



Four Steps to Cash Management Success

An NADA White Paper



NATIONAL
AUTOMOBILE
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ASSOCIATION

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The National Automobile Dealers Association (NADA) has prepared this white paper to assist its dealer members in being as efficient as possible in the operation of their dealerships. The presentation of this information is not intended to encourage concerted action among competitors or any other action on the part of dealers that would in any manner fix or stabilize the price or any element of the price of any good or service.

Four Steps to Cash Management Success

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I. WHERE IS MY CASH?

Most dealerships operate cash-hungry—especially in good times. When sales are high, contracts in transit and vehicle receivables increase and used-vehicle inventory inflates. This massive increase in these two asset types causes a staggering gap between cash inflows and outflows. Combine this with the increases in other receivables, and a dealership can often run out of cash in a matter of days after a fantastic month. This is probably the most frustrating issue for a dealership operation: You made a lot of profit last month but where is the cash? This guide uses a four-step method to help you determine what happened to your cash and develop a plan to provide better cash flow management.

II. CASH FLOW MANAGEMENT

The first step in cash flow management is to define what contributes to cash flow in our industry. We are not the same as other industries; construction companies, for instance, use an advance on the percentage of completion to fund their business. Our cash flow is highly controlled by floor plan balances, the funding of vehicle contracts and how quickly we turn our used inventory. Using a cash flow worksheet will help you understand what consumed your cash. Next we'll look at various metrics to determine what an acceptable month-end balance is. The third step is an understanding of the timing of your cash flow to develop best practices and policies to manage cash and, most importantly, get the results you need—today. Finally, we'll develop a long-term cash flow management plan to forecast these cash flow needs and reward your managers for better cash flow management.

III. CASH FLOW DEFINED

Simply defined, cash flow is the movement of funds into your dealership, through the various balance sheet accounts, and back out of your dealership to purchase vehicle inventory, parts and the supplies needed to run your store. Cash flow is cyclical. The cycle begins with the purchasing of inventory, then receipting the sales of this inventory, and then moves to cash disbursements for expenses. Cash is retained when the sales exceed the expenses and the business makes a profit.

Cash comes into the dealership from these sources:

- Profit
- Payment of contracts in transit

- Reduction of used inventory/vehicle receivables
- Payment of accounts receivable
- Customer deposits
- Payment of factory incentives/warranty

Cash leaves the dealership to pay for:

- Floor plan reduction
- Trade payables for parts and sublet
- Lien payoffs on trade-ins
- Expenses and supplies
- Payroll
- Taxes and licenses
- Loan and interest payments
- Purchasing fixed assets
- Investment purchases

The cash flow worksheet on the next page is created from two financial statements, one from last year and one from last month. We advise you to follow the same procedure to create your own cash flow worksheet; it is the best way to do a comparative cash flow statement.

Cash Flow Worksheet

Assets	Last Month	Last Year	Amount of Increase or Decrease
Current Assets			
Cash	\$(325,255)	\$501,205	\$(826,460)
Contracts in transit/vehicle receivables	\$2,252,522	\$952,521	\$1,300,001
AR + factory receivables	\$5,252,412	\$3,103,593	\$2,148,819
New inventory less floor plan	\$12,325	\$15,252	\$(2,927)
Used inventory less floor plan	\$1,896,252	\$325,258	\$1,570,994
Parts/Sublet/WIP	\$631,241	\$639,730	\$(8,489)
Prepaid/Other Assets	\$187,566	\$147,142	\$40,424
Rental units	\$-	\$-	\$-
Total current assets	\$9,907,063	\$5,684,701	\$4,222,362
Total fixed assets	\$1,958,525	\$1,644,555	\$313,970
Less accumulated depreciation	\$(1,178,515)	\$(1,102,405)	\$(76,110)
Total fixed assets	\$780,010	\$542,150	\$237,860
Other assets	\$1,685,945	\$1,363,738	\$322,207
Total assets	\$12,373,018	\$7,590,589	\$4,782,429
Current liabilities			
Accounts payable	\$245,776	\$193,212	\$52,564
Other notes payable	\$3,062,918	\$1,284,481	\$1,778,437
Other: taxes, payroll, insurance	\$1,010,913	\$924,122	\$86,791
Total current liabilities	\$4,319,607	\$2,401,815	\$1,917,792
Long term debt	\$894,798	\$-	\$894,798
Profit or loss	\$1,969,839	\$1,205,796	\$764,043
Capital and dividends	\$2,313,052	\$2,313,052	\$-
Retained earnings	\$2,875,722	\$1,669,926	\$1,205,796
Total term debt and equity	\$8,053,411	\$5,188,774	\$2,864,637
Total liabilities and capital	\$12,373,018	\$7,590,589	

