Cash (Flow) is King

The Ultimate Checklist for Businesses

Created by FROEHLING ANDERSON

a Minneapolis-based CPA firm specializing in creative financial solutions

Take charge of your company's **future.**

Even if your business seems healthy and successful, there's a chance that the numbers lying just beneath the surface might reveal an entirely different story.

At Froehling Anderson, we want to help you learn how to take a look underneath the hood of your business, and evaluate its performance with a detailed understanding of the hidden factors at play.

This checklist is designed to arm you with ample knowledge about the concept of cash flow, including why it's so important, what it can tell you about your business, and the potential issues it can cause if you aren't vigilant. We'll also shed light on several topics directly related to cash flow.

Coming off the worst pandemic in more than a century, it's now more important than ever to grasp what cash flow means for your business. The government aid reserves that businesses typically turn to when in dire straits (such as **PPP loans**) have likely dried up — those who face 2021 hardships may be left to fend for themselves.

The most crucial tool you have at your disposal now is foresight, and working with a leading CPA firm like Froehling Anderson is like putting on binoculars.

Get ready to start seeing what's ahead.

The Ultimate Checklist

FROEHLING ANDERSON
Accountants & Advisors

01. Understand the importance of cash flow

a. Learn the definition of cash flow.

b. Learn the role of accounts payable.

c. Learn the role of accounts receivable.

d. See the difference between cash flow and profit.

e. Study the six types of cash flow.

f. Your cash flow statement is the most important yet most often overlooked of all your financial statements.

g. Avoid costly cash flow mistakes.

a. Learn the definition of cash flow

Cash flow: *The movement of liquid assets (i.e. money) in and out of your business.*

Managing your cash flow cleverly is one of the most important aspects of running a business. Much like the flow of water in and out of a lake, your cash flow is likely to fluctuate based on a wide variety of factors — some more difficult to predict than others.

Successful management of your cash flow hinges on your ability to do three things:

Forecast the levels of cash that will flow in and out of your business over a given period of time.

Pad your accounts with enough emergency cash reserves to cover your expenses whenever your forecasting turns out to be inaccurate.

Assess Inventory to free up cash flow from sitting on inventory that could yield revenue.

Obviously, it's not always easy to manage these things, but keeping track of your accounts payable is a great place to start.

b. Learn the role of accounts payable

Accounts payable:
The money you owe.

This includes things like:

- **Rent or mortgage payments**
- **Utilities**
- **Payroll**
- **Vendor invoices**
- **Loan payments**

Knowing how much money you owe and when those payments are due is a huge part of fiscal responsibility. But in order to determine how exactly you'll be able to pay, you'll need to keep tabs on your accounts receivable.

c. Learn the role of accounts receivable

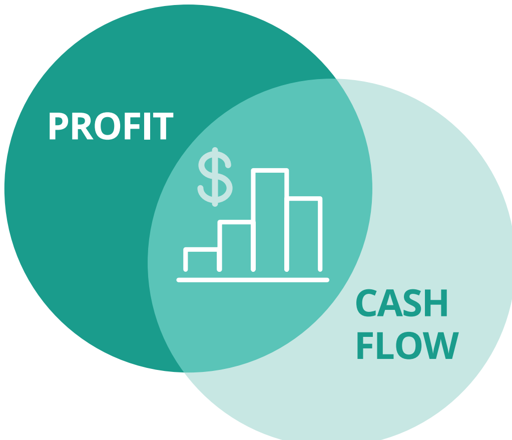
Accounts receivable:
The money that others owe you.

Knowing the amount of cash you have coming your way (and when you're due to receive it) can help you better predict your cash flow, and plan your payments and capital investments accordingly.

There's certainly risk involved in leaning too heavily on your accounts receivable — late payments or defaults can make a negative impact on your cash flow — but a keen awareness of your accounts receivable can nonetheless empower you to make some savvy moves.

Consider the benefit of forming a credit policy to prevent large or overdue customer balances.

d. See the difference between cash flow and profit



Profit
Includes money tied up in accounts receivable

Cash Flow
Measures money flowing out of your business

Both
Measures money flowing into your business

The terms **profit** and **cash flow** aren't interchangeable.

