

Effective Bookkeeping and Payroll

Chapter 16 - Cash Flow

WORKBOOK

What is Cash Flow?

Quite simply stated, cash flow is the net affect of cash that flows into a business minus that which leaves the business.

Inflows:

- Cash from customers – Revenue
- Cash from the sale of assets or investments
- Cash from owners or stockholders - Investments
- Cash from banks – loans

Outflows:

- Cash paid to vendors and employees – Expenses
- Cash used to buy assets or investments
- Cash withdrawn by owner or stockholders
- Cash paid back to banks – loans

Categories of Cash Flow

Cash Flow from Operations

- | | |
|-------------------------------------|-----|
| ➤ Cash from customers (receivables) | xxx |
| ➤ Cash paid to suppliers (payables) | xxx |
| ➤ Cash held up in inventory | xxx |

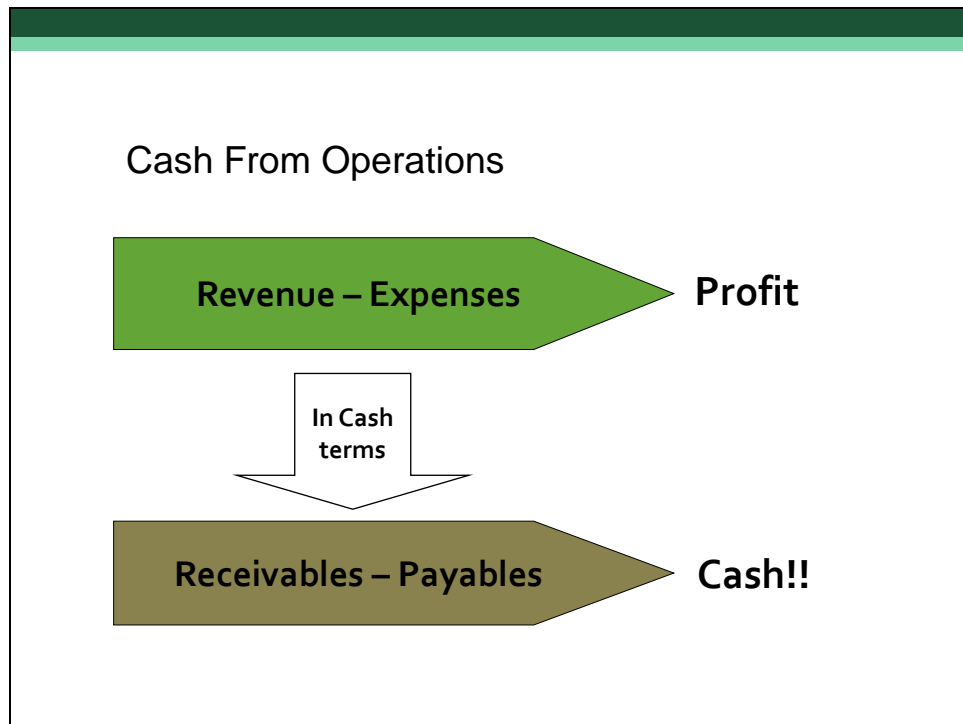
Cash Flow from Investing

- | | |
|---------------------------------|-----|
| ➤ Capital investment | xxx |
| ➤ Purchase or sale of a company | xxx |

Cash Flow from Financing

- | | |
|-----------------|-----|
| ➤ Stock or debt | xxx |
|-----------------|-----|

Net Cash Increase/decrease	<hr/> + / -
----------------------------	-------------



Why We Manage Cash Flow

- Need cash to operate business; without cash you can't pay bills.
- Cash is as important as net income
 - Can have a lot of net income but be cash poor = can't pay bills and can lead to bankruptcy
- Need cash to fund growth
- Protect financial health
 - More cash than debt
 - Quick Ratio

Cash Flow Statement Company XYZ FY Ended 31 Dec 2003	
All figures in USD	
Cash Flow From Operations	
Net Earnings	2,000,000
Additions to Cash	
Depreciation	10,000
Decrease in Accounts Receivable	15,000
Increase in Accounts Payable	15,000
Increase in Taxes Payable	2,000
Subtractions From Cash	
Increase in Inventory	(30,000)
Net Cash from Operations	2,012,000
Cash Flow From Investing	
Equipment	(500,000)
Cash Flow from Financing	
Notes Payable	10,000
Cash Flow for FY Ended 31 Dec 2003	1,522,000

- Add back any non-cash expenses.