Source: Sandi Jerome Computer Consulting

The cash flow worksheet on the previous page is a case study of a dealership that made close to \$2 million and has run out of cash. By completing the cash flow worksheet, you can summarize the situation into a cash flow statement.

Cash Flow Statement	
Cash provided by:	
Profit and retained earnings	\$1,969,839
Additional debt and capital	\$894,798
Increase in AR/Notes	\$1,917,792
Depreciation	\$76,110
Total inflows	\$4,858,539
Cash used by:	
Vehicle and other receivables	\$3,448,820
New and used equity	\$1,568,067
Parts and other inventories	\$31,935
Fixed assets and other	\$636,177
Total outflow	\$5,684,999
Cash decrease	\$(826,460)

Source: Sandi Jerome Computer Consulting

IV. CASE STUDY OF CASH MANAGEMENT

Using our sample cash flow worksheet and statement, let's see where the cash went.

Between the increase in retained earnings—\$1,205,796—and the current year's profit—\$764,043—the dealership operations contributed \$1,969,839 toward cash. In a perfect world, cash equals your profit plus depreciation—since depreciation is an expense that you don't have to pay in cash. The difficulty for this dealership is that it had to take on more debt—almost \$900,000—and their liabilities increased with another large note. That debt and profit came to almost \$5 million. Where did it all go?

As the dealership operation grew this year, so did the two biggest drains of cash—vehicle receivables and vehicle equity. The contracts in transit and vehicle receivables are now carrying a balance of \$1.3 million more than last year and the used equity is \$1.5 million more. The dealership also purchased more than \$300,000 in fixed assets. The final confusion came from the \$2 million increase in AR and factory receivables. For the accounting office the answer was simple: the dealership operations had grown and this new cash shortage was just another one of the growing pains.

But let's take a closer look at the numbers.

The first chore after creating your worksheet and cash flow statement is to determine the validity of the numbers. The cash decrease was verified; the dealership was experiencing daily overdrafts and was unable to release floor plan payments. A quick printout of the contracts in transit and vehicle receivables determined that \$2.2 million was a valid figure for those accounts. It was the AR and

factory receivables line that made no sense for this dealership.

Upon further investigation, it was determined that the excess in this account came from an intercompany balance from the dealership's sister dealership. The excess was offset by the \$1.7 million note payable. Thus, to balance the worksheet and statement—and enable reliance on them—the intercompany amounts were netted and a payment was received from the sister dealership.

Intercompany receivables and retained earnings adjustments are the two greatest issues on cash flow worksheets. Make sure you net the intercompany balances and watch for actual reductions in retained earnings caused by year-end write-offs. Many dealerships can remember the \$2 million they made last year, but quickly forget the adjustments made for LIFO, depreciation, bad debts and used-vehicle write-down. Although you might be doing these entries “for tax purposes”—they actually are profit reductions.

V. APPLYING METRICS TO CASH MANAGEMENT

Now that you know where your cash is going, it's time to put some brakes on that outflow. To take control of the cash outflow, a dealership needs to create guidelines based on its individual situation. The next page shows the set of guidelines—or “metrics”—that our case study dealership adopted to manage its cash flow. This dealership decided that keeping seven days' worth of contracts in transit and vehicle receivables on the books per month is plenty. According to that guideline, 23% (seven days divided by 30 days) of the dealership's sales for the month should be in the account at the end of the month. It is not a perfect science—you might have customer deposits in that account, and trade-ins and lien payoffs might offset the sales amount, but it is a guide and a starting point toward developing your own metrics and best practices. If you're already at 23%, then move the bar up to 15%.

