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Supporting Egypt's Processed Foods Export Industry

Financial Management Controls and Policy

Managing Your Business Toolbox

Distributed By
Agriculture-Led Export Businesses (ALEB)

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Revised for
Agriculture-Led Export Businesses (ALEB)

A USAID Funded Project to
Increase Processed Foods Exports from Egypt

MANAGING YOUR BUSINESS

Management Controls and Policy
From
Managing Your Agricultural Business - A Primer To Understanding and Growing Your Business
By
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MANAGEMENT ACCOUNTING

Article V in a Series of XIV

- **Pro Forma Budgets**
- Pro Forma Cash Flow
- Break Even Analysis
- Profit & Loss Statement
- Balance Sheet
- Changes in Financial Position Statement
- Footnotes
- Glossary of Terms
- Financial Ratios

Overview

Regardless of the status of your business, whether it is in the planning, beginning, or on-going stages, management must initiate an acceptable set of accounting records, commonly referred to as "the books".

The accounting books are divided into several distinct components and, taken as a whole, are called Financial Statements or "the financials" by bankers, investors and shareholders. When any one of these interested parties is asked to take a "stake", hence the term "Stakeholder", in your business, they will typically ask for a look at your "financials". These financial statements are standardized forms developed by accountants and financial managers to record business transactions. Financial statements are designed to report standard accounting practices and follow a fundamental principle of accounting: matching costs and expenses with the income they create.

These components consist of a **Profit and Loss Statement** (also referred to as a ***P & L*** or ***Income & Expense Statement***), a **Balance Sheet** (also called a ***Statement of Financial Position***), **Source and Application of Funds** (also referred to as a ***Cash Flow Statement*** or ***Statement of Changes in Financial Position***) and the accompanying footnotes to the aforestated documents.

A set of accounting books are maintained for two distinct purposes:

- **To report on the financial condition (cost and subsequent profits or losses) of the operations to investors or lenders**
- **To use the reported financial information to plan and budget for the future in order to grow and expand the operations and increase profits.**

The second aspect of the above is critical and the single most important reason to maintaining a set of accounts for any operation. Once an accounting period is finished and the accounts are reported, the results are the classical "water under the bridge". Nothing that any person can do can change the outcome or the results of the report, as it is history. But historical information can provide a benchmark for future operations. Therefore, the good manager will review the results of this "history" and use the information to plan ahead and to initiate changes to the enterprise that will result in "tighter" operations and subsequent stability and long term sustainability of the enterprise. To use an analogy, this is similar to a pilot filing a "flight plan". One knows where one has been, and more importantly, "where one is going!"

Accounting periods can be adjusted to the management skills and interest and need in monitoring the cash flow (income, expenses and profits or losses) for a specified period of time. For example, accurate cost accounting on a daily, weekly or monthly basis in a larger enterprise can reveal financial strengths or weaknesses in the operations and inform managers of appropriate action to be taken to reduce expenses, revise assumptions and improve profit/loss projections for management and shareholders or owners. Normally, monthly or even quarterly reporting is sufficient for a small enterprise.

Additionally, a company will have to prepare statements for financial planning or forecasting. These documents are typically called "pro forma" statements. They consist of a **Budgeted Balance Sheet, P & L Statement**, a **Cash Flow Statement** and a **Break Even Analysis** (usually for start-up business or a radical shift in a businesses' core focus). They are prepared at the beginning stages of forming a business to determine if your business or proposed business is viable and, if so, what capital one will require to proceed. And, based on the accounting reports generated by an on-going business - the **P & L, Balance Sheet** and **Changes in Financial Position** Statements - additional pro forma statements will be generated to plan ahead for the next accounting period. One should review the order in which these forms are given at the top of the first page of this article. This is the order in which these documents are generally prepared, which establishes the accounting reports cycle. Once the first year's reports are generated, the cycle repeats itself.

It is important to establish the format of your P & L Statement and Balance Sheet first to determine the categories and line items one will be recording and reporting, then establish your Chart of Accounts (how you will distribute income and expenses, assets, liabilities and owner's equity), before one starts the budgeting and cash flow processes. This will focus the exercise on all the considerations one must take into account in the planning process.

