IE – Business Economics Fundamentals – Lesson 4 – Cash Flow Statement – Video

Cash Flow Statement:

- Focuses on changes in cash over a specific single period – in this example (see spreadsheet below, periods M1-M6)
- Starts amount of cash on hand at beginning of period (from previous cash flow statement, its ending cash – but in this example, at the beginning of a business, 0)
- Does the arithmetic on the cash depending on what business did in the meanwhile to calculate ending cash at end of the period
- Two primary sources for the arithmetic: Sources of cash; and Uses of cash. Where did you get cash, where did you spend it?

Sources of cash: two primary ways a company gets cash: from operations or from financing.

Cash from operations

- Based on the ending amount of net profit from P&L for the period under review. From the example P&L, this was -20,600.
- Things like Accounts Receivable (A/R), Accounts Payable (A/P) and Depreciation – all things that impact cash but are treated differently in the P&L – need to be accounted for. We did not show these in this simple example, but:
    - for increases in A/R for the period (you sold something which is recorded as income but you've not been paid yet) this reduces cash flow.
    - for increases in A/P for the period – you bought something that was recorded as an operating expense, but haven't yet had to pay for it, this increases cash flow for the period.
    - for Depreciation – you actually spent the cash when you bought whatever asset, but on the P&L only a percentage of that purchase price gets depreciated and entered as an expense, so you add the amount of Depreciation back into the cash flow, since you actually didn't spend any more cash.

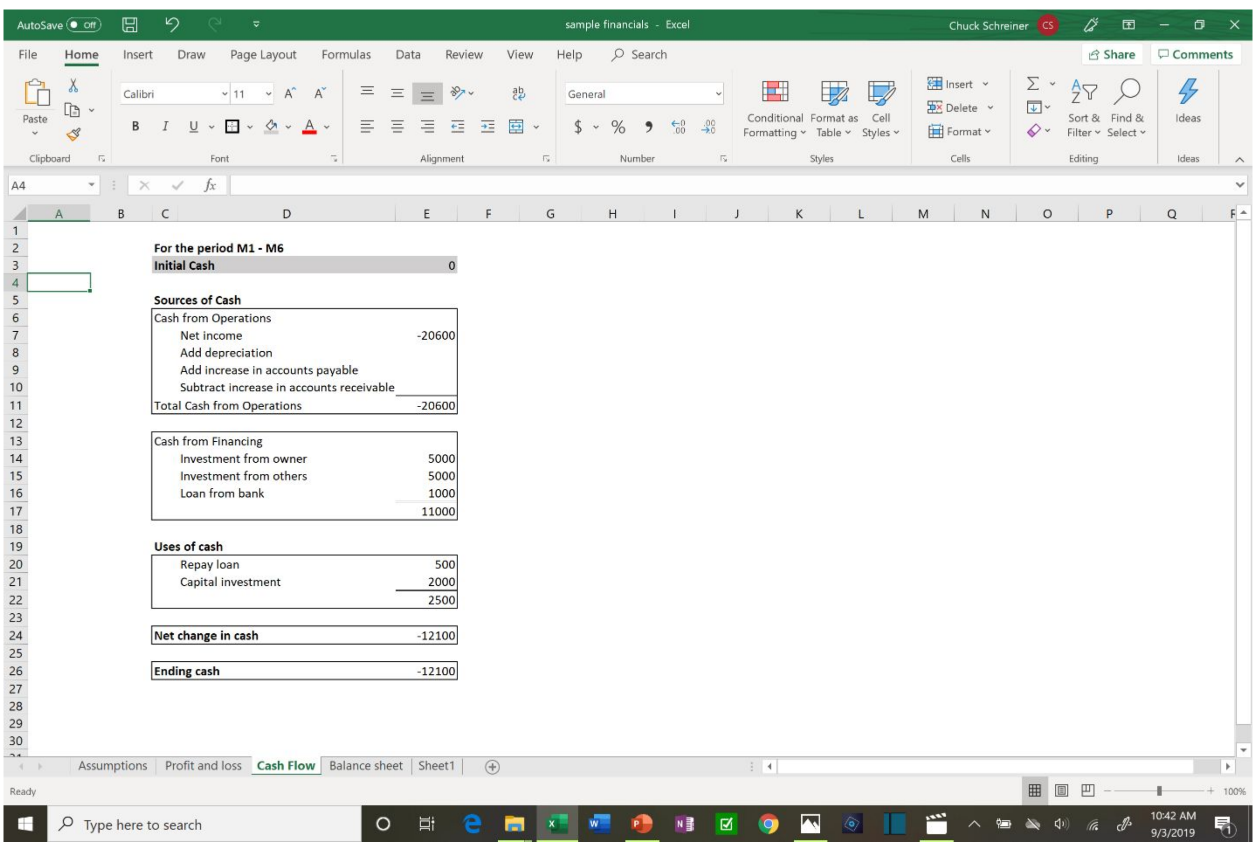
Cash from financing

- Includes any inflow of cash from events like loans or issuing stock.
- In our example, we received 5,000 investment by owner, 5,000 from other investors and 1,000 bank loan. This 11,000 is added to our cash flow.

Uses of Cash: Two major categories of uses of cash are Investing and financing.

- When the business acquires a capital asset which is depreciated over time and not recorded as an Operating Expense, the amount of that purchase is a use of cash that lowers cash flow for the period. Likewise, if a business sells an asset, the cash from that sale is recorded here.
- Any outflow of cash, like repaying the principle of a loan (but not the interest – that was accounted for in the P&L) is a use of cash.
- In our example, we repaid some of the loan principle (500) and bought an asset (2,000) for a total of 2,500. Note: the interest we paid on the loan was captured in the P&L, not in Cash Flow.

This is a very simple Cash Flow Statement, but it addresses the basics. There are other ways to organize the Cash Flow Statement (e.g. break things into Operations, Investing Activities and Financing Activities and include Sources/inflow and Uses/outflow within each category).



For the period M1 - M6	
Initial Cash	0
Sources of Cash	
Cash from Operations	
Net income	-20600
Add depreciation	
Add increase in accounts payable	
Subtract increase in accounts receivable	
Total Cash from Operations	-20600
Cash from Financing	
Investment from owner	5000
Investment from others	5000
Loan from bank	1000
	11000
Uses of cash	
Repay loan	500
Capital investment	2000
	2500
Net change in cash	-12100
Ending cash	-12100

In this little exercise, you see the business, with this set of assumptions, runs out of money (-12,100). As you build a basic plan built on decent assumptions, you may indeed find yourself facing this problem. What if you really can't generate enough money quickly enough and your initial investment runs out?

In the projection – you may need to rethink assumptions and plan because you can't implement a plan that you see will take you to a place of no cash without directly addressing it.

Exercise: take this cash flow and tweak assumptions so the business never runs out of cash over the 6 months.

Reflection Task:

Cash Flow Statement

Sources of Cash

- Operations
- Financing

Uses of Cash

- Capital investment
- Financing

Exercise: download the example cash flow statement and tweak assumptions so the business never runs out of cash over the 6 months period