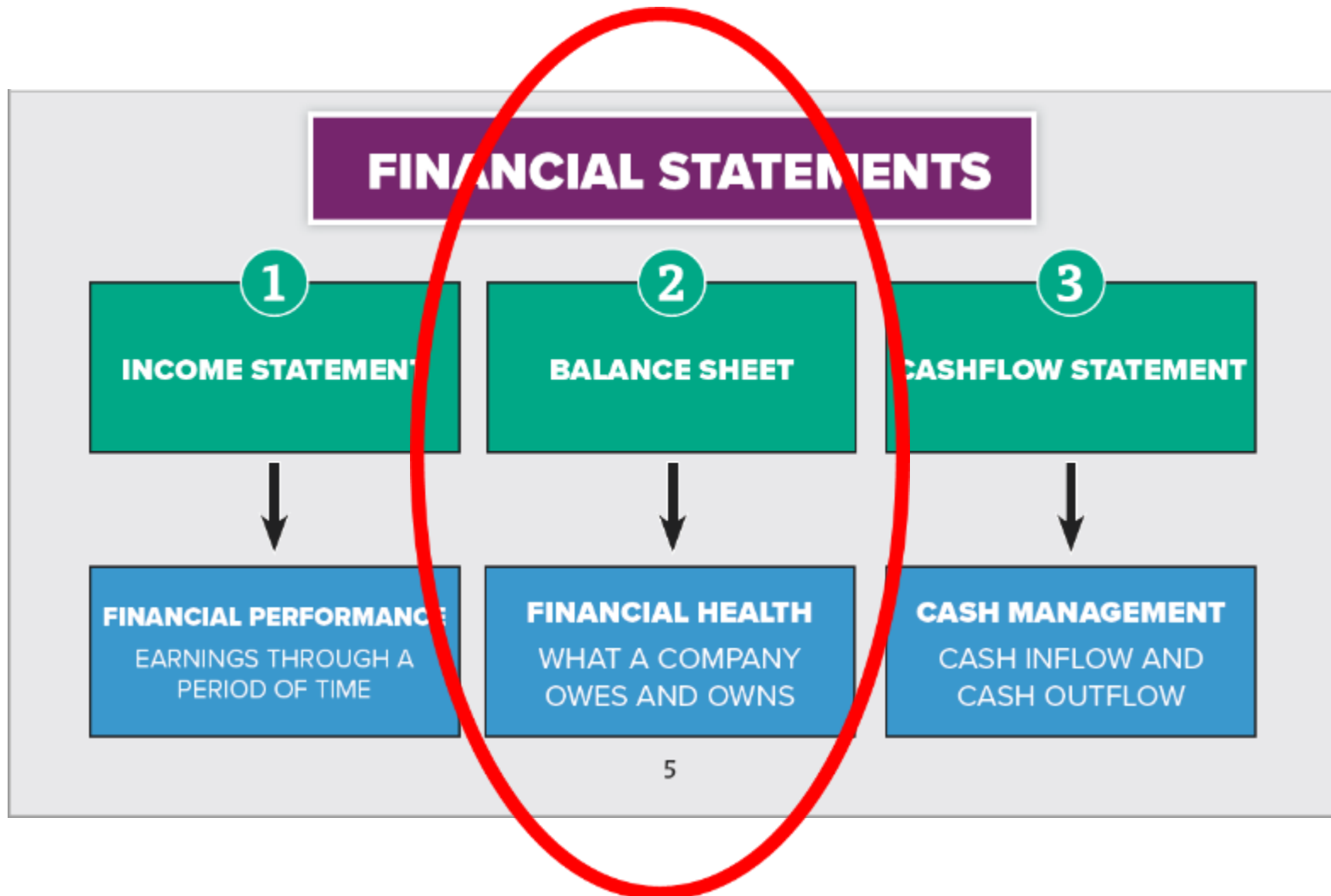


Finance Management & Planning

Balance Sheet (cont.) + Cashflow

- Recap of Last week
 - Long Term Assets
 - Depreciation
 - Current Assets
 - Stock Valuation
 - Current Liabilities
- This Week
 - Overview of a Balance Sheet
 - Working Capital
 - Long Term Liabilities
 - Overview of Cashflow



- The Balance Sheet is a statement of its financial position.
- The Balance sheet is a lists of the assets , liabilities and the capital within its organisation.