Finally, you will have to maintain subsidiary accounts. These consist of ***Sales***, ***Purchase*** and ***Payroll*** journals and ***Customer***, ***Vendor***, ***Inventory*** and ***Payroll*** ledgers. These are maintained on a daily basis, are summarized and become a part of the financial reports. See other articles in this series for a description of these documents.

The following articles will discuss in detail each of these accounting documents and provide model templates for guidance to the enterprise. Depending on the size, scope and sophistication of the operation, one will no doubt wish to change some of the line items in these templates. There is nothing wrong with this. The financial documents, first and foremost, are documents that must be applicable to the enterprise's operation. Secondly, they must be practical and understandable by Management in order to utilize the information to manage, sustain and "grow" the operation. **However, thirdly, they must conform to generally acceptable accounting practices (GAAP) if one is to expect a Stakeholder to participate in one's business.**

It is important to note here that there is distinction between Financial Accounting and Management Accounting. Financial Accounting follows a fairly strict format in accordance with GAAP. However, for the purposes of these series of articles, we will be discussing Management Accounting principles. This allows management to format financial documents in a manner that provides more useful information for financial management purposes, and, generally, become more comfortable with the financial information as it applies to their specific company.

Finally, there is a distinction between *cash* and *accrual* accounting. Cash accounting recognizes receivables only when they are received and expenses only when they are paid. Accrual accounting matches income with expenses. Accordingly, receivables are recognized when invoiced regardless of whether they are actually received at the time of invoicing and liabilities are recognized when they are incurred, rather than when they are paid. Accrual accounting gives a more accurate portrayal of the "state of the company" at a given time.

Additional Resources and References

Anderson, Douglas A. 1995. The ***BUSINESS PLAN TOOL BOX*, Preparing a Winning Business Plan from *Managing Your Agricultural Business - A Primer To Understanding and Growing Your Business*.** Bakersfield, CA; Anderson Associates International.

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Managing Your Business
Profit & Loss Statements
Article IX in a Series of XIV

- **Sales**
- Direct (Variable) Cost
- Variable Overhead
- Contribution to Margin
- General & Administrative Expense
- Earnings Before Depreciation, Interest and Taxes (EBDIT)
- Depreciation
- Income (Expenses) From Other Sources
- Earnings Before Interest & Taxes (EBIT)
- Financing Income (Expenses)
- Net Profit
- Retained Earnings

This article will discuss the Management format of the **Profit and Loss Statement**, which is the report typically generated on at least a quarterly basis (every three months), but more generally on a monthly basis. It is a capsule look at the operational income, expenses and profit of the business at the time of the reporting period. It is divided into distinct components that enable a manager or owner to analyze the operational aspects of the business from a financial viewpoint. It is a critical management tool and indispensable to day-to-day operations and survival. Following are definitions of terms and general observations of the components that constitute a Management P & L Statement.

Sales
The Sales line item is the gross revenue of the operation, sometimes referred to as "turnover". Sales should be sorted or reported by Profit Center, Strategic Business Unit (SBU) or Distinct Operation.

Direct (Variable) Costs
This is also referred to in a manufacturing, agroprocessing or retail operation as ***Cost of Goods Sold*** or ***Cost of Sales*** (Financial Accounting Terms). These are the direct costs of producing the product to sell. These costs are almost always variable, rather than fixed. They vary due to the size, scope and timing of the operation. If one chooses to plant one hectare of tomatoes, rather than five hectares, the cost is naturally reduced, and conversely. The Direct Labor component is the labor involved in the direct production of the commodity for sale, as opposed to the administrative, or fixed, labor cost to oversee the operation and get the product to market. The direct labor will always vary according to the size, scope and timing of production. It is usually a wage or "piece-meal" compensation based on labor performed to get the commodity to the point of sale. Line items, e.g., seed, fertilizer, etc. will vary according to the actual direct input needs (costs) of the operation. These components are the integral, or most important factors, of the cost of production and should be accounted for the purposes of monitoring costs in order to control the end result - profits. Additionally, as the grower becomes more sophisticated in tracking the input costs, additional line items may be added or existing line items may be split into more defined operational costs. For instance, a grower may be interested in breaking costs into actual production components, i.e. land preparation, cultural (growing) costs and harvest costs.

