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Moss Adams Construction Group Newsletter

July 2009

CASH IS KING Are You Giving It the Respect It Deserves?

Cash management is an integral part of a business's financial operations, especially during times of economic stress. Now more than ever, businesses must manage their cash position and cash flow effectively in order to increase interest earnings, reduce collection times on receivables, and allow the business greater flexibility with such things as taking advantage of purchase discounts.

Cash management encompasses the development of annual cash flow projections, down to individual projects. In order to implement and monitor these projections, businesses must support them with sound internal accounting controls. A business with a healthy bottom line can still put itself in a difficult situation with poor cash management, affecting margins negatively. Indicators of poor cash management include:

- Significant underbillings
- Large number of change orders
- Undocumented credit and collection policies
- No review or lack of follow-up on delinquent accounts receivable
- Performing work for customers with a history of write-offs or slow payment
- Inadequate working capital
- Monthly billings sent in an untimely fashion, causing delays in collection for work performed
- Invoices not approved and submitted to the home office on a timely basis
- No credit line established to cushion delays in collection of monthly billings
- Not taking advantage of purchase discounts
- Purchasing long-term assets with cash or short-term debt

The ideal cash balance a business should maintain depends on that business's projected fluctuations, which will impact cash inflows or outflows. The first step is to convert the annual budget into monthly budgets and then convert the monthly budgets into monthly cash flows. A business's financial statement further assists in calculating the current number of days to collect accounts receivable, pay accounts payable, and key ratios.

If a business finds that it's collecting on receivables in 90 days and must pay employees and vendors in 30 days, the business might have to fund three months of operations before the collection process is complete. For example, a business generating monthly earnings of \$1 million, with a 15 percent gross profit margin, means costs of \$1.7-\$2.5 million could be paid out of the business before the first month's billing is collected, leaving a shortfall in the third month of \$1.5 million.

Management should work closely with the business's accounting department and project managers to address many of the indicators and problems of poor cash management identified above. In times like these, managing cash is essential. If you'd like to discuss some techniques to assist with cash management, contact a Moss Adams LLP office and ask for a professional who works closely with the construction industry.

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