

The YEBDC Small Business Information Column

by Sue Gingerich, Business Advisor

"Importance of Monitoring Cash Flow"

What is a cash flow? How is a cash flow different from an income statement? Why should a business project the future movement of cash through their business? Should they also monitor how the cash actually, did flow?

First of all a cash flow is simply that - a flow of CASH. When does cash come into your business and when does it leave your business? What are all the sources that could bring cash into your business in any given month: cash sales, paid receivables, the sale of an asset, interest on an investment, rental income, a bank loan, or owner investment? What are all the ways that cash leaves your business in any given month: wages, owner drawings, expenses, asset purchases, paying old bills, loan payments (principle and interest)?

How is a cash flow different from an income statement? Well, a cash flow tracks the movement of cash, and an income statement shows profitability. These can be two very different things. An owner may decide one month to take drawings of a very large amount of cash, possibly because they had a very successful month. If this is a sole proprietorship, the net income would still show high; however, the cash flow would greatly be affected. Or, if your business bought a new asset and paid cash, your cash on hand would be reduced, however your net income would not be affected as much. It would only be reduced by the amount of depreciation that the government allows you to deduct. Another way that a cash flow is different than an income statement is because of your loan payments. On your cash flow the entire payment effects your cash situation, however, on the income statement the only allowable portion that is expensed is the interest. So again, the bottom line would be different.

Will you always have the cash you need to meet your obligations? How do you know? The best way to know is to do a cash flow forecast. What if you want to buy a large, new piece of equipment next year? Better to determine ahead of time if it is a good idea, then to spend the cash and find out after the fact that the next month you don't have enough cash to pay all your bills! Instead, you could see if it is more feasible to borrow the money to buy this equipment. Or maybe the purchase just needs to be delayed for a month or two. By looking at your income statement, as well as your cash flow, you may see that it might make more sense to lease this item instead of buying it outright. The cash flow may not be affected as dramatically and you may actually have a higher allowable expense, thus possibly reducing the amount of tax you will have to pay that year.

If you also monitor how the cash actually did move through your company, it will help you to make more accurate projections for future cash flow forecasts. It may also help you to catch a small problem before it turns into a big one. One thing you may be able to see from this exercise is that by just moving bills from one month to a different time of the year, that you will be able to avoid the embarrassment of cash shortages or even NSF cheques. Insurance payments are a good one to monitor, because they are often lump sum payments, paid in advance. Often you can work with your insurance agent to pick a better time of the year to make this payment.

By projecting and monitoring the movement of cash in and out of your business, you may save yourself from unnecessary stress down the road and most surely you will catch things, that if left unattended could actually jeopardize your business.

If you have a small business and have a question or problem that you think The YEBDC could help you with please call or write to: The Yellowhead East Business Development Corporation, Box 249, Sangudo, Alberta, T0E 2A0
1-800-556-0328 or 1-780-785-2900, e mail: yebdc@yebdc.ab.ca or access our Website at:
www.yebdc.ab.ca

"Takin' Care of Business... Takin' Care of You!"