

# **How to Prepare a Cash Flow Statement**

## **A Step by Step Guide to Cash Flow Management in a Small Business**

By BizMove Management Training Institute

**Other free books by BizMove that may interest you:**

[Free starting a business books](#)

[Free management skills books](#)

[Free marketing management books](#)

[Free financial management books](#)

[Free Personnel management books](#)

[Free miscellaneous business management books](#)

[Free household management books](#)

Copyright © by BizMove. All rights reserved.

One of the most important elements contributing to the successful financial management of a business is the preparation of a Cash Flow Statement (sometimes called the Cash Flow Budget).

### **The Cash Flow Statement**

The Cash Flow Statement identifies when cash is expected to be received and when it must be spent to pay bills and debts. It shows how much cash will be needed to pay expenses and when it will be needed. It also allows the manager to identify where the necessary cash will come from. For example, will it be internally generated from sales and the collection of accounts receivable - or must it be borrowed? (The Cash Flow Projection deals only with actual cash transactions; depreciation and amortization of goodwill or other non-cash expense items are not considered in this Pro Forma.)

The Cash Flow Statement, based on management estimates of sales and obligations, identifies when money will be flowing into and out of the business. It enables management to plan for shortfalls in cash resources so short term working capital loans may be arranged in advance. It allows management to schedule purchases and payments in a way that enables the business to borrow as little as possible. Because all sales are not cash sales, management must be able to forecast when accounts receivable will become "cash in the bank" and when expenses - whether regular or seasonal - must be paid so cash shortfalls will not interrupt normal business operations.

The Cash Flow Statement may also be used as a Budget. permitting the manager increased control of the business through continuous comparison of actual receipts and disbursements against forecast amounts. This comparison helps the small business owner identify areas for timely improvement in financial management.

By closely watching the timing of cash receipts and disbursements, cash balance on hand, and loan balances, management can readily identify such things as deficiencies in collecting receivables, unrealistic trade credit or loan repayment schedules. Surplus cash that may be invested on a short-term basis or used to reduce debt and interest expenses temporarily can be recognized. In short, it is the most valuable tool management has at its disposal to refine the day-to-day operation of a business. It is an important financial tool bank lenders evaluate when a business needs a loan, for it demonstrates not only how large a loan is required but also when and how it can be repaid.

A Cash Flow Statement or Budget can be prepared for any period of time. However, a one-year budget matching the fiscal year of your business is recommended. As in the preparation and use of the Pro Forma Statement of Income, the projected Cash Flow Statement should be prepared on a monthly basis for the next year. It should be revised not less than quarterly to reflect actual performance in the preceding three months of operations to check its projections.

In preparing the Cash Flow Statement or Budget start with the sales budget. Other budgets are related directly or indirectly to this budget. The following is a sales forecast in units:

<b>Sales Budget-Units</b>					
For the Year Ended December 31, XXX1					
<b>Territory</b>	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
East	26,000	5,000	6,000	7,000	8,000
West	11,000	2,000	2,500	3,000	3,500
	<u>37,000</u>	<u>7,000</u>	<u>8,500</u>	<u>10,000</u>	<u>11,500</u>

Assume you sell a single product and the sales price for it is \$10. Your sales budget in terms of dollars would look like this:

<b>Sales Budget-Dollars</b>					
For the Year Ended December 31,XXX1					
<b>Territory</b>	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
East	\$260,000	\$50,000	\$80,000	\$70,000	\$ 80,000
West	110,000	20,000	25,000	30,000	35,000
	<u>370,000</u>	<u>70,000</u>	<u>85,000</u>	<u>100,000</u>	<u>115,000</u>

Say the estimated per unit cost of the product is \$1.50 for direct material, \$2.50 for direct labor, and \$1.00 for manufacturing overhead. By applying unit costs to the sales budget in units, you would come out with this budget:

**Cost of Goods Sold Budget**  
For the Year Ended December 31, XXX1

	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Direct material	\$ 55,500	\$10,500	\$12,750	\$15,000	\$17,250
Direct labor	92,500	17,500	21,250	25,000	28,750
Mfg. overhead	37,000	7,000	8,500	10,000	11,500
	185,000	35,000	42,500	50,000	57,500

Later on, before a cash budget can be compiled, you will need to know the estimated cash requirements for selling expenses. Therefore, you prepare a budget for selling expenses and another for cash expenditures for selling expenses (total selling expenses less depreciation):

