



credit**HEROES**

**2020** ONLINE

Conference and Expo

# Credit HEROS Cash Flow Statement

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*“Joan and Joe: A Tale of Woe”*

*Joe added up profits and went to see Joan,  
Assured of obtaining a much-needed loan.*

*When Joe arrived, he announced with good cheer:*

*“My firm has had an outstanding year,  
“And now I need a loan from your bank.”*

*Eyeing the statements, Joan’s heart sank.*

*“Your profits are fine,” Joan said to Joe.*

*“But where, oh where, is your company’s cash flow?*

*I’m sorry to say: the answer is ‘no’.”*

*—L. FRASER*

# Session Objectives

Review Financial Statements

Discuss the Parts of the Financial Statements and how they tie into cash flow

Provide examples of sections of the CFS

# Creation of Cash Flow Statement

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To create CFS need

Last two Balance Sheets

Income Statement

Statement of Retained Earnings

- Part of Balance Sheet

# The Financial Statements

Balance Sheet (Statement of Financial Position)

- Statement of Retained Earnings

Income Statement (Operating Statement)

Statement of Cash Flows (Statement of Inflows and Outflows of Cash)

Statements are generated in GAAP using accruals and estimates



# The Interrelationship of Financial Statements

## EXHIBIT 2-1

ABC Company

### The Interrelationship of Financial Statements

Balance Sheet December 31, 2012		Statement of Cash Flows for the Year Ended Dec. 31, 2013		Balance Sheet December 31, 2013	
<b>Assets</b>		<b>Cash flow from operating activities:</b>		<b>Assets</b>	
Cash	\$25,000	Net Income	\$ 20,000	Cash	\$ 40,000
Receivables	20,000	+ Decrease in inventory	10,000	Receivables	20,000
Inventory	30,000	- Decrease in accounts payable	(5,000)	Inventory	20,000
Land	10,000	Net cash flow from operating activities	25,000	Land	20,000
Other assets	10,000			Other assets	10,000
Total assets	<u>\$95,000</u>			Total assets	<u>\$110,000</u>
<b>Liabilities</b>		<b>Cash flow from investing activities:</b>		<b>Liabilities</b>	
Accounts payable	\$25,000	- Increase in land	(10,000)	Accounts payable	\$ 20,000
Wages payable	5,000	Net cash flow from investing activities	(10,000)	Wages payable	5,000
Total liabilities	<u>30,000</u>			Total liabilities	<u>25,000</u>
<b>Stockholders' Equity</b>		<b>Cash flow from financing activities:</b>		<b>Stockholders' Equity</b>	
Capital stock	40,000	+ Capital stock	10,000	Capital stock	50,000
Retained earnings	25,000	- Dividends	(10,000)	Retained earnings	35,000
Total stockholders' equity	<u>65,000</u>	Net cash flow from financing activities	0	Total stockholders' equity	<u>85,000</u>
Total liabilities and stockholders' equity	<u>\$95,000</u>	Net increase in cash	15,000	Total liabilities and stockholders' equity	<u>\$110,000</u>
		Cash at beginning of year	25,000		
		Cash at end of year	<u>\$ 40,000</u>		
		<b>Income Statement for the Year Ended Dec. 31, 2013</b>			
		Revenues	\$ 120,000		
		- Expenses	(100,000)		
		Net income	<u>\$ 20,000</u>		
		<b>Statement of Retained Earnings for the Year Ended Dec. 31, 2013</b>			
		Beginning balance	\$ 25,000		
		+ Net income	20,000		
		- Dividends	(10,000)		
		Ending balance	<u>\$ 35,000</u>		

Source: ABC Company 2010 10-K

# First accounts to review

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I always look at the cash account on the balance sheet for the last 2 years

Also want to review the retained earnings

Want to know if increase / decrease

Allows me the opportunity to identify my expectations for cash flow



# Balance Sheet

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**Company name & date**

- **Statement is at a point in time**

**Assets:**

**Current**

- **Assets that turnover quickly**

**Fixed**

- **Long-term investments**

**Other**

- **Usually intangibles**

**Liabilities:**

**Current**

- **Obligations due within one year**

**Long-term**

- **Obligations due beyond one year**

**Equity:**

**Common stock**

- **Par value of outstanding stock**

**Paid-in capital**

- **Amount in excess of par value**

**Retained earnings**

- **Usually, profits less dividends paid.**

# The Balance Sheet: An Overview

## Accounting equation

- $\text{Assets} = \text{Liabilities} + \text{stockholders' equity}$
- Measured at a point in time

## Assets: (Investments)

- What the firm owns

## Liabilities: (Financing)

- What the firm owes to creditors

## Equity: (Financing)

- What the firm owes to internal owners (shareholders).