Variable Overhead
There are also overhead items that are directly related to production but cannot be allocated to specific projects or products. Under Management Accounting, these are called *mixed costs* or ***Variable Overhead*** costs. Since it is difficult to allocate these expenses directly to a product they should be cost accounted below the Direct Cost of production in the Variable Overhead section on the statement. For instance, an enterprise may hire foremen or supervisors and obligate themselves to an annual salary plus their social costs, but their responsibilities are related directly to production. Variable Overhead labor is usually labor that is hired on an annual (fixed) salary to supervise production and becomes a constant fixed figure. However, since they are directly involved in producing the goods and services the company offers for sale, they should be expensed accordingly. In the event that production declined or ceased these workers would generally be the last to be terminated in the production area. Additionally, commissions (not salaries) paid on sales are directly related to the direct cost of a product and allocated to this section. Finally, that portion of the electricity and repairs and maintenance that can be identified and allocated to the cost of production, while generally fixed, should be included in this category, as they fluctuate with production. These are also called ***Mixed Costs***. All of these are variable and should be accounted for as a variable expense, but as Variable Overhead. For the purposes of Management Accounting these semi-fixed costs are identified as a variable cost, and one should have a separate category or line item for ***Variable Overhead***. Remember that Variable Overhead does not change in respect to volume costs allocated to a specific project or product.

Contribution Margin
In Financial Accounting terms, this category is called ***Gross Profit***. Operations is the exercise that is the main focus of the company, i.e., production and sales of the crop(s) or commodity (product) for sale. **Contribution to Margin** is the profits from operations, i.e. **Sales minus Variable Costs and Variable Overhead.**

General and Administrative Expense
This section of the P & L Statement is also referred to as ***Operating Expense*** or ***Fixed Expense*** as these are costs incurred for "operations" as opposed to "production". These are fixed costs that a company incurs and continues to pay just to be in business. In other words, before a company can start producing a product to sell, it must have the capital, land, buildings, equipment and administrative staff to conduct the production, promotion and sales of the product. While these costs can and will increase as income grows (the company expands), there is a minimum level of costs incurred just to get to the point of, and maintain, production. If sales decrease, some administrative staff may be terminated, office supply costs may be reduced or the cost of utilities may decrease - natural steps taken to reduce overhead during contractions in the economy (macro) or the business (micro). However, these cost line items continue to incur some cost and are, therefore, fixed.

Conversely, Direct Labor, for instance, is proportionate to actual production of the product to sell. The less production, the less labor hired to produce. In the final analysis, even if a crop is not planted or a product not produced - therefore not incurring direct costs - payments still continue on vehicles, equipment, interest, minimal staff to administer the business, staff and office supplies to obtain sales, telephones to conduct business, etc.

Earnings Before Depreciation, Interest & Taxes (EBDIT)
This is the income after Direct Costs, Variable Overhead and General and Administrative Expenses are deducted from gross sales. This line item on the P & L Statement represents the earnings power of the core focus of the company. Since, under Management Accounting, depreciation has not been accounted for yet, this line item shows the real cash flow from operations. This is what a banker looks at to see if a prospective customer for a loan can service debt out of proceeds from the operation. A banker or investor generally does not loan money based on profit, but rather on the ability to pay the loan back out of cash flow (but keeping in mind that the borrower must not operate at a loss in order to cover the cost of operations).

Depreciation
Depreciation, while it is a use of assets, is a non-cash item and should be reflected on the P & L Statement under the cost and earnings from the operation. For purposes of financial analysis and risk analysis, it is important to separate this item under the Management Accounting format. Additionally, as depreciation is not a controllable expense under the management of the Production Manager - who is responsible for production costs - and who generally does not have the final word on committing to capital expenses, he/she should not be penalized with the expense for the purposes of determining production costs and subsequent bonuses or performance evaluations. See ***Article X, Balance Sheet***, for an explanation of depreciation.

