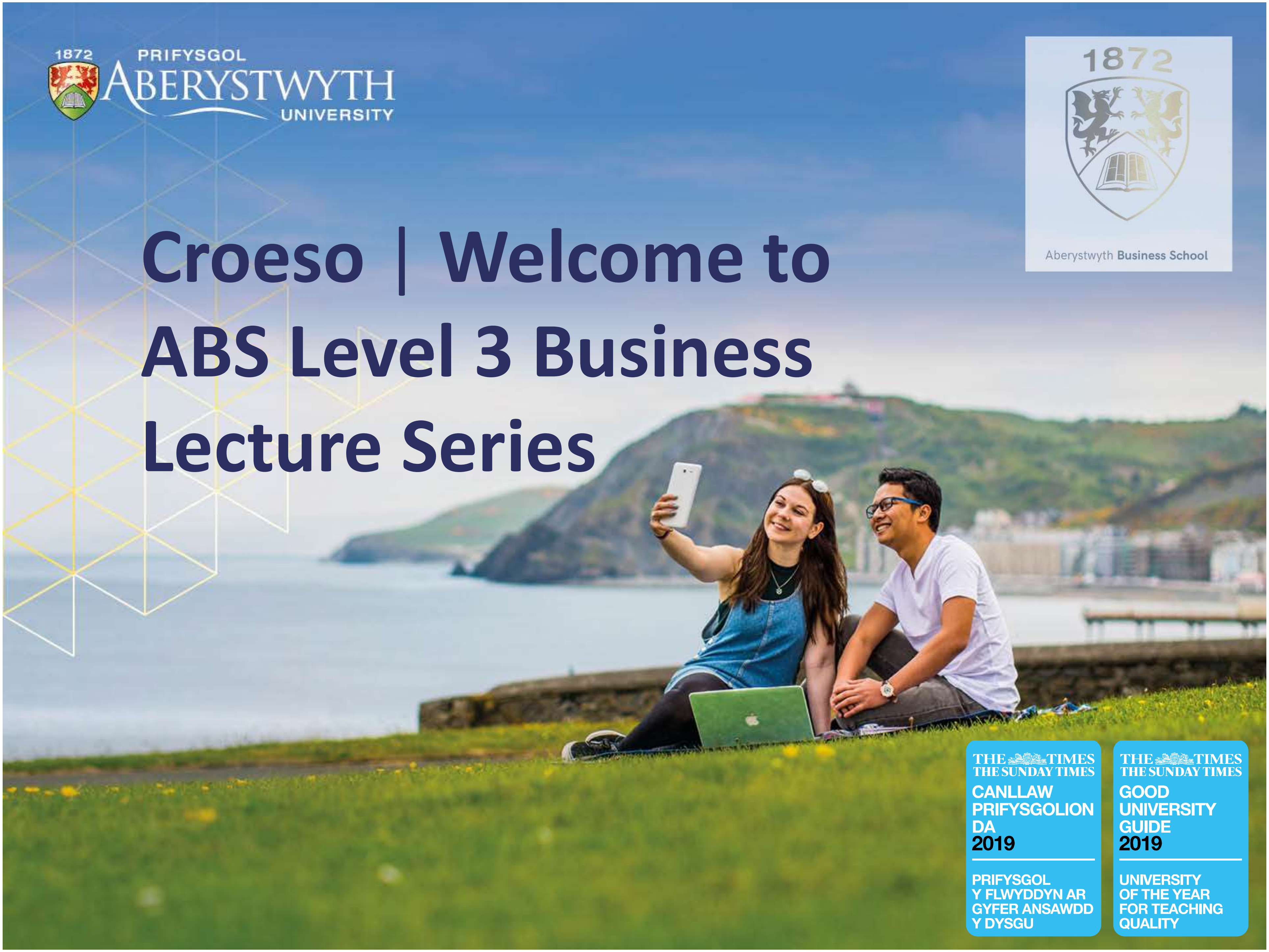
Croeso | Welcome to ABS Level 3 Business Lecture Series



Setting Financial Objectives
Focus- Cash Flow

Content to support Level 3 Business

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Learning Outcomes

- Understanding of financial objectives
- The value of setting financial objectives.
- The distinction between cash flow and profit.
- Cash flow objectives.
- The cash flow statement
- The cash flow forecast

Understanding of financial objectives

- **What is a financial objective?**
  - Is part of the financial planning process of a business.
  - Targets of a business that can be expressed in monetary terms within a set timescale.
  - Financial objectives are different from other types of objectives.