Cash flow compares the amounts of money coming in and out of your business.

Profit compares revenue generated by sales with the expenses involved in those sales.

So if revenue remains tied up in accounts receivable, a business could generate a profit but still have a negative cash flow over the same period of time.

Conversely, if a business decides to **sell a large volume inventory** at a loss in a given period, it would make a negative profit but could still have a positive cash flow.

e. Study the six types of cash flow

Cash Flow Type	Definition	Formula
Free Cash Flow	The difference between cash generated from operations, and cash spent on assets.	**FCF** = operating cash flow - capital expenditures
Operating Cash Flow	The money a business earns from operating.	**OCF** = cash from sales - operating expenses
Net Cash Flow	The difference between money entering your business and leaving it over a given period.	**NCF** = cash received - cash paid
Discounted Cash Flow	A measure of the value of an asset based on the future cash flows it projects to generate.	**DCF** = cash $flow_1/(1+interest\ rate)^1$ + cash $flow_2/(1+interest\ rate)^2$ + ... + cash $flow_n/(1+interest\ rate)^n$
Levered Free Cash Flow	The amount of capital your business has after accounting for financial obligations.	**LFCF** = EBITDA - change in net working capital - capital expenditures - mandatory debt payments
Unlevered Free Cash Flow	The cash flow of your business if you were to entirely ignore interest payments.	**UFCF** = EBITDA - capital expenditures - change in working capital - taxes

Each of these different cash flow types (and their corresponding formulas) can come in handy in specific situations. To learn more about the different types of cash flows and when to use them, contact Froehling Anderson today.

f. Your cash flow statement is the most important yet most often overlooked of all your financial statements.

Your **cash flow statement** is the most intuitive of all your financial statements. It shows data pertaining to every cent of **cash that passes through your business, whether as a product of operations, investments, or financing**.

This information gives both investors and potential future buyers an idea of how valuable your company is.

g. Avoid costly cash flow mistakes

Understanding your cash flow can give you a good idea of when is the right time to hire a new employee or make capital investments, but perhaps more importantly, it can help you steer clear of disaster.

If you're a seasonal business, you'll want to study your cash flow statements from past years carefully. They can help you determine a plan to save your excess cash from your busy season, and ration it throughout your slow season, all while still making savvy purchasing and investing decisions along the way.

Even extremely profitable businesses can accidentally hamstring themselves if they don't keep enough cash on hand to pay their debts. Money tied up in capital investments or accounts receivable can't be accessed efficiently, meaning they may be forced into executing strategies that aren't cost-efficient, and compound their liabilities.

02. Build a better balance sheet

a. Reassess your inventory’s value.

b. Form a clever accounts payable strategy.

c. Be proactive with your accounts receivable.

d. Account for fringe benefits in addition to payroll.

e. Record purchased and leased assets accurately.

f. Leverage good debt to increase your profitability.

a. Reassess your inventory's value

The value of your inventory is likely to fluctuate over time—but what's most important is considering what sitting on inventory means for your cash flow. Without a strategy to move valuable inventory, you could be missing out on impactful ways to positively influence your accounts receivable. For example, consider reducing your inventory to three months instead of six months to help with cash flow.

More likely, though, your inventory's value will depreciate over time. If you don't account for this, you could accidentally overvalue your company and cause yourself problems.

b. Form a clever accounts payable strategy

You can give yourself wiggle room in terms of cash flow by delaying payments until the last minute. Conversely, you might prioritize paying vendors or contractors who offer early payment incentives in order to reduce your overall liabilities.

c. Be proactive with your accounts receivable

Overdue payments can result in cash flow crunches and other burdens. And the longer an invoice remains outstanding, the less likely it is to ever be paid in full.

Here are a few ways to boost the efficiency of your accounts receivable:

- **Automate your invoice reminders**
- **Follow up firmly and quickly on past due receivables**
- **Make payments as easy as possible for your clients**
- **Offer early payment incentives**
- **Form a policy to withhold services from clients with long overdue balances**

d. Account for fringe benefits in addition to payroll

Fringe benefits: Benefits that are provided to employees beyond their normal salary or wages, such as health insurance, retirement contributions, or vacation days.