Income (Expenses) From Other Sources
Income is then added back and expenses are deducted from other sources. It is important to differentiate income and expenses as a result of one's primary business enterprise (the main source of your income) from incremental income and expenses that are generated by other non-production activities, such as income from renting a building to another party and the expenses created by repairing and maintaining it; income or expense attributable to a restructuring of the organization; interest income from a loan to another party; income from sales of assets; expenses as a result of "extraordinary" (unusual and nonrecurring) charge-offs to the business, etc. Bear in mind that some extraordinary income may be taxed at a different rate than "earned income" or some extraordinary expenses may not be entirely deductible in the accounting period and thus may not be completely deducted. These non-production, "side-line" or extraordinary activities (incremental) are classified as ***Income (Expenses) from Other Sources***.

Earnings Before Interest & Taxes (EBIT)
After all the costs of sales, overhead and depreciation are deducted and other income and/or expenses are added or subtracted for the company (not just operations), this line item recognizes the overall earnings capacity of the organization as a whole. This is a critical element, particularly if Income (Expenses) from other Sources are substantial.

Financing Income (Expenses)
This category separates the cost (expense) of financing the company or recognizes gains from financing and receiving interest, regardless of whether it is earned from the "operations" (the core focus) or the company as a whole.

Net Profit (Net Loss)
The sum of all of the above is the ***taxable income***, and a ***Provision for Income Tax*** line is then established. After the tax provision is made, the company shows a ***Net Profit*** (or ***Net Loss***).

Retained Earnings
Retained earnings are net profits minus taxes, reinvested into the company. Retained Earnings are carried forward to the Balance Sheet and increases Owners Equity. A Net Loss is carried forward to the balance sheet and decreases Owners Equity.

As the year progresses and it becomes apparent to management that a liability exists for income tax, steps may be taken to mitigate this liability and put the profits to other uses, i.e. increase expense supply inventory, pay bonuses, reinvest, acquire additional capital equipment, etc. that will serve to increase the potential in the short and longer term for expansion of the business or increased profits. It is important to note that taxes are usually never eliminated, but they can be deferred and, in the interim, the money will expand the economy in the private sector. On the other hand, it is extremely important to retain some earnings to offset future possible losses or to pay for unexpected expense, e.g. major equipment failure, diversification to new income opportunities, etc.

General Observations
More line items tracked on a P & L Statement gives the enterprise more detailed information on the costs involved and, comparatively, gives the operator more opportunities to manage costs and increase profits. However, the cost line items chosen to report should be easily tracked and manageable. Sophisticated, detailed accounts require a similar level of management skills and proportionate time and costs involved in recording and reporting individual line items.

Do not concern yourself with the terminology that is used interchangeably on an accounting document, such as Direct Costs as opposed to Cost of Goods Sold or Cost of Sales, or Operating Expense as opposed to General & Administrative Expense. This author believes that the term General & Administrative Expense is more descriptive of overhead than Operating Expense, and to a non-accountant it is important that in the process of applying expenses, the manager or owner have a clear definition and understanding where expenses are categorized. **It is more important to understand the terms and apply the terminology you feel most comfortable with (as long as they are technically correct), so that you are able to use the information to your advantage.** As long as you are consistent in reporting and are able to converse with your Stakeholders and understand how you arrived at the figures you are reporting, that is all that matters.