Used inventory was the next issue for our case study dealership. Although it had a strict policy of no units in stock over 45 days old, the dealership always carried more than a 45-day supply. Since its used floor plan was limited and its lender allowed only “in-line” vehicles to be floored, the store had over \$1 million in excess units. It is easy to see what the dollar amount for a 45-day supply should be: Take your financial statement for the month and use as a guide 150% (one and a half months) of your monthly retail cost of sales. If you want to carry a 60-day supply, double your monthly amount, using 200% as a guide. In the example, a 60-day supply would be \$4.6 million—and this dealership would be in guide. The dealership in the case study didn't have an actual AR issue after the intercompany was eliminated, but did have an excessive warranty claim balance and made collecting it a high priority.

Again, create your own metrics and monitor them. Create metrics for all your key asset accounts. You can go a step further and determine how much this “frozen” or excess capital costs per month and charge interest on the excess to the department manager responsible for the excess.

Cash Management Metrics

Monthly Amount From Financial Statement	Metric Calculations	Excess
New and used retail sales	\$6,252,412	
7 days' worth divided by 30 days	x 23%	
Metric amount for 7 days	= \$1,458,896	
Actual contracts in transit and vehicle receivables	\$2,252,522	\$793,626
Used-vehicle cost of sales (retail)	\$2,325,212	
Guide for 45 days' worth of used vehicles	x 150%	
Metric amount for 45 days	= \$3,487,818	
Actual used-vehicle inventory	\$4,525,212	\$1,037,394
Parts wholesale sales	\$383,477	
Body shop customer labor/parts	+ \$19,046	
Metric amount for AR accounts (1 month of sales)	= \$402,523	
Actual AR balance	\$2,821,265	\$2,418,742
Warranty labor and parts	\$130,006	
Guide for warranty claims (10 days)	x 30%	
Metric amount for 10 days	= \$39,002	
Actual warranty balance	\$197,252	\$158,250
Total excess		\$4,408,012

Source: Sandi Jerome Computer Consulting

VI. CASH FLOW TIMING

The key element to cash flow is timing. If you receive a payment of a contract in transit before you have to pay the floor plan, lien payoff on the trade-in, and sales commission—then your cash flow is OK. Unfortunately, the timing is not always right, and it may be compounded by such circumstances as a customer using a trade-in to pay for a portion of his or her vehicle purchase. That trade-in can stay in your inventory for months, reducing your cash flow. The metrics in our case study pointed out the problem areas. Creating best practices and policies will enable you to correct the issues that harm your cash flow.

VII. CASH FLOW BEST PRACTICES

Following are best practices for getting your cash into the bank faster. They might not work in every dealership, and they might require that additional training and policies be put in place, but experience has proved that many of these solutions are effective in turning your receivables and inventories into cash faster.

- Have the F&I office pull and submit the contracts.

- Use a post office box for receiving checks in the mail. Receipt them in and deposit the same day to a deposit clearing account. Have the clerks distribute the payments to the various accounts from the receipt and check stub instead of holding the checks.
- Have a policy for used vehicles that you will carry in stock by year, make and model. If a unit comes into stock outside of that policy, wholesale immediately and adjust the actual cash value (ACV) of the car deal that took it in trade.
- Use sweep accounts to move excess cash from your checking accounts into investment accounts and include the payroll account to earn on that account's "float."
- Issue a daily report of all contracts in transit and vehicle receivables to the sales department. Don't wait for accounts to become past due to collect.
- Issue a weekly report of all accounts receivable and warranty claims to the service and parts managers. The best person to collect the funds is the department manager who created the receivable.

VIII. DAILY CASH WORKSHEET

Creating the practices and policies that will provide long-term benefits of improved cash flow will not help you when you're overdrawn at the bank today—or if you're getting a surprise floor plan inspection. Often the amount of cash in your bank account is not a true measurement of your cash position. First of all, there is a daily "float" between what the bank shows and what your computer system shows. The "float" consists of checks that are not yet cashed by your payees and checks that the dealership has created but not yet released. Here is a worksheet that helped our case study dealership determine its true cash position for today.