**Selling Expenses Budget**  
For the Year Ended December 31, XXX1

	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Commissions	\$46,500	\$ 8,750	\$10,625	\$12,500	\$14,375
Rent	9,250	1,750	2,125	2,500	2,875
Advertising	9,250	1,750	2,125	2,500	2,875
Telephone	4,625	875	1,062	1,250	1,437
Depreciation-office	900	225	225	225	225
Other	22,250	4,150	5,088	6,025	6,983
	\$92,500	\$17,500	\$21,250	\$25,000	\$28,750

**Selling Expenses Budget - Cash Requirements**  
For the Year Ended December 31, XXX1

	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Total selling expenses	\$92,500	\$17,500	\$21,250	\$25,000	\$28,750
Less: depreciation: expense-office	900	225	225	225	225
Cash requirements	\$91,600	\$17,275	\$21,025	\$24,775	\$28,525

Basic information for an estimate of administrative expenses for the coming year is easily compiled. Again, from that budget you can estimate cash requirements for those expenses to be used subsequently in preparing the cash budget.

**Administrative Expenses Budget**  
For the Year Ended December 31, XXX1

	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Salaries	\$22,200	\$4,200	\$5,100	\$ 6,000	\$ 6,900
Insurance	1,850	350	425	500	575
Telephone	1,850	350	425	500	575
Supplies	3,700	700	850	1,000	1,150
Bad debt expenses	3,700	700	850	1,000	1,150
Other expenses	3,700	700	850	1,000	1,150
	37,000	7,000	8,500	10,000	11,500

**Administrative Expenses Budget - Cash Requirements**

For the Year Ended December 31, XXX1

	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Estimated adm. expenses	\$37,000	\$7,000	\$8,500	\$10,000	\$11,500
Less: bad debt expenses	3,700	700	850	1,000	1,150
Cash requirements	\$33,300	\$6,500	\$7,650	\$ 9,000	\$10,350

Now, from the information budgeted so far, you can proceed to prepare the budget income statement. Assume you plan to borrow \$10,000 at the end of the first quarter. Although payable at maturity of the note, the interest appears in the last three quarters of the year. The statement will resemble the following:

**Budgeted Income Statement**  
For the Year Ended December 31, XXX1

	Total	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Sales	\$370,000	\$70,000	\$85,000	\$100,000	\$115,000
Cost of goods sold	185,000	35,000	42,500	50,000	57,500
Gross Margin	<u>\$185,000</u>	<u>\$35,000</u>	<u>\$42,500</u>	<u>50,000</u>	<u>57,500</u>
Operating expenses:					
Selling	\$ 92,500	\$17,500	\$21,250	\$ 25,000	\$ 28,750
Administrative	37,000	7,000	8,500	10,000	11,500
Total	<u>\$129,500</u>	<u>\$24,500</u>	<u>\$29,750</u>	<u>\$ 35,000</u>	<u>\$ 40,250</u>
Net income from operations	\$ 55,500	\$10,500	\$12,750	\$ 15,000	\$ 17,250
Interest expense	450		150	150	150
Net income before income taxes	<u>\$ 55,050</u>	<u>\$10,500</u>	<u>\$12,600</u>	<u>\$ 14,850</u>	<u>\$ 17,100</u>
income tax	27,525	5,250	6,300	7,425	8,550
Net income	<u>\$ 27,525</u>	<u>\$ 5,250</u>	<u>\$ 6,300</u>	<u>\$ 7,425</u>	<u>\$ 8,550</u>

Estimating that 90 percent of your account sales is collected in the quarter in which they are made, that 9 percent is collected in the quarter following the quarter in which the sales were made, and that 1 percent of account sales is uncollectible, your accounts receivable budget of collections would look like this:

**Budget of Collections of Accounts Receivable**

For the Year Ended December 31, XXX1

	<b>Total (Net)</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
4th Quarter Sales XXX0	\$ 6,000	\$ 6,000			
1st Quarter Sales XXX1	69,300	63,000	\$ 6,300		
2nd Quarter Sales XXX1	84,150		76,500	\$ 7,650	
3rd Quarter Sales XXX1	99,000			90,000	\$ 9,000
4th Quarter Sales XXX1	103,500				103,500
	<u>\$361,950</u>	<u>\$69,000</u>	<u>\$82,800</u>	<u>\$97,650</u>	<u>\$112,500</u>

Going back to the sales budget in units, now prepare a production budget in units. Assume you have 2,000 units in the opening inventory and want to have on hand at the end of each quarter the following quantities: 1st quarter, 3,000 units; 2nd quarter, 3,500 units; 3rd quarter, 4,000 units; and 4th quarter, 4,500 units.