Template for
ANNUAL PROFIT & LOSS STATEMENT
for
[Company Name]
ending
[Date]

Sales [By Profit Center]

Total Sales **Add ⇒ ⇒ ⇒ ⇒__________**

Direct Costs (Variable):

- Material
- Direct Labour
- Equipment Rental
- Transportation
- Other Direct Costs (Expendables). __________
- **Total Direct Costs** **Add ⇒ ⇒ ⇒ ⇒(__________)**
- **% of Total Sales:** **%**

Variable Overhead

- Supervisory Labour
- Fuel/Utilities
- Maintenance Labour
- Maintenance Materials __________
- **Total Variable Overhead** **Add ⇒ ⇒ ⇒ ⇒(__________)**
- **% of Total Sales** **%**

Contribution Margin __________
% of Total Sales: **%**

General & Administrative Expense

- Sales & Marketing
- Research & Development
- General & Administrative Expense
- Miscellaneous Expense __________
- **Total G & A** **Add ⇒ ⇒ ⇒ ⇒(__________)**
- **% of Total Sales** **%**

Earnings Before Depreciation, Interest & Taxes (EBDIT) __________
% of Total Sales **%**

Depreciation Charge - Total (__________)

Income (Expense) from other sources:

- Exchange Gain (Loss) __________
- Valuation/Inflation Adjustments __________
- Other - Non-Operating (Expenses) __________
- ***Total Other Income (Expenses)*** **Add ⇒ ⇒ ⇒ ⇒__________**

Other - Financing Income (Expenses) __________

Earnings Before Interest & Taxes (EBIT): __________

Provision for Income Tax: (__________)

Net Profit: __________

Managing Your Business
Balance Sheet
Article X in a Series of XIV

- **Balance Sheet**
- Current Assets
- Fixed Assets
- Other Assets
- Nonperforming Assets
- Depreciation & Amortization
- Liabilities
- Long Term Liabilities
- Owner/Shareholder Equity

A **Balance Sheet**, also called a ***Statement of Financial Position***, reflects the financial position of the company at the end of a reporting period, such as the end of the month, the quarter or the year. This document really reflects a picture or "camera snapshot" of the company's financial position on a specific date for a specific period of time, including what the company owns (assets), owes (liabilities) and the equity of the owner(s). The P & L Statement shows your sales revenue and related expenses resulting in your net income (or loss). This "bottom line" of the Profit & Loss Statement, whether it is a profit or a loss, is transferred to the Balance Sheet and either increases (in the case of profit) or decreases (in the case of a loss) the equity portion of the Balance Sheet.

The Balance Sheet is divided into two parts that must always equal one another:

Assets = Liabilities + Equity

Assets
Assets are those items your company owns. On a Balance Sheet, these assets are commonly categorized into Current Assets, Fixed Assets and Other Assets.

Current Assets
Current Assets consist of cash and other assets that are expected to be converted into cash or be consumed within a time period of one year or less - the accounting Fiscal Year (twelve months). These may include investments, accounts receivable, notes receivable (sales and other income that have been reported on the P & L Statement but have not been collected yet) that are due the company within a year; inventory, including raw and finished materials and goods in process. Other current assets include prepaid expenses such as insurance premiums or advertising costs. These are expensed out on the P & L Statement over the period of time they are used.

Sometimes assets are not always *liquid*, or easily convertible to cash. Or they may be worth less than book value for a variety of reasons. Old inventory is a good example of this. And some assets may not be recoverable at all. Some accounts receivable may fit in this category. While some statutes in some countries do not allow the discounting or chargeoff of the original value of discounted or nonrecoverable assets, it is important from a Management Accounting standpoint to recognize the true value of these assets so reasonable projections for cashflow purposes can be made. For this purpose a *reserve* line item is established to offset any doubtful value of current assets and to recognize the true value of assets for working capital purposes.

Fixed Assets
Also referred to as ***Capital Assets***, these consist of assets that are durable and can be expected to generate revenue over a period of more than one year. Fixed Assets can include land, buildings, machinery and equipment, office equipment, furniture and fixtures and vehicles. These are entered on the Balance Sheet at original cost (capitalized) and then, as resale or usable value declines (as they wear out), are depreciated over a projected period of time.

Other Assets
This category may include deposits for utilities or telephone that may not be refunded within a year, patents, copyrights and organizational costs. Patents, copyrights and organizational costs have a useful period of time and are usually capitalized and then amortized over that period.

