

Cash Flow Statement

Chapter 4

Introduction

Management and other interested external parties have always recognized the need for a cash flow statement but it was never required until the FASB (Financial Accounting Standards Board) issued Statement # 95 "Statement of Cash Flows" in 1988. This statement required that:

- businesses include a statement of cash flow as part of their financial reporting.

Introd. Contd.

Under GAAP, most businesses use accrual basis of accounting. This method requires that revenue is recorded when earned and expenses recorded when incurred. Now, revenue may include credit sales that have yet to be collected in cash and expenses that have yet to be paid.

Thus under accrual accounting net income will generally not equal net cash flow from operations.

Need for the CF statement?

Fact is, not all revenue that is earned is received in cash or received immediately, and not all expenses incurred is paid. So a cash flow statement reconciles the accrual income statement to net cash collected or paid.

Cash is critical to any hospitality business. A hotel or restaurant's success or failure will be determined by, among other things, how the flow of cash is utilized by management.

Purpose of Cash Flow statement

- To use information about the past sources of cash to predict the hotel or restaurant's ability to generate positive cash flows in the future.
- To establish the hotel or restaurant's ability to pay its bills – ability to meet its obligations.

Purpose – contd.

- To ascertain whether the business' cash is coming from operations mostly or from other sources instead. Most interested parties will prefer that cash flows come mostly from operations.
- To understand the effect of investment and financing activities on the operation of the business.

Some ways to maximize cash flow

- Buy from suppliers offering longer payment terms so you can stretch your cash longer.
- Keep tight control over inventory and turn it over as quickly as possible. The less cash the business has tied up in inventory the more cash it will have for other needs.

Ways to maximize – contd.

- Be vigilant in the pursuit of accounts receivables. Bill on a timely basis and offer incentives if you must.
- Be frugal – don't invest in expenses that do not contribute to the bottom-line.

Some things to note about Cash Flow

- Everything in business takes longer and costs more than what management plans for. So be extremely conservative, under-estimated revenues and over-estimate expenses many times over.
- Keep cash flow adequate at all times. Since the business environment is dynamic keep checking cash flow frequently and adjust when necessary.

Things to note – contd.

- Payroll is the company's top financial priority. Do whatever you must to meet payroll.
- You cannot avoid paying Federal and state taxes. Although when times are tough Fed. and state authorities will negotiate payment plans with company, the obligations must still be met.
- Always satisfy debts you have personally guaranteed, other creditors will have their turn.

Structure of Cash Flow statement

- Opening balance of cash
- Amounts of cash received during the operating period
- Amounts disbursed
- The difference between 2 and 3 equals net increase or decrease in cash for the operating period.
- The sum of 1 and 4 will yield the final cash flow balance.

Classification of cash flows

The cash flow statement classifies all cash receipts and disbursements as:

- Operating activities
- Investing activities
- Financing activities

Operating Activities

These are activities primarily related to the hotel or restaurant's on-going ability to generate cash from operations. It includes all inflow and outflow transactions related to the income statement, current assets and current liabilities which directly affect operation of the hotel or restaurant. The net outcome is what net income would have been if cash basis accounting was used. The information is presented using the direct or indirect methods.

Examples of activities

Operating Inflows

- Cash from sale of products and services
- Collection of accounts receivable or note receivable
- Interest received on loans
- Dividend received on investments

Examples – contd.

Operating outflows

- Cash payment for cost of sales
- Payment of salaries and wages, taxes etc.
- Interest expense paid on loans
- Rental payments to landlord

Investing Activities

These are activities primarily related to non-current assets. They relate mostly to cash flows from the acquisition and disposal of fixed assets, purchase and sale of stocks and bonds of other companies, and making loans to other entities and/or collecting the principal on loans owed to the company.

Most of this information is found in the non-current asset section of the balance sheet.