Cash per bank	\$32,524.21
Deposit today	\$73,251.02
Adjusted cash per bank	\$105,775.23
Cash per computer	\$(193,437.07)
Hold checks	\$77,380.82
Net cash per books	\$(116,056.25)
Float	\$(148,580.46)
Demands	
Payroll 1-15	\$73,250.00
Release payable 1-20	\$32,528.25
Total demands	\$105,778.25
Resources	
Contracts in transit and vehicle receivables	\$197,252.24

Source: Sandi Jerome Computer Consulting

For this dealership, the situation is OK today: The “float” and today’s deposit represent enough cash to release the “hold checks,” and the upcoming resources should meet the demands of the payroll and accounts payable that need to go out.

Use our worksheet to develop your own worksheet and then use your worksheet with your own, real, numbers every day. You might want to expand our sample daily cash worksheet to include vehicle equity—floor plan demands. The worksheet doesn’t provide any magic numbers to help you find cash. Rather, it is an exercise to be performed daily so you will know how much of a “float” you have—i.e., the difference between the “cash per the bank” and the “net cash per the books”—and be prepared for immediate demands on your cash.

IX. CASH MANAGEMENT FORECAST

When a dealership makes a major change, such as adding a franchise, opening a used lot or creating a BDC, there is a need to forecast how the change will affect cash. In addition, most dealerships forecast growth for the following year. If you plan on selling 20% more used vehicles, you’ll need more inventory. Even if you plan to floor your used vehicles, there are some used vehicles that cannot be floored due to age, make or cost amount. Following is a cash management forecast worksheet for our case study dealership using the metrics already created. As you’ll see, the dealership forecasts a 20% increase in new and used retail sales and in cost of sales, a 10% increase in wholesale parts sales, and a 15% increase in warranty labor and parts sales.

Cash Management Forecast			
Monthly Amount From Financial Statement	Metric Calculations	Forecast Increase	Increase
		20%	
New and used retail sales	\$6,252,412	\$7,502,894	
7 days’ worth divided by 30 days	23%	23%	
Metric amount for 7 days	\$1,458,896	\$1,750,675	\$291,779
		20%	
Used-vehicle cost of sales (retail)	\$2,325,212	\$2,790,254	
Guide for 45 days’ worth of used vehicles	150%	150%	
Metric amount for 45 days	\$3,487,818	\$4,185,382	\$697,564
		10%	
Parts wholesale sales	\$383,477	\$421,825	
Body shop customer labor/parts	\$19,046	\$20,951	
Metric amount for AR accounts (1 month of sales)	\$402,523	\$442,775	\$40,252
		15%	
Warranty labor and parts	\$130,006	\$149,507	
Guide for warranty claims (10 days)	30%	30%	
Metric amount for 10 days	\$39,002	\$44,852	\$5,850
Total cash required			\$743,666

Source: Sandi Jerome Computer Consulting

X. REACHING CASH GOALS

Often the person most responsible for cash flow management has the least control over cash flow. Your office manager or controller might be able to monitor cash, but how can he or she reduce used-vehicle inventory or get the contracts in transit paid faster? Although there are various processes that can be improved in document flow and reporting, overall these objectives require that department managers reach their goals. We pay department managers on the gross and net profit they produce, but rarely on reaching the dealership's cash flow management goals. Yet the best way to reach any goal is to pay the manager who is directly responsible for reaching it.

We suggest you consider measuring achievement of cash goals—use the 15th or 20th day of the month to avoid the financial statement's misleading influx of activity at month's end—and adopting cash goal bonuses, examples of which follow.

Used Sales Manager

- Used vehicles at 45-day supply: \$1,000 bonus
- Used vehicles at 60-day supply: \$500 bonus

Service Manager

- Warranty claims at a 10-day supply: \$700
- Warranty claims at a 20-day supply: \$250

Finance & Insurance Manager

- 7-day supply of CIT/VR or less: \$1000
- 10-day supply of CIT/VR or less: \$500

Of course there are issues for each manager. The F&I manager might say that he or she has no control over some vehicle receivables or special finance deals, but if we are paying a bonus for a seven-day supply, then he is getting credit for all those deals, including cash deals.