It highlights :

- The company's ability to meet its current obligations.
- Financial Health of an organisation.
- Why is it important ?
 - Short term Liquidity
 - Long Term Liquidity

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Assets

- Property
- Plant & equipment
- Fixtures and fittings
- Patents and trademarks
- Debtors (those who owe the business – trade receivables), and
- Investments

Liabilities

- Bank loan or overdraft
- Creditors (trade payables)
- Mortgage
- HP or Lease agreements
- Owners capital

‘A resource held by a business’

All 4 conditions must apply to be an ‘asset’

- A probable future economic benefit with some monetary value
- The benefit must arise from some past transaction or event
- The business must have the right to control the resource
- The asset must be capable of measurement in monetary terms

Does not have to be physical – can be non physical: - tangible or non-tangible

Straight Line

Vs

Reducing Balance

1. Equal depreciation each year
2. Total of depreciation and repairs may increase as the asset gets older
3. Value of asset could be reduced to Rs zero or scrap value
4. Depreciation rate = $\frac{\text{Depreciation} \times 100}{\text{Cost}}$
5. Suitable for assets which have low repairs and maintenance costs e.g leases, copyrights etc

1. Reducing depreciation each year
2. Total of depreciation and repairs may not vary much from year to year
3. Value of asset cannot be extinguished
4. Depreciation rate = $1 - \sqrt[n]{\frac{\text{Residual Value}}{\text{Cost of Assets}}} \times 100$
5. Suitable for plant and machinery which have high repairs and maintenance costs as the machine gets older

Balance Sheet



Straight Line Method

	Income Statement	Balance Sheet	Expected Residual Value
Year 0	0	100,000	10,000
Year 1	18,000	82,000	
Year 2	18,000	64,000	
Year 3	18,000	46,000	
Year 4	18,000	28,000	
Year 5	18,000	10,000	

Reducing Balance Method

	Income Statement	Balance Sheet	Expected Residual Value
Year 0	0	100,000	10,000
Year 1	36,900	63,100	
Year 2	23,284	39,816	
Year 3	14,692	25,124	
Year 4	9,271	15,853	
Year 5	5,850	10,003	

Balance sheet example

TEDDY FAB INC. BALANCE SHEET December 31, 2100

ASSETS

Current assets

Cash and cash equivalents	\$ 100,000
Accounts receivable	20,000
Inventory	15,000
Prepaid expense	4,000
Investments	10,000
Total current assets	149,000

Property and equipment

Land	24,300
Buildings and improvements	250,000
Equipment	50,000
Less accumulated depreciation	(5,000)

Other assets

Intangible assets	4,000
Less accumulated amortization	(200)

Total assets **\$ 472,100**

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities

Accounts payable	\$ 30,000
Notes payable	10,000
Accrued expenses	5,000
Deferred revenue	2,000
Total current liabilities	47,000

