

Cash is King of the Balance Sheet

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Every business owner or manager knows that to pay the bills, make payroll, or buy capital equipment, the company needs cash. The issue for business owners and managers is to manage the cash resource applications in mind and especially during cash flow shortfalls.

Why Cash Is the First Line on the Balance Sheet

Ever wonder why cash is the first line on the company's balance sheet? Assets and liabilities on the Balance Sheet are organized from most current to non-current or, saying it another way, from most liquid to least liquid. Cash is the most liquid of all the assets a company has and therefore is the first line of the balance sheet. Companies reconcile cash on a monthly basis to ensure that the most liquid asset is being accounted for properly. On the liability side of the Balance Sheet, accounts payable are the most current liability and the most current operating expense is typically payroll and payroll taxes.

Cash can be used to pay the company's bills or to make other investments, but before spending cash, you have to have cash in the bank to spend.

Cash is the End Result of Everything That Happens in a Company

The cycle for a manufacturing company is: order – build – ship – bill – collect, while the cycle for a service company is: order – provide service – bill – collect. Both cycles involve using cash from the start for sales and marketing to generate the sale, in the middle for inventory and produce the product or provide the service, to the end of the cycle with the collection of cash.

An easy way to look at cash is to break it down into three areas: How cash is used, how cash is generated, and other sources of cash.

Cash is used for:

- Funding accounts receivable
- Purchasing inventory
- Prepaying for items such as annual insurance premiums or deposits for services
- Paying operating and accrued expenses
- Paying payroll and payroll taxes

Cash is generated from:

- Accounts receivable payments from customers
- Prepaid sales

Other sources of cash:

- Borrowing money
- Owner(s) putting cash back into the business
- Public companies selling their stock or bonds to generate cash

Cash Flow Makes the Business Run

If your company has an annual audit, then you are aware that the Statement of Cash Flows is a required accounting statement, as are the Income Statement and Balance Sheet. The Statement of Cash Flows takes all the business's activities starting with the company's bottom line profit or loss, changes in non-cash Balance Sheet accounts, and activities for financing or capital contributions to arrive at the cash balance the company is showing on the Balance Sheet. Though the Statement of Cash flows is an important part of getting audited statements, what a company needs to operate its business on a daily, weekly, or monthly basis is a basic internally generated cash flow projection report.

Cash flow projection reporting needs to be done on a routine basis and be used as a management tool. Cash flow projections should forecast rolling cash balances for the company at least 5 weeks into the future, though 13 weeks (one quarter) maybe more helpful. Cash flow projections help owners and management estimate when cash will be collected and when and where all the cash will be spent. The ending balance of the current period should tie out to the cash balance on the Balance Sheet of the same date.

The key is to develop a cash projection report that will help management know in advance if there is going to be a cash shortfall in a future period and start reacting to the potential problem today, rather than being blindsided in the future.

Timing Problems with Cash Are Normal

Every company experiences the need for a temporary cash infusion due to:

- Seasonality of business cycles that require building up inventory
- Seasonality of business cycles that will result in increased funding of accounts receivable
- Large capital expenditures for new equipment
- Acquisition of a company or product line

The idea is to be able to predict and understand any cash shortfall in advance, so that the company either has the cash on hand or credit facilities available to help during these temporary negative cash flow times.

Borrowing Cash is Not the Same As the Business Generating Cash

A business can borrow cash in many different ways including term loans, unsecured lines of credit, or asset-based lending secured by accounts receivable or inventory. Borrowing money is a way to help a company over a temporary cash shortfall, due to timing issues, or to help cover one-time large cash outflows for capital equipment or an acquisition.

Cash loans should be avoided for funding the normal operating expenses of the business unless action is taken to correct the negative excess cash outflows. To correct the negative cash outflows, a company will need to make difficult decisions as where to cut expenses to correct the cash shortfall. This may require

the company to reduce employees' work hours, suspending pay increases for the current year, reduce various operating expenses, or stop certain expenses completely. Remember that lenders expect to get back the money they loan back over a fixed period of time plus interest, and even revolving lines of credit have to be renewed, often on an annual basis. Borrowed money must be repaid, which will be a use of cash until the debt is completely paid off.

In Conclusion

The fact is a business can only continue to operate if it has positive cash flow. Cash is what a business generates at the end of the sales cycle. Too often cash is only managed when a company is having cash flow issues. Borrowing money is a tool to help a business over temporary cash shortages due to timing issues, but in no way should borrowing money be considered a permanent fix for a company's cash flow problems. As an owner and manager of a business, you need to understand and be able to predict the company's cash flow to ensure the well-being and longevity of the company today and into the future.

The Siburg Company, LLC is a boutique consulting firm specializing in the areas of financial and operational consulting, business development, and mergers and acquisitions.

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Dan is the Managing Director of The Siburg Company, LLC and has experience as both a President and Chief Financial Officer. He has helped companies to improve operational functions and organization to manage costs and increase revenue streams, while implementing strategic policies and procedures that focus companies on profitability.

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Howard has had success operating four publishing companies. He has founded, built and sold two successful trade book publishing companies, one to a major newspaper chain and one to a major New York publisher. Howard now is a consultant for The Siburg Company, LLC in the areas of business development and mergers and acquisitions.

We invite you to call us to discuss your current business needs or to schedule a future appointment.

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