be seen as a last resort if the future is bright.

Borrowing additional funds -- This solution brings no additional shareholders to the table, but borrowed funds must be repaid along with interest. Thus, the business cost and risk is increased. On a related note, many companies will establish a standing line of credit that enables them to borrow as needed, and not borrow at all if funds are not needed. This solution provides a ready source of liquidity, without actually increasing debt levels. Banks typically provide such lines of credit in exchange for a fee based on the amount of the line of credit.

The company may look within its own operating structure to find internal cash flow enhancements:

Accelerate cash collections -- If a company can move its customer base to pay more quickly, a significant source of cash is found! Simple tools include electronic payment, credit cards, lockbox systems (i.e., the establishment of bank depositories near to the customer for quick access to funds/thereby avoiding mail and clearing delays), and cash discounts for prompt payment.

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Postponement of cash outflows -- Companies may “drag their feet” on cash outflows, delaying payment as long as possible. In addition, paying via check sent through the mail allows use of the “float” to preserve cash on hand. However, you need to know that it is illegal to issue a check when there are insufficient funds in the bank to cover that item (even if you know a deposit is forthcoming that will cover the check). Some companies make travel advances to employees for anticipated costs to be incurred on an upcoming trip; it is better for cash flow to have the employee incur the cost (perhaps on a credit card) and then submit receipts for reimbursement.

Cash control -- Systems and procedures should be adopted to safeguard an organization’s funds. Internal control for cash is based on the same general control features introduced in the previous chapter; access to cash should be limited to a few authorized personnel, incompatible duties should be separated, and accountability features (like prenumbered checks, etc.) should be developed.

- The control of receipts from cash sales should begin at the point of sale and continue through to deposit at the bank. Specifically, cash registers (or other point-of-sale terminals) should be used, actual cash on hand at the end of the day should be compared to register tapes, and daily bank deposits should be made. Any cash shortages or excesses should be identified and recorded in a Cash Short & Over account.

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- Control of receipts from customers on account begins when payments are received (in the mail or otherwise). The person opening the mail should prepare a listing of checks received and forward the list to the accounting department. The checks are forwarded to a cashier who prepares a daily bank deposit. The accounting department enters the information from the listing of checks into the accounting records and compares the listing to a copy of the deposit slip prepared by the cashier.

- The controls over cash disbursements include procedures that allow only authorized payments for actual expenditures and maintenance of proper separation of duties. Control features include requiring that significant disbursements be made by check, performance of periodic bank reconciliations, proper utilization of petty cash systems, and verification of supporting documentation before disbursing funds.

The bank reconciliation and petty cash systems referred to above have specific accounting implications to consider, and are the subject of the following sections of this chapter.

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