Cash Flow Statement Company XYZ FY Ended 31 Dec 2003	
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Cash Flow From Operations	
Net Earnings	2,000,000
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Cash Flow From Investing	
Equipment	(500,000)
Cash Flow From Financing	
Notes Payable	10,000
Cash Flow for FY Ended 31 Dec 2003	1,522,000

Add in any increase in
Accounts Payable and
subtract any decrease

Cash Flow – The Indirect Method

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all figures in USD	
Cash Flow From Operations	
Net Earnings	2,000,000
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Net Cash from Operations	2,012,000
Cash Flow From Investing	
Equipment	(500,000)
Cash Flow From Financing	
Notes Payable	10,000
Cash Flow for FY Ended 31 Dec 2003	1,522,000

Add any increase in any
other current liability

Subtract any increase in
inventory and add any
decrease in inventory

Cash Flow Statement	
Company XYZ	
FY Ended 31 Dec 2003	
All figures in USD	
Cash Flow From Operations	
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— Add any cash borrowed from banks or invested by owners

EMERSON CORPORATION		
Statement of Cash Flows (Direct Approach)		
For the Year Ending December 31, 20X5		
Cash flows from operating activities:		
Cash received from customers		\$ 3,000,000
Less cash paid for:		
Merchandise inventory	\$1,050,000	
Wages	480,000	
Interest	100,000	
Other operating expenses	270,000	
Income taxes	<u>300,000</u>	<u>(2,200,000)</u>
Net cash provided by operating activities		\$ 800,000

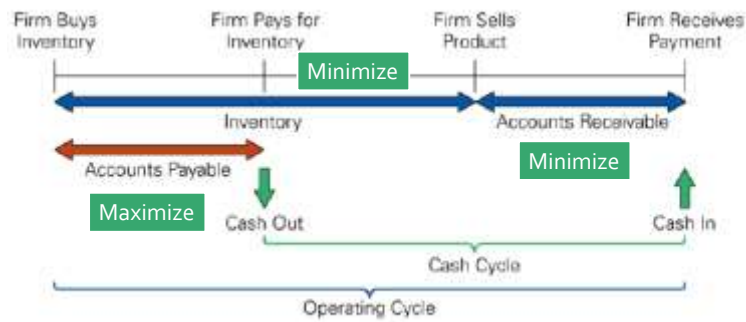
Very difficult to get
data from the
accounting system

Maximizing Cash Flow

The next few slides describe how a company can maximize its cash flow from operations and how a bookkeeper can help.



Cash Cycle



Revenue & Receivables

Revenue ultimately drives cash.

- Revenue generates receivables that ultimately result in cash inflow. **(Bookkeeper must bill quickly after sale and without error)**
- Maximize revenues using volume and price
- Manage receivables to collect quickly. **(Bookkeeper relationship with vendor)**
- Sell to solid customers who will pay.



Expenses & Payables

- Minimize expenses and you will minimize cash outflows. **(Bookkeeper distributes spending reports for spending control)**
- Be frugal with the companies money. Get multiple quotes when possible.
- Monitor spending on a monthly basis so there are no surprises. **(Bookkeeper sees spending before all others)**
- Purchasing must negotiate longer payment terms (60 vs. 30)
- Never pay bills early unless the management wants the discount. **(Bookkeeper pays the bills and can manage this.)**

Inventory

Low Inventory levels are best!
Inventory is essentially cash sitting in the warehouse or store.

To manage:

- We should make to order or don't stock too much if the business allows for it.
- Frequent communication between Operations & Sales so we know what we have & push to sell it.
- Buy or make inventory at a lower cost if possible.



Capital / Investment

Fixed Assets are added to the business or sold.

➤ To manage:

- Minimize necessary asset spending and always ask if asset is really needed?
- Prevent over-spending - Manage projects closely (**Bookkeeper may be in charge of preparing or distributing project spending reports**)



Quick Ratio

$$\frac{\text{Cash} + \text{Marketable Securities} + \text{Accounts Receivable}}{\text{Current Liabilities}}$$



> 1

Cash Flow Adequacy Ratio

Cash flow Adequacy

Measures sufficiency of cash.

Did you generate enough cash to run your business?

Cash from Operations
L/T debt paid + Fixed Asset Purchases +
Cash Dividends Distributed

Needs to be at least 1

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Questions

and

Answers

Review Questions:

1. Which of the following is a cash outflow?
 - A. Investment by owner
 - B. Depreciation expense
 - C. Buying assets
 - D. None of the above
2. True or False: Cash received from customers is an operating activity on the cash flow statement.
3. True or False: Cash is critical to the management of the company because they must pay dividends to stockholders.
4. Which is not correct regarding how a bookkeeper helps to manage cash of the company?
 - A. Form a relationship with the vendor to collect cash quickly
 - B. Prepare invoices without error
 - C. Get multiple quotes from vendors
 - D. Distribute monthly spending reports and research expenses for management
5. True or False: Businesses monitor and manage cash flow in order to protect the financial health of the business.

Answer Key:

1. C
Investment by owner is an outflow and there is no cash transaction when recording depreciation.
2. A
True. Cash received from customers is an operating activity on the cash flow statement.
3. B
False. It is critical because they must pay the bills of the company.
4. C
A bookkeeper can help to manage the cash of the company by forming a relationship with the vendor to collect cash quickly, preparing invoices without error, and by distributing monthly spending reports and research expenses for management.
5. A
True. Businesses monitor and manage cash flow in order to protect the financial health of the business.