**Production Budget - Units**

For the Year Ended December 31, XXX1

	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Sales requirements	7,000	8,500	10,000	11,500
Add: ending inventory requirements	3,000	3,500	4,000	4,500
<b>Total requirements</b>	<u>10,000</u>	<u>12,000</u>	<u>14,000</u>	<u>16,000</u>
Less: beginning inventory	2,000	3,000	3,500	4,000
<b>Production requirements</b>	<u>8,000</u>	<u>9,000</u>	<u>10,500</u>	<u>12,000</u>

Next, based on the production budget, prepare a budget to show the purchases needed during each of the four quarters. Expressed in terms of dollars, you do this by taking the production and inventory figures and multiplying them by the cost of material (previously estimated at \$1.50 per unit). You could prepare a similar budget expressed in units.

**Budget of Collections of Accounts Receivable**

For the Year Ended December 31, XXX1

	<b>Total (Net)</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
4th Quarter Sales XXX0	\$ 6,000	\$ 6,000			
1st Quarter Sales XXX1	69,300	63,000	\$ 6,300		
2nd Quarter Sales XXX1	84,150		76,500	\$ 7,650	
3rd Quarter Sales XXX1	99,000			90,000	\$ 9,000
4th Quarter Sales XXX1	103,500				103,500
	<u>\$361,950</u>	<u>\$69,000</u>	<u>\$82,800</u>	<u>\$97,650</u>	<u>\$112,500</u>

Going back to the sales budget in units, now prepare a production budget in units. Assume you have 2,000 units in the opening inventory and want to have on hand at the end of each quarter the following quantities: 1st quarter, 3,000 units; 2nd quarter, 3,500 units; 3rd quarter, 4,000 units; and 4th quarter, 4,500 units.

**Production Budget - Units**

For the Year Ended December 31, XXX1

	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Sales requirements	7,000	8,500	10,000	11,500
Add: ending inventory requirements	3,000	3,500	4,000	4,500
<b>Total requirements</b>	<u>10,000</u>	<u>12,000</u>	<u>14,000</u>	<u>16,000</u>
Less: beginning inventory	2,000	3,000	3,500	4,000
<b>Production requirements</b>	<u>8,000</u>	<u>9,000</u>	<u>10,500</u>	<u>12,000</u>

Next, based on the production budget, prepare a budget to show the purchases needed during each of the four quarters. Expressed in terms of dollars, you do this by taking the production and inventory figures and multiplying them by the cost of material (previously estimated at \$1.50 per unit). You could prepare a similar budget expressed in units.

**Budget of Direct Materials Purchases**

For the Year Ended December 31, XXX1

	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Required for production	\$12,000	\$13,500	\$15,750	\$18,000
Required for ending inventory	4,500	5,250	6,000	6,750
<b>Total</b>	<u>\$16,500</u>	<u>\$18,750</u>	<u>\$21,750</u>	<u>\$24,750</u>
Less: beginning inventory	3,000	4,500	5,250	8,000
<b>Required purchases</b>	<u>\$13,500</u>	<u>\$14,250</u>	<u>\$18,500</u>	<u>\$18,750</u>

Now suppose you pay 50 percent of your accounts in the quarter of the purchase and 50 percent in the following quarter. Carryover payables from last year were \$5,000.

Further, you always take the purchase discounts as a matter of good business policy. Since net purchases (less discount) were figured into the \$1.50 cost estimate, purchase discounts do not appear in the budgets. Thus your payment on purchases budget will come out like this:

<b>Payment on Purchases Budget</b>					
For the Year Ended December 31, 19					
	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
4th Quarter Sales xxx0	\$ 5,000	\$ 5,000			
1st Quarter Sales xxx1	13,500	6,750	\$ 6,750		
2nd Quarter Sales xxx1	14,250		7,125	\$ 7,125	
3rd Quarter Sales xxx1	16,500			8,250	\$ 8,250
4th Quarter Sales xxx1	9,375				9,375
<b>Payments by Quarters</b>	<b>\$58,625</b>	<b>\$11,750</b>	<b>\$13,875</b>	<b>\$15,375</b>	<b>\$17,625</b>

Taking the data for quantities produced from the production budget in units, calculate the direct labor requirements on the basis of units to be produced. (The number and cost of labor hours necessary to produce a given quantity can be set forth in supplemental schedules.)