Long-term debt 200,000

Total liabilities **247,000**

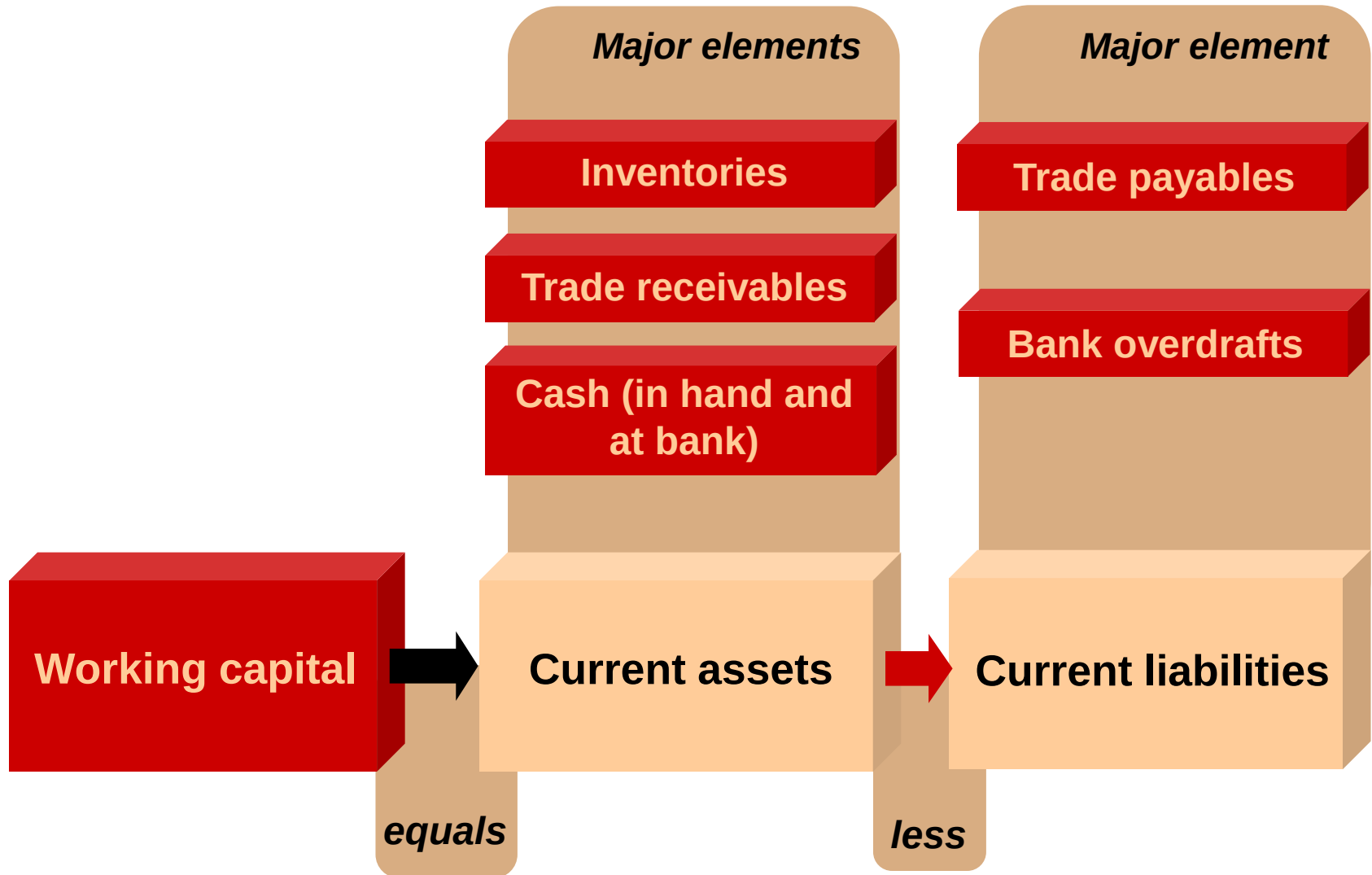
Shareholders' Equity

Common stock	10,000
Additional paid-in capital	20,000
Retained earnings	197,100
Treasury stock	(2,000)

Total liabilities and shareholders' equity **\$ 472,100**

Current Assets made up of

- Stock / Inventory
 - Raw Materials
 - Work in Progress
 - Finished Goods
- Cash and Cash Equivalents
- Market Securities
- Debtors
- Prepayments



Working Capital Lifecycle



How do we influence this ?

<https://youtu.be/XvHALui-Bno>

How can we reduce the Working Capital Lifecycle

- Reduce the need for stock or stockholding time – Just in Time Methodology ?
- Negotiate quicker payments from our customers – Incentives ?
- Negotiate longer payment times to suppliers – Reputation risk if seen as a slow payer.

Why is it important?

- Business requires sufficient working capital to meet its day to day running costs
- Working capital is 'dead' money because :
 - it earns no interest
 - it is high risk (e.g. debtors not paying, stock becoming obsolete)
- The objective is for the business to operate with as little working capital as possible, and to therefore make what they have work as hard as possible.
- Working Capital Cycle should be as short as possible.....

