

Webinar Objectives

- What is cash and cash flow?
- Measurement
- Why positive cash flow is required
- The cash flow cycle
- Cash budgeting
- Statement of cash flow (SCF)



Objective 1 What is cash?

Its not ...



Objective 1 What is cash?

It is (from Wikipedia)

...a derivative of the [Latin capsa](#) (box, chest). From the original meaning of a box or a chest, the word came to refer to a sum of money that might be contained in one, and eventually to [specie](#) or, with the elimination of metallic standards, [banknotes](#).



Objective 1 What is cash?

In accounting terms, cash includes:

- Currency and coins,
- Checking accounts,
- Savings accounts, and
- Negotiable instruments.



Objective 1 What is cash flow?

It is not...



Objective 1 What is cash flow?

In accounting terms, cash flow refers to:

- Cash received by the business,
- Cash spent by the business,
- During a period of time.

Positive cash flow results from the cash received exceeding cash spent.



Objective 1 What is cash flow?

Operating cash flow (OCF) is the subset of cash flow that includes cash received and spent for the company's operations.

OCF does *not* include:

- Cash received from loans.
- Cash spent on property, plant and equipment.



Objective 2 Measurement

With cash basis accounting:

- Recognize revenue when cash received, and
- Recognize expense when cash paid.

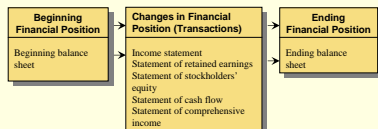
With accrual accounting:

- Recognize revenue when earned, and
- Recognize expense when incurred.



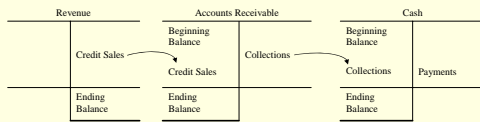
Objective 2 Measurement

Summary of Basic Financial Statements



Objective 2 Measurement

Illustration of flows in accounts:



Objective 3 Positive cash flow

- In business, cash is king.



Objective 3 Positive cash flow

The three rules of accounting and finance:

1. Get the cash!
2. Get the cash!
3. Get the cash!



Objective 3 Positive cash flow

How much cash should a business keep?

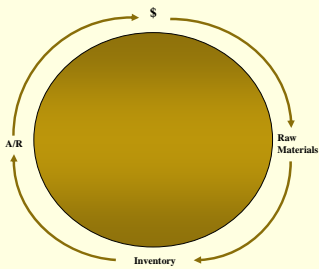
To answer that question, you have to consider:

- The cost of keeping cash, and
- The cost of not keeping cash.

Balancing these competing costs is easier if a company has positive cash flow.



Objective 4 Cash flow cycle



Objective 5 Cash budgeting

Why use a cash budget?

- It is a forward-looking document that helps anticipate changes in cash.
- To plan borrowing to cover cash shortages.
- To plan investment of excess cash.

Objective 5 Cash budgeting

Monthly Cash Budget Second Quarter 2007			
	April	May	June
Beginning cash balance	\$120	\$113	\$152
Collections:			
Cash sales	700	2100	2400
Credit Sales:			
Current Month	490	1470	1680
Prior Month	300	210	630
Total Cash available	\$1610	\$3893	\$4862
Less disbursements:			
Materials:			
Current month	523	1248	1141
Prior month	100	131	312
Direct Labor	288	720	672
Overhead	408	840	792
Marketing Expense	123	323	323
R & D Expense	28	28	28
Administrative	27	27	42
Equipment	600		
Total Disbursements	2897	3317	3310
Minimum Cash Balance	100	100	100
Total Cash Needs	\$2197	\$3417	\$3410
Excess (deficiency) of cash	(587)	476	1452
Financing:			
Borrowings	600	(400)	(200)
Repayments			
Interest Expense	13	52	124
Balance after financing (repayment)	100	100	100
Plus: Minimum cash balance			
Ending cash balance	\$113	\$152	\$1334



Objective 6 SCF

Why use a SCF?

- It is required by GAAP.
- It is a backward-looking statement.
- Helpful when analyzing a company's sources and uses of cash.



Objective 6 SCF

On the SCF, cash receipts and payments are classified according to the company's major activities.

Those activities are:

- Operating,
- Investing, and
- Financing.




Objective 6 SCF

Operating Activities:

Cash flows from company's operations.

Accrual based amounts from the income statement adjusted to cash flows.

Example:

Sales  Cash collected from customers.



Objective 6 SCF

Investing Activities:

Cash flows involving non-current assets on the balance sheet.