# Operating Statement

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Net sales

- Cost of goods sold

Gross profit

- Selling & administrative

- Depreciation & amortization

- Other operating expenses

Operating profit

- Income taxes

Net earnings

Yr. 1   Yr. 2   Yr. 3

This is an example of a multiple-step income statement.

The SEC requires three years of data to be shown.

# Operating Statement: Overview

**Represents *estimates* for revenues and costs using accrual accounting**

- Accrual and cash accounting differ
- Net income not equal to cash profits

**Income statement usually presented for a month, a quarter, or a year**

**No common format is required for presentation purposes**

- Multiple step versus. single step.

# Important

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Profit / loss

Wall street and management love net income

Easy to compare and calculate

# Parts of the SCF

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**Statement consists of three basic parts**

**Cash flows from operating activities**

**Direct Method**

**Indirect Method**

**Cash flows from investing activities**

**Cash flows from financing activities**

**The sum of these activities equals the change in the cash account on the balance sheet**



# Cash Flow Sections

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Each Section indicates an Investment or Financing Decision the company makes

## Operating

- Represents daily operations

## Investing

- Investment in Company

## Financing

- Share holder decisions

# Preparing a SCF

Calculate changes in all balance sheet accounts

## Rules:

Treat an increase in an asset as a *use* (outflow) of cash and a decrease as a *source* (inflow) of cash

Treat an increase in a liability or equity account as a *source* (inflow) of cash and a decrease as a *use* (outflow) of cash

Treat revenues as *sources* (inflows) of cash and expenses as *uses* (outflows) of cash

Total sources = Total uses.

# SCF rules

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*Inflow*

– Asset account  
+ Liability account  
+ Equity account

*Outflow*

+ Asset account  
– Liability account  
– Equity account

# Overview of the SCF

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Why is it called the *Statement of Cash Flows*?

*Shows changes in the cash account over a period of time*

Take the perspective that all transactions are run through the cash account

The statement shows which activities contributed to cash and which activities reduced cash.

# Creating Cash Flow Statement

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Create 6 column Spreadsheet

- Col 1-List all the Accounts on the Balance Sheet
- Col 2- List Beginning balances for all accounts
- Col 3- List ending balances for all accounts
- Col 4- Calculate the changes
- Col 5- Determine if source or use of cash
- Col 6- Determine category for CFS

Balance Sheet: Beginning		Ending	Change	U/S
Cash	10	15	5	USE
Receivables	120	105	15	Source
Inventory	175	190	15	Use
Fixed assets	200	250	50	Use
Total assets	505	60	55	Use
Payables	90	130	40	Source
Accruals	25	30	5	Source
Long-term debt	150	135	15	Use
Common stock	90		90	
Retained earn	150	175	25	Source
Total financing	505	560	55	Source



Income Statement:

Sales	300	Source
Cost of sales	<u>160</u>	Use
Gross profit	140	
SG&A	<u>80</u>	Use
Operating profit	60	
Interest Expense	<u>5</u>	Use
Earnings before taxes	55	
Taxes	<u>15</u>	Use
Net income	40	Source

# Operating Activities

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Sales of goods or services

Change in Current assets and liabilities

Return Interest on Loans or Dividends

Payment of salaries, taxes interest

# Operations Direct

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Cash sales	\$214,990	
Cash cost of sales	<u>\$132,933</u>	
Cash gross profit margin	\$ 82,057	
Cash SG&A + other costs	<u>\$ 62,392</u>	
Cash income before interest & taxes		\$ 19,665
Cash interest expense	<u>\$ 2,163</u>	
Cash income before taxes	\$ 17,502	
Cash income taxes	<u>\$ 7,478</u>	
Cash profits	\$ 10,024	

# Direct calculate cost sales

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Cash collected from sales =

Sales on the income statement

+ decrease in accounts receivable balance

-increase in accounts receivable balance

- A decrease is a source of cash
- An increase is a use of cash
- Answer:  $\$215,600 - 610 = \$214,990$

Set up to mirror the income statement

## Direct Method

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Requested by banks / financial institutions

# Operations indirect

Net income (Accounting profit)	9,394
Non-cash charges:	
Depreciation	3,998
Increase in deferred tax liability	208
Cash provided (used) by net working capital	
Increase in accounts receivable	(610)
Increase in inventory	(10,272)
Decrease in prepaid expenses	247
Increase in accounts payable	6,703
Increase in accrued liabilities	<u>356</u>
Cash flow from operating activities (Cash profit)	\$10,024