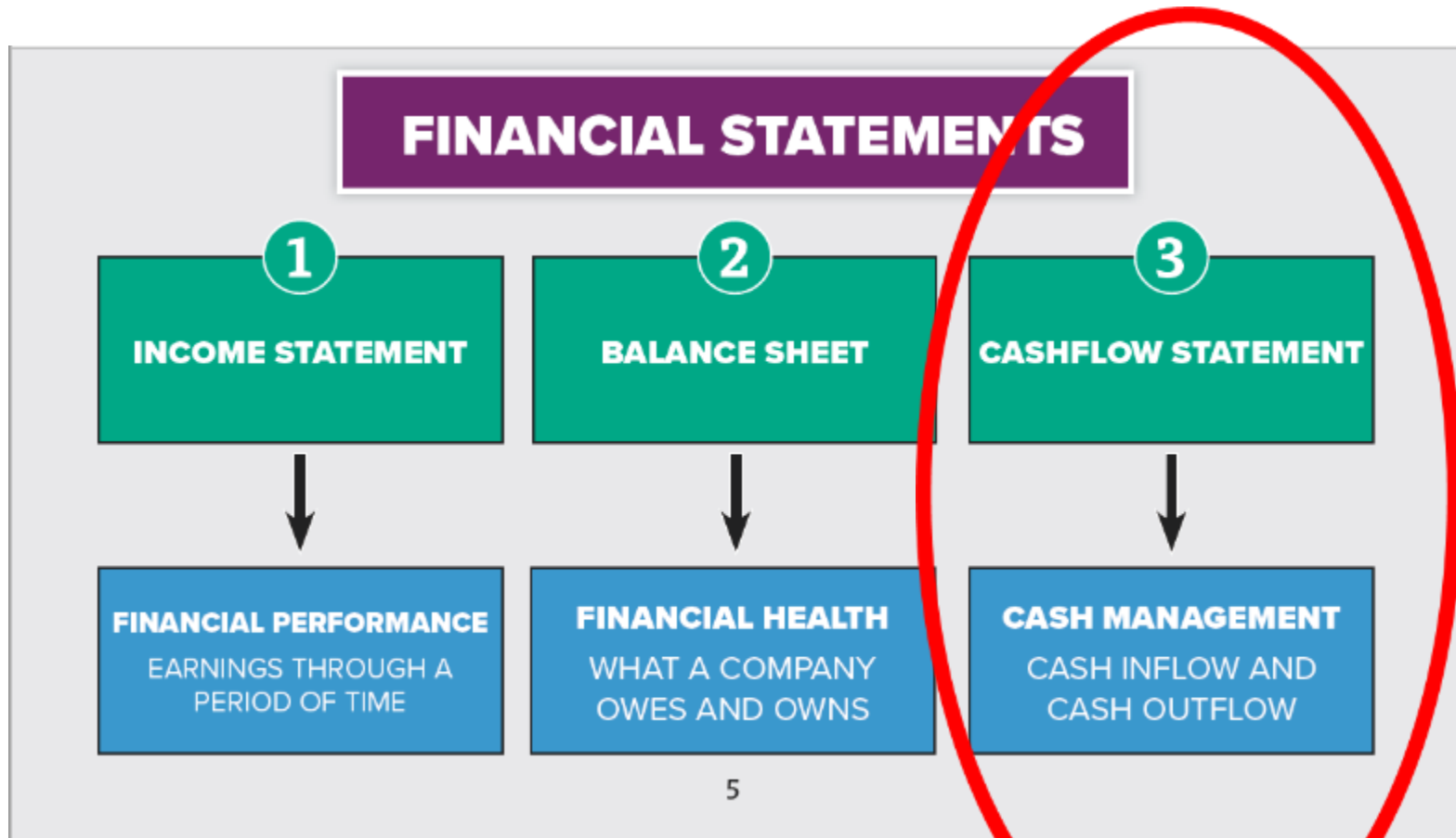
- Liabilities (What the organisation owes)
- Long Term Liabilities (Obligation not to be paid in the current year)
 - Directors Loan
 - Long Term Bank Loans
 - Bonds

- Stockholders Equity
 - Retained Earnings
 - Shares

Financial Ratios

Balance Sheet	
Year	2017
Fixed Assets	100,000
Stock	20,000
Cash and Cash Equivalents	20,000
Debtors	30,000
Other Current Assets	5,000
Current Assets	75,000
Total Assets	175,000
Creditors	50,000
Accruals	10,000
Current Liabilities	60,000
Long Term Liabilities	50,000
Total Liabilities	110,000
Net Assets	65,000
Ordinary Shares	60,000
Retained Earnings	5,000
Shareholders Equity	65,000