Examples of investing cash *inflows*:

- Cash received from selling equipment
- Cash received from selling non-current investments

Examples of investing cash *outflows*:

- Purchase of equipment
- Purchase of non-current investments



Objective 6 SCF

Financing Activities:

Cash flows involving stockholders and creditors providing long-term financing.

Examples of financing cash *inflows*:

- Sale of company's stock
- Receiving a loan

Examples of financing cash *outflows*:

- Payment of principle on debt
- Payment of dividends on company's stock
- Purchase of treasury stock



Objective 6 SCF

General rules

If:	Then:	If:	Then:
CA ↑	Cash ↓	CL ↑	Cash ↑
CA ↓	Cash ↑	CL ↓	Cash ↓



Objective 6 SCF

Generic Corporation
Statement of Cash Flows for the Year Ended December 31
(\$ Millions)

	2007	2006
Operating Activities:		
Net Income	28	20
Depreciation	14	12
Change in Working Capital:		
Accounts Receivable	-6	-2
Inventories	-2	0
Other Current Assets	0	-2
Accounts Payable	2	0
Taxes Payable & Deferred Tax	6	4
Current Portion of LTD	5	-2
Cash Provided by Operations	42	34
Investing Activities:		
Capital Expenditures	-34	-16
Other Fixed Assets	-4	-2
Cash Used by Investing Act.	-38	-18
Financing Activities:		
Change in LTD	10	-10
Cash Dividends	-12	-6
Cash Used by Financing Act.	-2	-16
Increase in Cash & Equiv.	2	0
Beginning Cash & Equiv.	8	8
Cash & Equiv. at Year End	10	8



Objective 6 SCF

Generic Corporation
Balance Sheet as of December 31
(\$ Millions)

Assets	2007	2006	2005
Cash & Marketable Sec.	10	8	8
Accounts Receivable	20	14	12
Inventories	12	10	10
Other Current Assets	8	8	5
Total Current Assets	50	40	36
Net Plant & Equipment	200	180	176
Other Fixed Assets	20	16	14
Total Assets	270	236	226
Liabilities			
Accounts Payable	8	6	6
Notes Payable	2	2	2
Current Taxes Payable	8	4	2
Current Portion LTD	10	10	8
Total Current Liabilities	28	22	18
Long-term debt (LTD)	86	76	86
Deferred Income Taxes	20	18	16
Total Liabilities	134	116	120
Equity			
Common Stock (10,000,000 shs)	10	10	10
Additional Paid-in Capital	20	20	20
Retained Earnings	106	90	76
Total Equity	136	120	106
Total Liabilities & Equity	270	236	226



Objective 6 SCF

Generic Corporation
Income Statement for the Year Ended December 31
(\$ Millions)

Statement of Income	2007	2006	2005
Sales	200	160	140
Less: Cost of Goods Sold	120	100	90
Gross Income	80	60	50
Selling & General Admin	10	8	6
Depreciation	14	12	12
EBIT	56	40	32
Interest Expense	8	6	8
Income Taxes	20	14	10
Net Income	28	20	14
Dividends Paid	12	6	4



Objective 6 SCF

For each of the years on the statement of cash flows:

1. What were the firm's major sources of cash? Its major uses of cash?
2. Was cash flow from operations greater than or less than net income? Explain in detail the major reasons for the difference between these two figures.
3. Was the firm able to generate enough cash from operations to pay for all of its capital expenditures?
4. Did the cash flow from operations cover both the capital expenditures and the firm's dividend payments, if any?
5. If it did, how did the firm invest its excess cash?
6. If not, what were the sources of cash the firm used to pay for the capital expenditures and/ or dividends?
7. Were the working capital (current asset and current liability) accounts other than cash and cash equivalents primarily sources of cash or users of cash?
8. What other major items affected cash flows?



Objective 6 SCF

Over a period of years, what was the trend in:

- Net income?
- Cash flow from (continuing) operations?
- Capital expenditures?
- Dividends?
- Net borrowing (proceeds less payments of short- and long-term debt)?
- Working capital accounts?

Based on the evidence in the statement of cash flows alone, what is your assessment of the financial strength of this business? Why?



Questions



Contact

Brian Lavery, Professor of Accounting
Diana R. Franz, Ph.D., CPA
Professor and Chair, Department of Accounting
The University of Toledo
Phone: 419 - 530 - 4264
Fax: 419 - 530 - 5516
DFranz@UTNet.UToledo.Edu
BLavert@UTNet.UToledo.Edu
