



## Cash Flow Statements

The cash flow statement shows the impact of cash flowing from three sources:

1. Operating activities,
2. Financing activities (borrowing money, selling stock, and repaying debt to finance the business),
3. Investing activities (including purchasing equipment and other fixed assets that will benefit the business over the long term). Amounts shown in the cash flow statement show actual cash amounts used or generated in these three types of activities.

This statement reflects the cash that flows into and out of a business, and may be most relevant for a new company— to illustrate the sources of cash needed to operate the business.

The amounts are calculated using certain items from your P&L, and then by calculating the change in certain balance sheet accounts. The purpose of the statement is to reflect the sources and uses of cash.

In the operating section, sources of cash include decreases in current assets (accounts receivable, inventory) and increases in current liabilities (accounts payable and accrued expenses). This sounds very “accountantish!”

Just remember, a cash flow statement is showing what cash is available to your business. “Accounts Receivable” means you have given something to a customer and they owe you money—a receivable—for it. That is cash you don’t have yet.

On the other hand, an “Accounts Payable” is a debt you owe someone. You have received the good or service but have not yet paid for it. Therefore, you still have the cash. Uses of cash include increases in current assets and decreases in current liabilities.

In the investing activities section, sources of cash include bank loans and sale of stock in the company to investors. Uses of cash include repayment of bank debt. In the financing section, uses of cash include purchase of equipment and fixed assets.



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## Cash Flow Statement

For the period ending January 1, 2007

Cash flows from operating activities	\$ 4.25 profit available
Changes in working capital	
Inventory	(\$4.50) Parenthesis here means minus or negative. Cash was spent to create inventory
Accounts payable	\$8.25 This is positive because a "payable" is money owed –not yet paid. In other words, it's cash you still have in your possession.
Accrued taxes	\$0.75 Owed but not yet paid
Cash flow from operating activities	\$8.75
Cash flow from investing activities	\$0
Cash flow from financing activities	\$0
Net change in cash	\$8.75
Beginning cash	\$0
Ending cash	\$8.75 [total above: \$4.25 + (\$4.50) + \$8.25 + \$.75 = \$8.75

In reviewing my financials after a successful first day, I'm feeling pretty good. My P&L shows that I generated a great net profit (42.5 percent of revenue!). My cash flow statement shows I generated \$8.75 of cash. But my balance sheet shows me with debts of \$9 (see the balance sheet example above, line 6)—more than my cash! All of a sudden, I'm feeling I went backwards. Did I?

No. It's important to take a look at my equity...the business has a net worth of \$4.25 (balance sheet above, line 7). What happened is that I invested in inventory—\$4.50 (balance sheet above, line 2) to support the growth of the business. I funded that investment with credit from my vendors and Uncle Sam (balance sheet, lines 4 and 5), since he'll wait until the end of the quarter for his tax payment.

Tomorrow, I won't have to purchase cups or sugar—just \$1.25 in cash for lemons and ice. I'll spend another \$3 on marketing (purchase an advertisement in a local newsletter), purchased on credit. On \$10 of revenue, I'll generate another \$4.25 of net income, and \$8.75 of cash (\$10- \$1.25 for lemons and ice). At the end of tomorrow, I'll have \$17.50 in cash. My equity will be \$8.75, inventory will decrease to \$3.75 (as I used \$0.75 of sugar and cups), and my liabilities will be \$12.75 (yesterday's balance of \$9, plus \$3.75 of marketing and accrued taxes), which is comfortably less than my \$17.50 cash balance (money in my bank account). Voilà, I have a profit. What a difference a day can make!

This example illustrates a key point in financial management: tracking and trending of historical results and forecasting. Since your operating, investing, and financing activities play out over a period of time, it's useful, as well as important, to track results and then examine them over time with "trend analyses." Forecasts are like trend analyses; they just look forward as opposed to backwards at historical results. The numbers, then, will tell us a story about my lemonade business as it progresses.