<b>Direct Labor Budget-Cash Requirements</b>					
For the Year Ended December 31, XXX1					
	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Quantity	39,500	8,000	9,000	10,500	12,000
Direct labor cost	\$98,750	\$20,000	\$22,500	\$28,250	\$30,000

Now outline the items that comprise your factory overhead, and prepare a budget like the following:

<b>Manufacturing Overhead Budget</b>					
For the Year Ended December 31, XXX1					
	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Heat and power	\$10,000	\$1,000	\$2,500	\$ 3,000	\$ 3,500
Factory supplies	5,300	1,000	1,500	1,800	1,000
Property taxes	2,000	500	500	500	500
Depreciation	2,800	700	700	700	700
Rent	8,000	2,000	2,000	2,000	2,000
Superintendent	9,400	2,800	1,800	2,500	4,300
	<u>\$39,500</u>	<u>\$8,000</u>	<u>\$9,000</u>	<u>\$10,500</u>	<u>\$12,000</u>

Figure the cash payments for manufacturing overhead by subtracting depreciation, which requires no cash outlay, from the totals above, and you will have the following breakdown:

<b>Manufacturing Overhead Budget-Cash Requirements</b>					
For the Year Ended December 31, XXX1					
	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Productions-units	39,500	8,000	9,000	10,500	12,000
Mfg. overhead expenses	<u>\$39,500</u>	<u>\$8,000</u>	<u>\$9,000</u>	<u>\$10,500</u>	<u>\$12,000</u>
Less: depreciation	2,800	700	700	700	700
Cash requirements	<u>\$36,700</u>	<u>\$7,300</u>	<u>\$8,300</u>	<u>\$ 9,800</u>	<u>\$11,300</u>

Now comes the all important cash budget. You put it together by using the Collection of Accounts Receivable Budget; Selling Expenses Budget-Cash Requirements; Administrative Expenses Budget-Cash Requirements; Payment of Purchases Budget; Direct Labor Budget-Cash Requirements: and Manufacturing Budget Cash Requirements.

Take \$15,000 as the beginning balance, and assume that dividends of \$20,000 are to be paid in the fourth quarter.

<b>Cash Budget</b>					
For the Year Ended December 31, XXX1					
	<b>Total</b>	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Beginning cash balance	15,000	15,000	3,850	13,300	25,750
Cash collections	361,950	69,000	82,800	97,650	112,500
<b>Total</b>	<u>\$376,950</u>	<u>\$84,000</u>	<u>\$86,650</u>	<u>\$110,950</u>	<u>\$138,250</u>
Cash payments					
Purchases	\$ 58,625	\$11,750	\$13,875	\$ 15,375	\$ 17,625
Direct labor	98,750	20,000	22,500	26,250	30,000
Mfg. overhead	38,700	7,300	8,300	9,800	11,300
Selling expense	91,600	17,275	21,025	24,775	28,525
Adm. expenses	33,300	6,300	7,650	9,000	10,350
Income tax	27,525	27,525			
Dividends	20,000				20,000
Interest expenses	450				450
Loan repayment	10,000				10,000
<b>Total</b>	<u>\$376,950</u>	<u>\$90,150</u>	<u>\$73,350</u>	<u>\$ 85,200</u>	<u>\$128,250</u>
Cash deficiency		(\$6,150)			
Bank loan received	10,000	10,000			
<b>Ending cash balance</b>	<u>\$ 10,000</u>	<u>\$ 3,850</u>	<u>\$13,300</u>	<u>\$ 25,750</u>	<u>\$ 10,000</u>

Now you are ready to prepare a budget balance sheet. Take the account balances of last year and combine them with the transactions reflected in the various budgets you have compiled. You will come out with a sheet resembling this:

### Budgeted Balance Sheet

December 31, XXX1

<b>Assets</b>	XXX0	XXX1
<b>Current assets:</b>		
Cash	\$ 10,000	\$ 15,000
Accounts receivable	11,500	6,666
Less: allowance for doubtful accounts	(1,150)	(666)
Inventory:		
Raw materials	6,750	3,000
Finished goods	22,500	10,000
Total current assets	<u>\$ 49,600</u>	<u>34,000</u>
<b>Fixed assets:</b>		
Land	\$ 50,000	\$ 50,000
Building	148,000	148,000
Less: allowance for depreciation	(37,000)	(33,000)
Total fixed assets	<u>\$161,100</u>	<u>\$164,700</u>
Total assets	<u>\$210,600</u>	<u>\$198,700</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current liabilities:</b>		
Account payable	\$ 9,375	\$ 5,000
<b>Shareholders' equity:</b>		
Capital stock		
(10,000 shares; \$10 per value)	\$100,000	\$110,000
Retained earnings	101,225	93,700
	<u>\$201,225</u>	<u>\$193,700</u>
Total liabilities and shareholders' equity	<u>\$210,600</u>	<u>\$198,700</u>

In order to make the most effective use of your budgets to plan profits, you will want to establish reporting devices. Throughout the time span you have set, you need periodic reports and reviews on both efforts and accomplishments. These let you know whether your budget plan is being attained and help you keep control throughout the process. It is through comparing actual performance with budgeted projections that you maintain control of the operations.

Your company should be structured along functional lines, with well identified areas of responsibility and authority. Then, depending upon the size of your company, the budget reports can be prepared to correspond with the organizational structure of the company.

Two typical budget reports are shown below to demonstrate various forms these reports may take.

**Report of Actual and Budgeted Sales**  
For the Year Ended December 31, XXX1

	Actual sales	Budgeted sales	Variation from budget (under)	
			Quarterly	Cumulative
1st Quarter	_____	_____	_____	_____
2nd Quarter	_____	_____	_____	_____
3rd Quarter	_____	_____	_____	_____
4th Quarter	_____	_____	_____	_____

**Budgeted Report on Selling Expenses**  
For the Year Ended December 31, XXX1

Budget This Month	Actual This Month	Variation This Month	Budget Year to Date	Actual Year to Date	Variation Year to Date	Remarks
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____

Remember, the Cash Flow Statement used as the business's Budget allows the owner/manager to anticipate problems rather than react to them after they occur. It permits comparison of actual receipts and disbursements against projections to identify errors in the forecast. If cash flow is analyzed monthly, the manager can correct the cause of the error before it harms profitability.

[Go to Top](#)

\* \* \* \* \*

**Bonus Guides:**

**Introduction to Financial Management**

Financial management in the small firm is characterized, in many different cases, by the need to confront a somewhat different set of problems and opportunities than those confronted by a large corporation. One immediate and obvious difference is that a majority of smaller firms do not normally have the opportunity to publicly sell issues of stocks or bonds in order to raise funds. The owner-manager of a smaller firm must rely

primarily on trade credit, bank financing, lease financing, and personal equity to finance the business. One, therefore faces a much more severely restricted set of financing alternatives than those faced by the financial vice president or treasurer of a large corporation.

On the other hand, many financial problems facing the small firm are very similar to those of larger corporations. For example, the analysis required for a long-term investment decision such as the purchase of heavy machinery or the evaluation of lease-buy alternatives, is essentially the same regardless of the size of the firm. Once the decision is made, the financing alternatives available to the firm may be radically different, but the decision process will be generally similar.

One area of particular concern for the smaller business owner lies in the effective management of working capital. Net working capital is defined as the difference between current assets and current liabilities and is often thought of as the "circulating capital" of the business. Lack of control in this crucial area is a primary cause of business failure in both small and large firms.

The business manager must continually be alert to changes in working capital accounts, the cause of these changes and the implications of these changes for the financial health of the company. One convenient and effective method to highlight the key managerial requirements in this area is to view working capital in terms of its major components:

### **(1) Cash and Equivalents**

This most liquid form of current assets, cash and cash equivalents (usually marketable securities or short-term certificate of deposit) requires constant supervision. A well planned and maintained cash budgeting system is essential to answer key questions such as: Is the cash level adequate to meet current expenses as they come due? What are the timing relationships between cash inflows and outflows? When will peak cash needs occur? What will be the magnitude of bank borrowing required to meet any cash shortfalls? When will this borrowing be necessary and when may repayment be expected?

### **(2) Accounts Receivable**

Almost all businesses are required to extend credit to their customers. Key issues in this area include: Is the amount of accounts receivable reasonable in relation to sales? On the average, how rapidly are accounts receivable being collected? Which customers are "slow payers?" What action should be taken to speed collections where needed?