Paul's Guitar Shop, Inc. Balance Sheet December 31, 2015	
Assets	
Current Assets	
Cash	32,800
Accounts Receivable	300
Prepaid Rent	1,000
Inventory	39,800
Total Current Assets	73,900
Long-term Assets	
Leasehold Improvements	100,000
Accumulated Depreciation	(2,000)
Total Long-term Assets	98,000
Total Assets:	171,900
Liabilities	
Current Liabilities	
Accounts Payable	49,000
Accrued Expenses	450
Unearned Revenue	1,000
Total Current Liabilities	50,450
Long-term Liabilities	99,500
Total Liabilities	149,950
Owner's Equity	
Owner's Equity	
Retained Earnings	11,950
Common Stock	10,000
Total Owner's Equity	21,950
Total Liabilities and Owner's Equity	171,900



Cash Flow

Definition :

A Cash-flow is a **financial statement** that shows you how cash moves in and out of your business.

Purpose :

The cash flow statement is believed to be the most intuitive of all the financial statements because it follows the cash made by the business in three main ways—through operations, investment, and financing. The sum of these three segments is called net cash flow

- The Cash-flow Statement
- Highlights the movements in Cash during a specific period
 - Published Statements are usually 12 months.
 - Although internal can be 1 Month , Quarterly or half yearly.

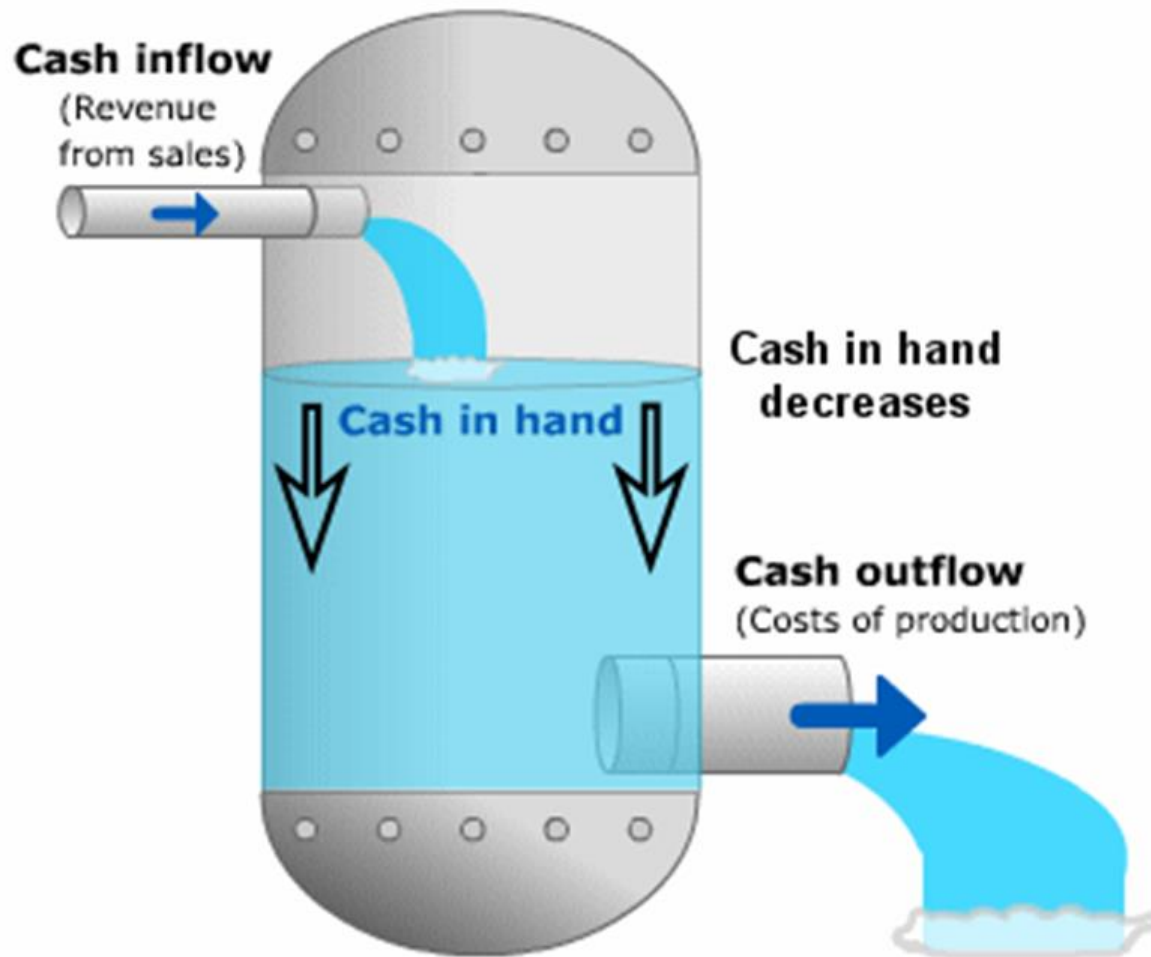
The information is presented in three sections:

- Cash flows provided by/used for operations
- Cash flows provided by/used for investments
- Cash flows provided by/used for financing?

Why are Cash Flow statements important?

- The P&L does not illustrate movements of cash
- The cash flow forecast is a cash flow statement that predicts net cash flows of the business over a future period. It shows when surpluses and deficits of cash are likely to occur to allow the taking of appropriate action, for example:
 - Cash surpluses may be re-invested
 - Cash deficits may be mitigated
- They can aid planning and decision-making for a business
- Prospective investors (banks etc.) may want to know how well cash is managed for the business before investing
- Remember “Cash is King” – it is the lifeblood of a business and a business cannot survive without it!!

Cash Flow Statements



How does a cashflow work ?

A simple example

	CASH FLOWS	
		£
Monday	Opening balance (cash introduced)	40
	Cash from sales of widgets for Monday	45
	Cash paid out to buy widgets	-40
	Closing balance of cash	45
		↓
Tuesday	Opening balance (from previous day)	45
	Cash from sales of widgets for Tuesday	48
	Cash paid out to buy widgets	-20
	Closing balance of cash	73
		↓
Wednesday	Opening balance (from previous day)	73
	Cash from sales of widgets for Wednesday	32
	Cash paid out to buy widgets	-46
	Closing balance of cash	59

Cash Flow Statements



ABC Company Inc. Cash Flow Statement

For the Year Ending: 31/12/201X
Cash at Beginning of Year: **14,300**

Operating Activities

Cash receipts from customers	741,000
Cash paid for	
Inventory purchases	(310,500)
General operating and administrative expenses	(100,000)
Wage expenses	(135,000)
Interest	(15,000)
Income taxes	(38,500)
Net Cash Flow from Operations	142,000

Investing Activities

Cash receipts from	
Sale of property and equipment	40,100
Collection of principal on loans	
Sale of investment securities	
Cash paid for	
Purchase of property and equipment	(81,000)
Making loans to other entities	
Purchase of investment securities	
Net Cash Flow from Investing Activities	(40,900)

Financing Activities

Cash receipts from	
Issuance of stock	
Borrowing	
Cash paid for	
Repurchase of stock (treasury stock)	
Repayment of loans	(38,000)
Dividends	(45,000)
Net Cash Flow from Financing Activities	(83,000)

Net Increase in Cash	18,100
-----------------------------	---------------

Cash at End of Year: **32,400**

Groups

What's more important ?

- 1) What is more important Cashflow or Profitability ?
- 2) What reasons could make a businesses change its view on the above ?

Cash flow and profit are different

Cash flow is the money that flows in and out of the business activities, whereas profit is what remains from revenue after all business expenses have been deducted.

A business may be profitable, but it needs cash to survive in order to pay its short-term liabilities

While profitability usually implies good cash flow in the long term, it may not hold true in the short to medium term.

What is the effect on profit and cash?

