



Exam FFM

Foundations in Financial Management

Pocket Notes

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chapter

1

Cash and cash flows

In this chapter

- Cash and cash flows.
- Sources and applications of finance.
- Cash flow and profit.
- Cash and accruals accounting.

Cash and cash flows

Definition

Cash: Paper money and money in bank accounts.

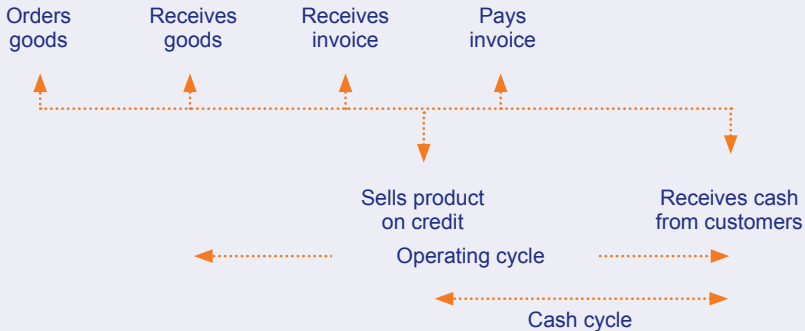
Cash flow: Receipts and payments of cash.

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: <ul style="list-style-type: none"> • Increase in long-term debt • Increase in equity • Increase in current liabilities Selling assets <ul style="list-style-type: none"> • Decrease in current assets • Decrease in non-current assets 	Paying payables or stockholders: <ul style="list-style-type: none"> • Decrease in long-term debt • Decrease in equity • Decrease in current liabilities Buying assets <ul style="list-style-type: none"> • Increase in current assets • Increase in non-current assets

Receipts	Payments
Revenue	
<ul style="list-style-type: none"> • Cash sales • Payments by receivables 	<ul style="list-style-type: none"> • Trade payables (goods and services purchased) • Employees (salaries) • Sundry expenses (petty cash)
Capital	
<ul style="list-style-type: none"> • Money from shareholders/capital from owners • Non-current asset sales 	<ul style="list-style-type: none"> • Non-current asset purchases
Drawings / dividends	
	<ul style="list-style-type: none"> • Drawings (sole trader / partnership) • Dividends (limited company)
Exceptional (unplanned)	
<ul style="list-style-type: none"> • Items not mentioned above 	<ul style="list-style-type: none"> • 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

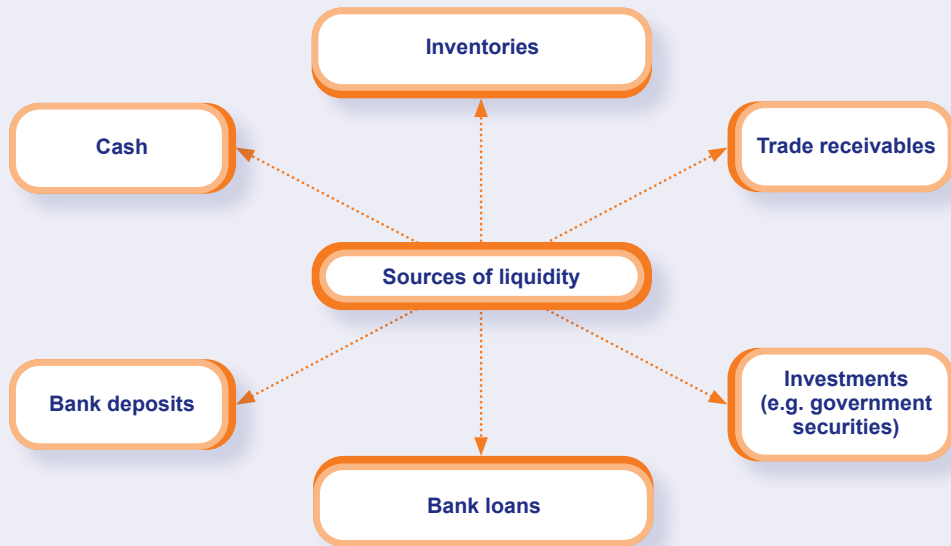
Statement of profit or loss		Cash effect		
	January	January	February	March
	\$	\$	\$	\$
Sale	1,000		1,000	
Purchase	(600)			(600)
Gross profit	400			
Wages	(200)	(200)		
Light and heat	(100)		(100)	
Net profit	100			
Cumulative cash flow		(200)	700	100

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.





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