Also, make sure you change the measurement date frequently to avoid the managers holding back deals or not closing repair orders.

XI. FORMULA FOR SUCCESS

Here's a recap of our four-step plan for cash management success:

1. A **Cash Flow Worksheet** and **Cash Flow Statement** enable you to determine what happened to your cash from one period to another.
2. Creating **metrics** will point out cash flow problem areas that can be corrected through best practices.
3. A **Daily Cash Worksheet** helps you meet your daily cash demands and prevent overdrafts.
4. Making long-term **forecasts** and setting **goals** can help you plan for improved cash flow and reward employees for better cash flow management.

The appendices provide blank worksheets for your use. Please make copies as needed.

APPENDIX A

Cash Flow Worksheet			
Assets	Last Month	Last Year	Amount of Increase or Decrease
Current Assets			
Cash			
Contracts in transit/vehicle receivables	\$	\$	\$
+ AR + factory receivables	\$	\$	\$
+ New inventory less floor plan	\$	\$	\$
+ Used inventory less floor plan	\$	\$	\$
+ Parts/Sublet/WIP	\$	\$	\$
+ Prepaid/Other assets	\$	\$	\$
+ Rental units	\$	\$	\$
= Total current assets (A)	\$	\$	\$
Total fixed assets	\$	\$	\$
- Accumulated depreciation	\$	\$	\$
= Total fixed assets (B)	\$	\$	\$
+ Other assets (C)	\$	\$	\$
= Total assets (A + B + C)	\$	\$	\$
Current Liabilities			
Accounts payable	\$	\$	\$
+ Other notes payable	\$	\$	\$
+ Other: taxes, payroll, insurance	\$	\$	\$
= Total current liabilities (D)	\$	\$	\$
Long-term debt	\$	\$	\$
+ Profit or loss	\$	\$	\$
+ Capital and dividends	\$	\$	\$
+ Retained earnings	\$	\$	\$
= Total term debt and equity (E)	\$	\$	\$
Total liabilities and capital (D + E)	\$	\$	

APPENDIX B

Cash Flow Statement	
Cash provided by:	
Profit and retained earnings	\$
+ Additional debt and capital	\$
+ Increase in AP/notes	\$
+ Depreciation	\$
= Total inflows (A)	\$
Cash used by:	
Vehicle and other receivables	\$
+ New and used equity	\$
+ Parts and other inventories	\$
+ Fixed assets and other	\$
= Total outflow (B)	\$
Cash decrease/increase (A - B)	\$

APPENDIX C

Cash Management Metrics		
Monthly Amount From Financial Statement	Metric Calculations	Excess
New and used retail sales	\$	
x 7 days' worth divided by 30 days	23%	
= Metric amount for 7 days	\$	
Actual contracts in transit and vehicle receivables	\$	\$
Used-vehicle cost of sales (retail)	\$	
x Guide for 45 days' worth of used vehicles	150%	
= Metric amount for 45 days	\$	
Actual used-vehicle inventory	\$	\$
Parts wholesale sales	\$	
+ Body shop customer labor/parts	\$	
= Metric amount for AR accounts (1 month of sales)	\$	
Actual AR balance	\$	\$
Warranty labor and parts	\$	
x Guide for warranty claims (10 days)	30%	
= Metric amount for 10 Days	\$	
Actual warranty balance	\$	\$
Total excess		\$

APPENDIX D

Daily Cash Worksheet	
Cash per bank	\$
+ Deposit today	\$
= Adjusted cash per bank	\$
Cash per computer	\$
+ Hold checks	\$
= Net cash per books	\$
Float	\$
Demands	
Payroll x-xx	\$
+ Release payable x-xx	\$
= Total demands	\$
Resources	
Contracts in transit and vehicle receivables	\$