	Effect on Profit	Effect on Cash
1. Repayment of borrowings	none	decrease
2. Making a profitable sale on credit	increase	none
3. Buying a non-current asset on credit	none	none
4. Receiving cash from a credit customer	none	increase
5. Depreciating a non-current asset	decrease	none
6. Buying some inventories for cash	none	decrease
7. Making a share issue for cash	none	increase

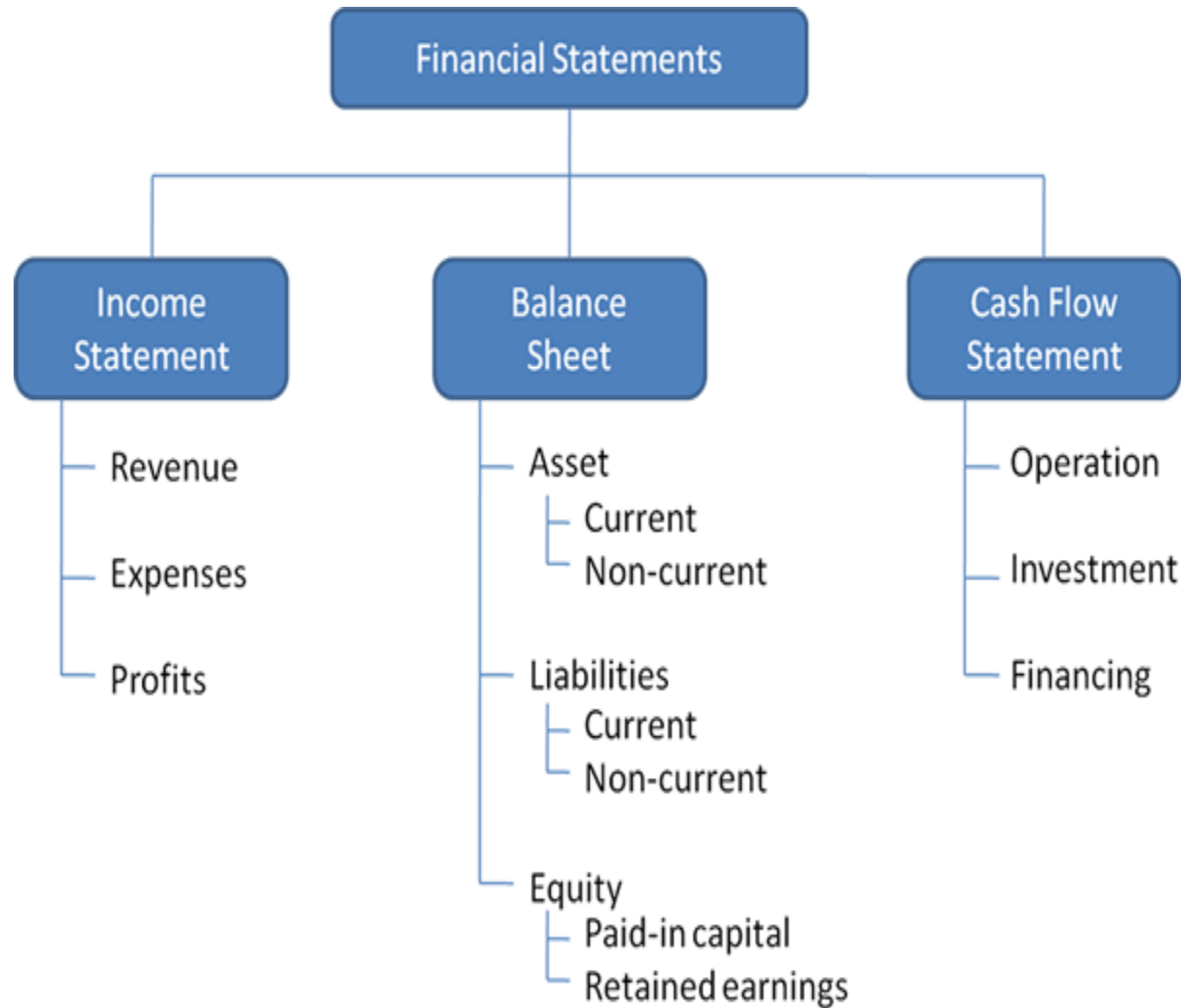
A business may see a profit every month, but its money is tied up in [assets](#) or [accounts receivable](#), and there is no cash to pay employees.

The absence of a profit eventually has a declining effect on the cash flow.

Another thing to remember when determining whether to focus on cash flow or profit is cash flow can be bought.

- A business owner can put up his or her personal assets as [capital](#) into the business
- Alternatively, they can get a small business loan from a bank to keep the business running until it starts seeing cash flow again.

Summary of Financial Statements



- Introduction to Ratios
- Profitability Ratios
- Activity Ratios