Fringe benefits are a liability that shouldn't go overlooked, as they impact your bottom line. Make sure to record these benefits as they are earned, not as they are issued.

e. Record purchased and leased assets accurately

Purchased asset — Recorded as an **asset** on your balance sheet.

Operating lease — Excluded from your balance sheet.

Finance lease — Added to both the assets and liabilities sections of the balance sheet.

f. Leverage good debt to increase your profitability

Though debt typically carries a negative connotation, adding debt in smart ways can be a good thing. Don't avoid adding debt to your balance sheet as a blanket rule.

Leveraging debt can empower you to make opportunistic investments that might not be possible based on your current cash flows, such as buying out a competitor or making a real estate purchase.

03. Learn from your **income statement**

a. Learn what an income statement is.

b. Learn the definition of net income.

c. Learn how gains and losses can impact your cash flow.

d. Understand how to manage expenses.

e. Forecast your future.

a. Learn what an income statement is

Your **income statement**, sometimes called a **profit and loss statement (P&L)**, shows your company's revenues and expenses over a given period of time.

Your income statement, balance sheet, and cash flow statement form a trifecta of important financial statements used to report on your company's performance.

b. Learn the definition of net income

Net income: *The difference between a business' income and [its expenses and losses over a period of time](#).*

Calculate your net income

net income = (revenue + value of gains) - (expenses - value of losses)

c. Learn how gains and losses can impact your cash flow

Gains and losses can make it tricky to forecast your cash flow.

For instance, inventory that has been unexpectedly damaged (perhaps due to a storm) would likely depreciate in value — that depreciation counts as a loss.

The inventory may be difficult to sell at the same price, so you'll either have to lower its cost, or accept that you will likely sell less of it than usual. If you haven't accounted for that loss, your drop in revenue could catch you off-guard, and cause cash flow issues.

Other assets such as real estate or stocks may appreciate in value, and if you don't keep track of those gains, you could mistakenly pass on purchasing or investing opportunities that you're fully able to take advantage of.

d. Understand how to manage expenses

One of the most important things your income statement tells you is how much you're spending on certain things.

If it turns out that you're consistently spending more on certain goods than you're earning from the revenue they generate, you'd realize that you either need to adjust your pricing, or stop selling those items.

If you're experiencing high employee turnover and you notice that you're making a wide margin on their labor, you might decide that you can pay them more in order to keep them around longer.

Getting an accurate understanding of your expenses can help you make smart business decisions.

04. Mind the do’s and don’ts of fiscal responsibility

There is much power in simply knowing—knowing where your business sits from a financial perspective. Maintaining positive cash flow is just one aspect of the overall financial strategy that supports your long-term success. Think of positive cash flow as the fuel used to continue to propel your business to growth and stability—with profitability being attainable.

Without a keen sense of how to manage financial operations, or the time necessary to effectively manage it, your business will suffer. Poor or no bookkeeping, overspending, and lack of regular review all lead to fiscal irresponsibility. Here are some do’s and don’ts to help you bolster your financial status and cash flow alike.

DO:

- **conduct regular reviews** of your Key Performance Indicators (KPI's), and compare them to prior periods
- **build a smart budget** based on your projected cash flows
- **evaluate your expenses** in detail to make sure you can justify them
- **compare vendors** and shop diligently for savings opportunities
- **compare and contrast your business** with your direct competitors
- **talk to a CPA regularly** in order to gain valuable insights and clarity

DON'T:

- **take your bank account at face value**; factor in accounts payable and accounts receivable to see the full picture
- **spend freely** without a good understanding of where that money will come from
- **turn a blind eye to small problems** and assume things will turn out fine
- **entirely ignore the risk** involved in spending based on your accounts receivable
- **be casual about overdue balances** owed to you
- **assume too much** about making the best decisions all on your own

04

Mind the do's and don'ts of fiscal responsibility

05. Bolster your business with a leading CPA firm

Elevating your cash flow acuity can help you see your financial picture with a whole new kind of clarity, empowering you to set achievable goals and make savvier decisions than ever before.

Meet with a CPA from Froehling Anderson for a complimentary business review, and start learning to see your business in a whole new way.

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