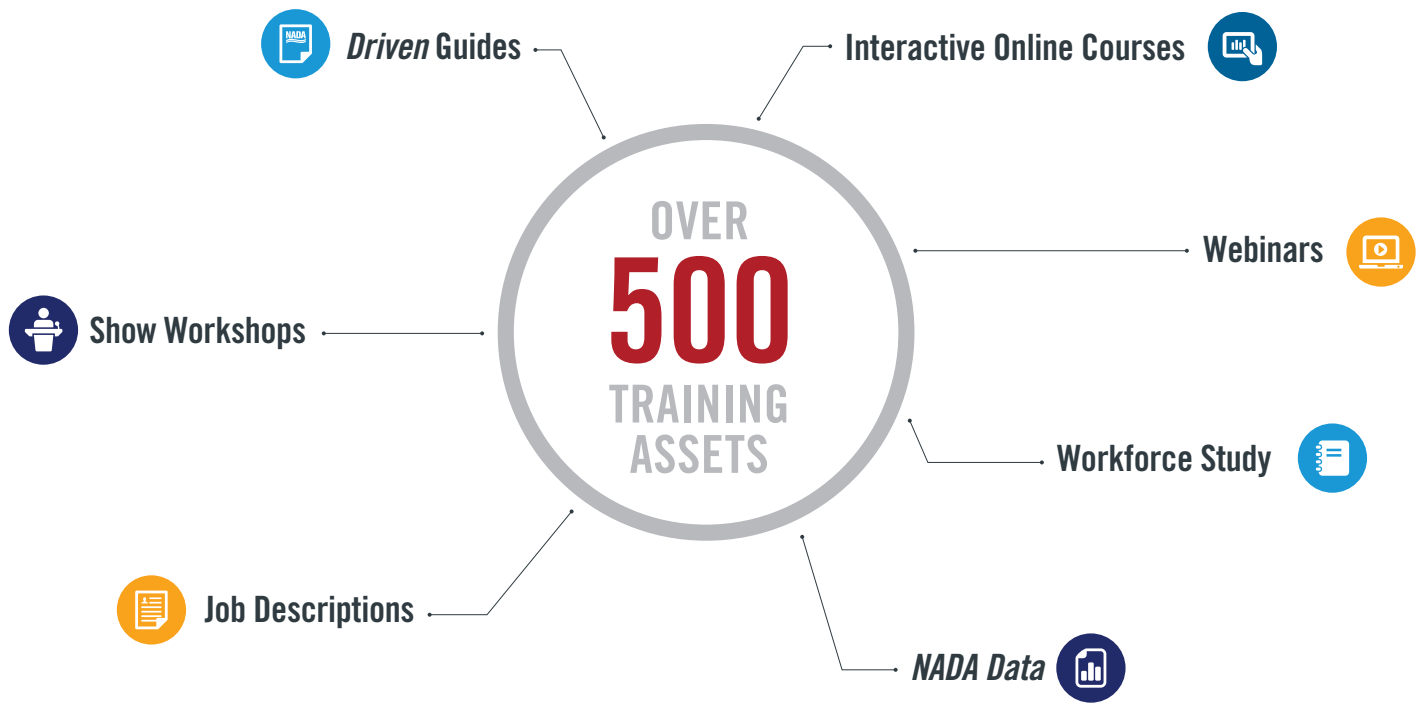
APPENDIX E

Cash Management Forecast			
Monthly Amount From Financial Statement	Metric Calculations	Forecast Increase	Increase
		%	
New and used retail sales	\$	\$	
x 7 days' worth divided by 30 days	23%	23%	
= Metric amount for 7 days	\$	\$	\$
		%	
Used-vehicle cost of sales (retail)	\$	\$	
x Guide for 45 days' worth of used vehicles	150%	150%	
= Metric amount for 45 days	\$	\$	\$
		%	
Parts wholesale sales	\$	\$	
+ Body shop customer labor/parts	\$	\$	
= Metric amount for AR accounts (1 month of sales)	\$	\$	\$
		%	
Warranty labor and parts	\$	\$	
x Guide for warranty claims (10 days)	30%	30%	
= Metric amount for 10 days	\$	\$	\$
Total cash required			\$

ACKNOWLEDGMENT

Prepared for NADA by:

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Sandi Jerome Computer Consulting



Additional NADA Resources

If the dealership you work for is a member of NADA you have access to all of these other great resources. Create an account today.

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