# Working Capital

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Balance Sheet Accounts

Current assets minus current liabilities

Major area of concentration for me as trade creditor

Need to understand liquidity of assets

# Working Capital

Net income (Accounting profit)	9,394	
Non-cash charges:		
Depreciation		3,998
Cash provided (used) by net working capital		
Increase in accounts receivable	(610)	
Increase in inventory		(10,272)
Increase in accounts payable	<u>6,703</u>	
Working Capital Cash Flow		9,213

# Operating Activity Affected

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## Non Cash Accounts

- Net Income
- Depreciation Expense

## Effects on operating activity

- Accounts Receivable
- Inventory
- Accounts Payable

# Depreciation

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Usually the largest non cash account

Changing depreciation methodology

No affect ???

WHAT ELSE

# Accounts Receivable

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Slow payments

Additional bad debts

Increase department metrics

WHAT ELSE

# Inventory

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Reduce Inventory levels (safety stock)

Need to special order product

Higher costs for new inventory

Maintain inventory for the future activity

WHAT ELSE



# Accounts Payable

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Less money coming in may cause delays in payments

Treatment by vendors with payment change

May increase with need to obtain more inventory

WHAT ELSE

# Net Income

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Depending on method can affect CFS

Increase expenses (Bad Debts)

Lower cash (reducing Price)

Difficulty in increasing price back to appropriate level

WHAT ELSE

# Investing Activities

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Selling or Acquiring long term assets

- Investments or plant property & equipment

Issue or Redeem Debt or Equity securities

# Cash Flow Investing

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Property, Plant & Equipment	\$14,100
Other Assets	(295)
Net cash used	\$13,805

- The firm is a net investor this period.

# Investment Activity

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Selling or Acquire long term assets

Not replacing aged equipment

Not reinvesting in the business

Keeping up with the competition

# Investment Activities

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Selling or paying off Debt / Equity securities

Inability to redeem outstanding debt

Lowering of measurements to increase cost of new issues

# Investing activity

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Is company investing in themselves

Are they keeping up with others in the industry  
efficiencies

# Financing Activities

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Relates to owners equity

Issue Stock

Pay dividends

Mortgages



# Financing Activity

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Issuing new stock market price declines

Payment of dividends do not meet legal requirements to pay dividends

Stopping payment of dividends will affect investor confidence

# Cash Flow financing

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Sale of common stock	\$256
Decrease in short-term borrowings	(30)
Additions to long-term borrowings	4,084
Dividends paid	(1,582)
Net cash provided	\$2,728

- The firm is a net borrower this period.

# Putting all together

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The change in the cash account equals the sum of:

Operating activities      \$10,024

Investing activities      (13,805)

Financing activities      2,728

Change in cash   (\$ 1,053)

- • Interpretation: Investing activities required more cash than provided by operating and financing activities. The cash account was

Statement of Cash Flows				
Inflows	2002		2001	
Operations	\$10,024	62.0%	\$ 0	0.0%
Sale of assets	295	1.8	0	0.0
Sale of stock	256	1.6	183	1.8
Short-term debt	0	0.0	1,854	18.7
Long-term debt	5,600	34.6	7,882	79.5
Total	\$16,175	100.0%	\$ 9,919	100.0%
Outflows Operations \$	0	0.0%	3,767	31.4%
Plant & equipment	14,100	81.8	4,773	40.0
Short-term debt	30	0.2	0	0.0
Long-term debt	1,516	8.8	1,583	13.2
Dividends	1,582	9.2	1,862	15.4
Total	\$17,228	100.0%	\$11,995	100.0%
Change in cash	(\$1,053)		(\$2,076)	

# Ratios

Operating Cash Return on Sales

Cash Flow from Operating Activities

Net Sales

Operating Cash Return on Investment (Assets)

Cash Flow from Operating Activities

Total Investments (Assets)

Operating Cash Return on Equity

Cash Flow from Operating Activities

Stockholders' Equity

Cash Flow Liquidity

Cash Flow from Operating Activities

Current Liabilities

# Ratios

Critical Needs Coverage

Cash Flow from Operating Activities + Interest Paid

Interest Paid + Current Portion of Debt + Dividends Paid

Interest Coverage

Cash Flow from Operating Activities - Current Portion of Debt + Interest Paid

Interest paid

Q & A