The value of setting financial objectives

- Acts as a focus for senior management and departments of a business.
- Measurement tool: Against previous years, targets, competitors etc.
- Improves coordination and efficiency.
- Shareholders and other Stakeholders are able to assess the financial viability of a company.

The value of setting financial objectives

- Identify and reduce risks.
- Anticipate future challenges and threats.
- Greater control over your budget and provides valuable data to aid decision making.
- Enables a business to grow and increase market share.

Examples of financial objectives

- Increase annual revenue by 10% per annum.
- Achieve a profit margin of 20% by 2021.
- Reduce stock levels.
- Maintain a positive cash flow.
- Exploit new markets to increase sales.
- Purchase new fixed assets to increase efficiencies and reduce overhead costs.
- Reduce level of debt.

The distinction between cash flow and profit

- Cash and profit are related BUT are not the same!
- Cash is an asset to a business and can be measured at a particular point in time.
- Profit can only be earned and measured over time.

The distinction between cash flow and profit

- The difference between them depends on the source of the cash transactions and the basis of accounting.

The Cash Flow Statement

- Part of the financial statements.
- A summary of the amount of cash coming in and out of the company.
- Measures how efficient a company is in managing its cash position.
- Identifies how well a business generates cash to fund its operating expenses and debt obligations.

The Cash Flow Statement

Made up of three parts:

1. Revenue / Income
2. Expenses / Outgoings
3. Balances

The Cash Flow Statement

Revenue

- Income received by a business for goods or services provided.
- This revenue can often be split into cash sales and debtor payments.

The Cash Flow Statement

Expenses

- All the money spent by a business within the time period is shown under expenses.
- Expenses are broken down within the cash flow to see where the money is being spent.
- Examples of expenses could include: Wages, electricity, rent, stationary etc.

The Cash Flow Statement

Calculating net cash flow

= Total Revenue – Total Expenses

Revenue > Expenses = + cash flow

Revenue < Expenses = - cash flow

The Cash Flow Statement

Closing balances

- Each period has an opening balance that has been carried forward from the previous period.
- This opening balance represents is the amount of cash available at the beginning of the period.
- The net cash flow is added or deducted from this opening balance to form the closing balance.

The Cash Flow Statement

Example

	January
Total Revenue	£1,200
Total expenses	£4,900
Net cash flow	- £3,700 Revenue – Expenses)

The Cash Flow Statement

Example

	January	February	March
Opening balance		-£3,700	-£5,360
+/- Net cash flow		- £1,660	-£700
Closing balance	-£3,700	-£5,360	-£6,060

The Cash Flow Statement

- The cash flow forms part of the financial statements and is a historic document.

- Cash flow statements are also used to forecast future periods, investments or particular scenarios.

The Forecasted Cash Flow Statement

- Predict the likely flows of cash into and out of the period.
- Based on:

➢ Past experience

➢ Current and expected future economic and financial trends

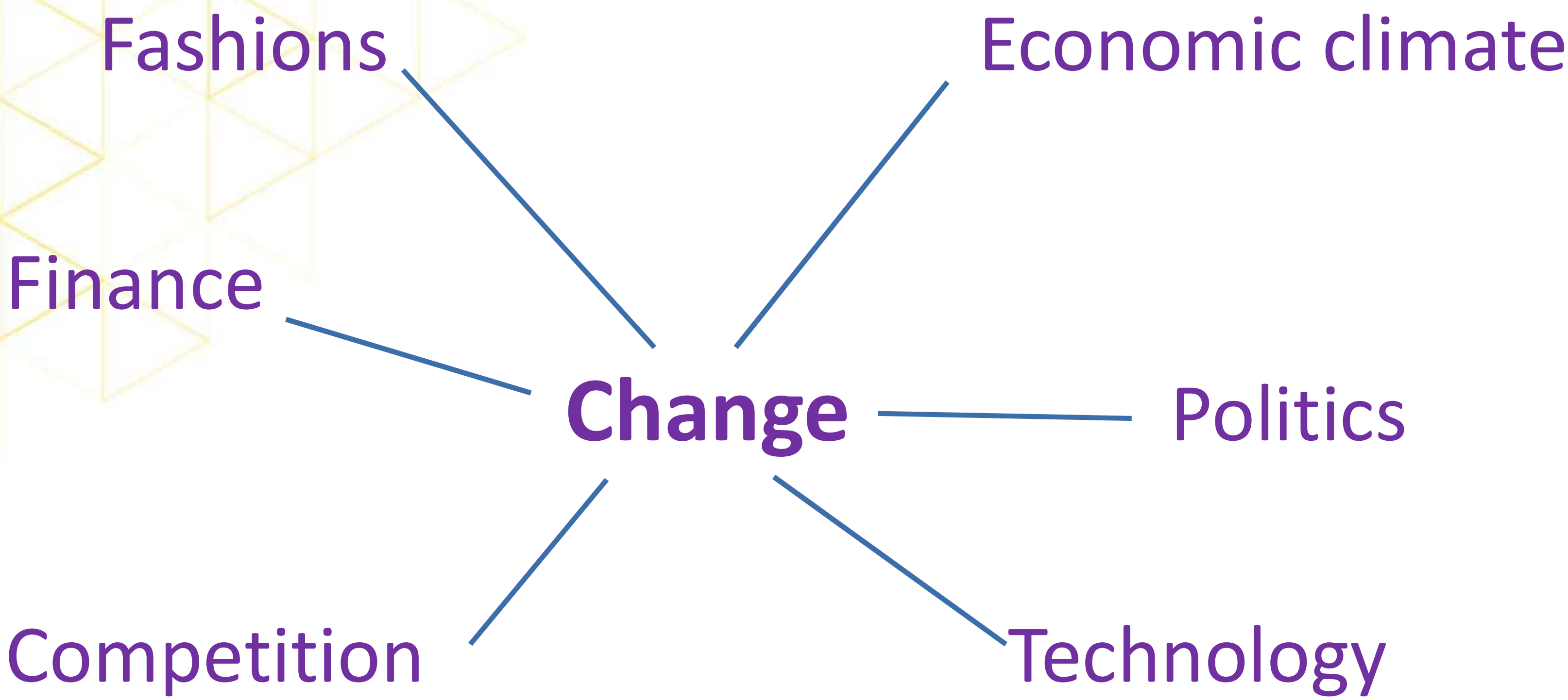
➢ Knowledge and understanding of managers

The Cash Flow Statement

A business' actual cash flow statement can differ considerably from its cash flow forecast.

Why?

The Cash Flow Statement



The Cash Flow Forecast

Typical reasons for cash flow forecast issues:

- Actual sales differ from expected level
- Costs increase
- Internal factors
- Inadequate or poor quality information

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The Cash Flow Forecast

- All business should monitor cash flow regularly.
- Examine deviances between actual and forecasted figures.
- With experience, the accuracy of forecasting should improve.
- The forecast should tell a business if they have sufficient funds to pay future expenses.

The Cash Flow Forecast

- Solutions to predicted cash shortage:
  - Increase revenue
  - Reduce costs
  - Delay payment
  - Additional funding
  - Invoice factoring

Cash Flow Objectives

- Evaluates cash position.
- Ensure future positive cash flow.
- Ensure the ability to pay dividends.
- Picture of liquidity position.
- Comparison with previous years.
- Provides greater detail and clarifies areas of concern.

Cash Flow Objectives Examples

- Reduce bank borrowings and over drafts to a targeted level.
- Reduce average debtor day ratio.
- Increase average creditor day ratio effectively.
- Develop a ‘rainy day’ fund.
- Stabilise cash flow and reduce peaks and troughs during the period.

Limitations of a cash flow forecast

- Time consuming to prepare and monitor
- To have value cash flow forecast must be accurate.
- The longer the timeframe, the less accurate the cash flow forecast will be.
- Rate of inflation can impact the figures.
- Not all information maybe shared.

Activities

- Edexcel Winter 2010 paper.
  Questions 7, 9, 10 and 11 (30 minutes)

- Multiple choice questions

Diolch | Thank you