### **(3) Inventories**

Inventories often make up 50 percent or more of a firm's current assets and therefore, are deserving of close scrutiny. Key questions which must be considered in this area include: Is the level of inventory reasonable in relation to sales and the operating characteristics of the business? How rapidly is inventory turned over in relation to other companies in the same industry? Is any capital invested in dead or slow moving stock?

Are sales being lost due to inadequate inventory levels? If appropriate, what action should be taken to increase or decrease inventory?

#### **(4) Accounts Payable and Trade Notes Payable**

In a business, trade credit often provides a major source of financing for the firm. Key issues to investigate in this category include: Is the amount of money owed to suppliers reasonable in relation to purchases? Is the firm's payment policy such that it will enhance or detract from the firm's credit rating? If available, are discounts being taken? What are the timing relationships between payments on accounts payable and collection on accounts receivable?

#### **(5) Notes Payable**

Notes payable to banks or other lenders are a second major source of financing for the business. Important questions in this class include: What is the amount of bank borrowing employed? Is this debt amount reasonable in relation to the equity financing of the firm? When will principal and interest payments fall due? Will funds be available to meet these payments on time?

#### **(6) Accrued Expenses and Taxes Payable**

Accrued expenses and taxes payable represent obligations of the firm as of the date of balance sheet preparation. Accrued expenses represent such items as salaries payable, interest payable on bank notes, insurance premiums payable, and similar items. Of primary concern in this area, particularly with regard to taxes payable, is the magnitude, timing, and availability of funds for payment. Careful planning is required to insure that these obligations are met on time.

As a final note, it is important to recognize that although the working capital accounts above are listed separately, they must also be viewed in total and from the point of view of their relationship to one another: What is the overall trend in net working capital? Is this a healthy trend? Which individual accounts are responsible for the trend? How does the firm's working capital position relate to similar sized firms in the industry? What can be done to correct the trend, if necessary?

Of course, the questions posed are much easier to ask than to answer and there are few "general" answers to the issues raised. The guides which follow provide suggestions, techniques, and guidelines for successful management which, when tempered with the experience of the individual owner-manager and the unique requirements of the particular industry, may be expected to enhance one's ability to manage effectively the financial resources of a business enterprise.

## **Essentials of Financial Planning**

There is one simple reason to understand and observe financial planning in your business - to avoid failure. Eight of ten new businesses fail primarily because of the lack of good financial planning.

Financial planning affects how and on what terms you will be able to attract the funding required to establish, maintain, and expand your business. Financial planning determines the raw materials you can afford to buy, the products you will be able to produce, and whether or not you will be able to market them efficiently. It affects the human and physical resources you will be able to acquire to operate your business. It will be a major determinant of whether or not you will be able to make your hard work profitable.

This section provides an overview of the essential components of financial planning and management. Used wisely, it will make the reader - the small business owner/manager - familiar enough with the fundamentals to have a fighting chance of success in today's highly competitive business environment.

A clearly conceived, well documented financial plan, establishing goals and including the use of Pro Forma Statements and Budgets to ensure financial control, will demonstrate not only that you know what you want to do, but that you know how to accomplish it. This demonstration is essential to attract the capital required by your business from creditors and investors.

### **What Is Financial Management?**

Very simply stated, financial management is the use of financial statements that reflect the financial condition of a business to identify its relative strengths and weaknesses. It enables you to plan, using projections, future financial performance for capital, asset, and personnel requirements to maximize the return on shareholders' investment.

### **Tools of Financial Planning**

This section introduces the tools required to prepare a financial plan for your business's development, including the following:

Basic Financial Statements - the Balance Sheet and Statement of Income

Ratio Analysis - a means by which individual business performance is compared to similar businesses in the same category

The Pro Forma Statement of Income - a method used to forecast future profitability

Break-Even Analysis - a method allowing the small business person to calculate the sales level at which a business recovers all its costs or expenses

The Cash Flow Statement - also known as the Budget identifies the flow of cash into and out of the business

Pricing formulas and policies - used to calculate profitable selling prices for products and services

Types and sources of capital available to finance business operations

Short- and long-term planning considerations necessary to maximize profits

The business owner/manager who understands these concepts and uses them effectively to control the evolution of the business is practicing sound financial management thereby increasing the likelihood of success.

[Go to Top](#)

\* \* \* \*