



The cash flow statement

An entrepreneurial perspective

By Don Nilson, CMA, FCMA

In the winter 2009 issue, we took a new look at the traditional accounts receivable aging schedule. In this issue, we look at a new approach to the cash flow statement, particularly geared to entrepreneurial business.

For us “old-timers,” the cash flow statement has had a fairly active history in the handbook. Over the years it has been known euphemistically as the “Where Got Where Gone,” and properly as the Statement of Sources and Uses, the Statement of Sources and Applications, the Statement of Changes in Financial Position and, lately, the Statement of Cash Flows. Previously it focused on net working capital, but it has evolved to instead focus on cash or cash equivalents. The categorical concept of operating, investing and financing subheadings was introduced in 1987.

While we produce handbook-style cash flow statements in the official financial statement package, we produce a modified version for separate reporting to our entrepreneurial clients. This includes a fourth subcategory, which we call “shareholder activities.” At first, this merely shuffles the reporting of dividend payments and shareholder loan activity from other places on the statement to the shareholder section.

But, more importantly, we adjust the operating and shareholder sections by adding back owner compensation. Thus, the operating earnings are “pre-owner remuneration,” and the shareholder section effectively includes all funds withdrawn, not just those off the balance sheet. We also present this information on a rolling five-year comparative, add up the five-year totals and express all of this in percentage as well as dollar terms. Each client’s historical information is kept in an Excel data file, and this is pasted annually to a template file in Excel.

Here’s how it looks:

Working down the categories in order, we can make several observations and inferences. (See the table on the opposite page.) First, we look at the dollar levels:

- Working capital (essentially the interplay of receivables, inventory and trade payables) has required significant funding year after year, totalling approximately \$1 million over five years, or \$200,000 per year on average.
- Cash inflow from operations hit an all-time high in 2009, and the company is averaging almost \$600,000 per annum.

- Owner salaries, dividends and shareholder loans have withdrawn \$1.6 million over the five years (approximately \$300,000 per year), and 2009 was the highest.
- The investment section shows the company has invested in plant and equipment to the tune of approximately \$600,000 over the five years.

Second, we can look at the five-year total percentage relationships between the various line items, expressed as a percentage of annual cash inflow:

- Over the five years, operating activities have provided almost all of the cash inflow (94 per cent), except for a bit of incoming financing for plant and equipment (mostly in 2008).
- Of that cash inflow, one-third has been required to finance working capital, 53 per cent has been withdrawn by owners and 19 per cent has been invested in plant and equipment.

Each year's percentages can be studied on their own as well. The last line at the bottom – Percentage of Operations Cash Flow – reflects owner withdrawals purely as a percentage of operating cash inflow, not total cash inflow, which can be skewed in years where there has been significant incoming financing for plant and equipment (e.g. 2008 – 35 per cent versus 52 per cent).

We use this report live, along with a traditional financial ratios worksheet, when we are reviewing year-end results with our clients. It's always nice to see a business do well; however, most clients would rather see more of that success go into their own pockets – allowing them to pursue life and happiness – than have it stay in the business to finance working capital and

equipment. The historical perspective of both these Excel sheets provides some context for making strategic decisions about how much can be withdrawn without impairing the business. We can also add context to that decision by drawing on the experience we have gained going through these Excel sheets with hundreds of other entrepreneur clients over the years.

This particular business is a wholesaler that carries \$1 million each in inventory and receivables, as well as a significant investment in capital equipment. As a result, the operating activities require financing, and lenders are loath to carry the full weight, so some retained capital is required from the owners. Thus, we see the shareholders have only been able to withdraw approximately half of the operating cash flow over the five years. The rest has been needed to sustain a growing, capital-intensive business. (On the other hand, a service business will have less capital need, and thus we see the owners can withdraw 80-100 per cent of the annual operating cash inflow.) For our wholesaler, we also keep an eye on the sales growth statistics and on the ratio of working capital to sales. This business has been growing at close to 20 per cent per annum for the last five years, and the working-capital-to-sales ratio has ranged from 17-21 per cent. Going forward, this helps us estimate how much capital will be needed next year if sales grow again by 20 per cent; for example, another \$1 million in sales will require new financing of approximately \$200,000. Where is it going to come from? Banks? Trade creditors? Retained earnings?

These analyses and insights help entrepreneurs manage proactively, rather than making a panic call to their banker when bills are due and the credit line has hit its max. ■



Don Nilson, CMA, FCMA is the Principal at Nilson & Company. He is also a member of the Update Editorial Task Force.

SOURCES AND (USES) OF CASH	2005	2006	2007	2008	2009	Five-Year Total
LESS (MORE) WORKING CAPITAL	(182,984)	(109,930)	(308,866)	(271,883)	(157,623)	(1,031,286)
% of total cash inflow	-41.4%	-21.7%	-49.7%	-30.7%	-21.2%	-33.7%
FROM OPERATIONS (*)	432,255	486,806	620,963	602,101	743,802	2,885,927
	97.8%	96.0%	100.0%	68.0%	100.0%	94.3%
BORROWING (REPAYMENT)	9,692	6,241	(92,769)	282,787	(33,010)	172,941
	2.2%	1.2%	-14.9%	32.0%	-4.4%	5.7%
TO SHAREHOLDERS (*)	(270,623)	(311,655)	(269,520)	(311,197)	(451,680)	(1,614,675)
	-61.2%	-61.4%	-43.4%	-35.2%	-60.7%	-52.8%
FROM (TO) INVESTMENTS	(48,776)	14,190	(78,510)	(373,210)	(97,719)	(584,025)
	-11.0%	2.8%	-12.6%	-42.2%	-13.1%	-19.1%
INCREASE (DECREASE) IN CASH	(60,436)	85,652	(128,702)	(71,402)	3,770	(171,118)
	13.7%	-16.9%	20.7%	8.1%	-0.5%	5.6%
% OF OPERATIONS CASH FLOW	-63%	-64%	-43%	-52%	-61%	-56%
*PRE-OWNER REMUNERATION						