# Exam FFM

## Foundations in Financial Management

Pocket Notes

KAPLAN PUBLISHING

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# Cash and cash flows

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# Cash and cash flows

**Definition**

**Cash**: Paper money and money in bank accounts.

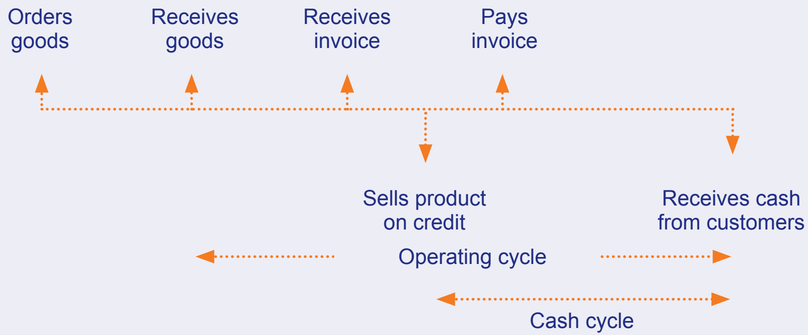
**Cash flow**: Receipts and payments of cash.

**Net cash flow**: Difference between cash received and cash paid.

Cash inflows vary depending on business type e.g.:

| | |
|---|---|
| Supermarket | Regular cash inflow |
| Hats | Seasonal – spring and summer |
| Ice cream | Seasonal – summer |
| College | Irregular – whenever courses start |

**Cash cycle and operating cycle**



# Sources and applications of finance

| Sources of cash | Uses of cash |
|---|---|
| Obtaining finance:<br>• Increase in long-term debt<br>• Increase in equity<br>• Increase in current liabilities<br>Selling assets<br>• Decrease in current assets<br>• Decrease in non-current assets | Paying payables or stockholders:<br>• Decrease in long-term debt<br>• Decrease in equity<br>• Decrease in current liabilities<br>Buying assets<br>• Increase in current assets<br>• Increase in non-current assets |

| Receipts | Payments |
|---|---|
| **Revenue** | |
| • Cash sales<br>• Payments by receivables | • Trade payables (goods and services purchased)<br>• Employees (salaries)<br>• Sundry expenses (petty cash) |
| **Capital** | |
| • Money from shareholders/capital from owners<br>• Non-current asset sales | • Non-current asset purchases |
| **Drawings / dividends** | |
| | • Drawings (sole trader / partnership)<br>• Dividends (limited company) |
| **Exceptional (unplanned)** | |
| • Items not mentioned above | • Items not mentioned above |

# Cash flow and profit

**Key Point**

- Profit = excess of income over expenditure in statement of profit or loss.
- For business to survive, cash inflows must exceed cash outflows.
- Cash flow and profits are different.
- Business can make a profit, but still have negative cash flows.

Reasons for differences in cash flows and profits

| Business activity | Effect on cash and profit |
|---|---|
| Purchase of non-current asset | Cash outflow, no effect on profit |
| Depreciation charge on statement of profit or loss | No effect on cash, profit decreased |
| Increase in working capital (e.g. inventory purchase) | Cash outflow, no effect on profit |
| Normal trading | See below |

| Statement of profit or loss | | Cash effect | | |
|---|---|---|---|---|
| | January | January | February | March |
| | $ | $ | $ | $ |
| Sale | 1,000 | | 1,000 | |
| Purchase | (600) | | | (600) |
| Gross profit | 400 | | | |
| Wages | (200) | (200) | | |
| Light and heat | (100) | | (100) | |
| Net profit | 100 | | | |
| | Cumulative cash flow | (200) | 700 | 100 |

From January sales only:

- Sales made in January give profit in January.
- Cash flow in January is negative because employees must be paid; no cash received.
- Cash flow in February is positive because receivables have now been paid.
- Only in March does cash flow = profit when payables finally paid.

## Definition

**Liquidity**: Cash or items that can be converted into cash quickly.