Nonperforming Assets
In a transitional economy, or due to specific laws or statutes, some assets may be underutilized or nonrecoverable. For instance, some taxing authorities do not allow receivables to be written down (discounted) or charged off to bad debt. These become long term receivables and are nonperforming. In other cases, plants (buildings) and equipment may be severely underutilized. Perhaps loans or claims against employees may be nonrecoverable. How should these be treated? They must be treated differently to give the manager a true picture of the financial condition of the company. Moreover, this is critical to establishing a true cost of overhead and pricing a product in order to be competitive. (See ***"Pricing Your Product in a Transitional Economy"*** Series) Accordingly, a ***nonperforming assets*** category should be established with a corresponding separation of depreciation for capital equipment.

Depreciation/Amortization
Usually, taxing agencies establish depreciation schedules, which mandate the period of time a fixed asset must be depreciated out. These are based on the generally expected useful life of an asset before replacement. Accordingly, real estate (improved land and buildings) will have a longer useful life than machinery or a truck, which may have a longer useful life than an automobile. Leasehold improvements are fixed assets that are durable, but because they are attached to non-owned property and generally cannot be removed at the end of the lease term, are ***amortized*** over the useful life, as are non-tangible assets such as patents, copyrights and organizational costs.

Both the monthly depreciation and amortization are recorded as an expense in the Budget and to the account called ***accumulated depreciation & amortization*** on the Balance Sheet, which acts as a reduction to the capitalized (original) cost of the fixed assets. The ***Net of Depreciation & Amortization*** is the present market value of these fixed assets.

It is important to bear in mind that depreciation and/or amortization are non-cash items. In other words, the intent of depreciation is to allow a company to expense and deduct from profits a corresponding amount of declining value of the asset in order to build a cash fund to replace the asset. This means that from a taxable standpoint, the company gets to reduce the tax liability (and payment with cash), while from a cashflow standpoint, cashflow increases. It is generally stated that a company with large amounts of capital assets enjoy a corresponding favorable cash flow, all other things considered, i.e. the company is well capitalized to start with and they are profitable.

Liabilities
Liabilities are those accounts or debts that the business owes others and are generally classified as Current Liabilities (payable in less than one year) and Long Term Debt (payable over more than one year).

Current Liabilities
These are debts or accounts that are expected to be repaid in the fiscal year, including trade accounts payables to suppliers for materials, supplies, etc., short term debt payable to the bank (including the current portion payable within twelve months of the long term debt - referred to as current portion of long term debt), other payables for line items such as payroll taxes and sales taxes, and accrued current liabilities for fringe benefits such as vacation, health benefits and pensions, sometimes referred to as ***social costs***.

Long Term Debt
Long Term Debt consists of loans to be repaid over a period of more than one year. Usually these are loans from bankers or lenders to purchase mortgages for buildings or to purchase capital (fixed) assets.

Owners Equity
Equity is the last category on the balance sheet. It is the value that is left in the company after liabilities are subtracted from assets. Equity summarizes the accumulated wealth of the company. If the enterprise is a stock company, corporation or limited liability company, then the wealth is reflected as common stock (owned by the shareholders). If it is a single proprietorship (a single owner), the line item is called owner's equity. If more than one owner is involved (a partnership), it is called partner's equity.

Payments to the owners are deducted from the equity. This comes in the form of ***dividends*** to the shareholders and ***draws*** to the owner or partners. ***Bonuses*** to the owners are also deducted here. (Bonuses to employees are expensed to the cost of labor). The beneficiaries report dividends, bonuses and draws on their personal income tax reports, as it is personal income.

BALANCE SHEET
[Company Name]
Ending [Date]

[Date]**ASSETS**

Current Assets

Cash on Hand & in the Bank
Accounts Receivable
Notes Receivable
Inventory
Other Current Assets

Less Reserves ( )
Net of Current Assets

Fixed (Working) Assets

Land
Buildings
Leasehold Improvements
Furniture & Fixtures
Vehicles
Machinery & Equipment

Less Accumulated Deprec./Amortization ( )
Net of Depreciation and/or Amortization

Other Assets

Deposits not refundable within one year
Patents, Copyrights
Organizational Costs

Less Accumulated Deprec./Amortization ( )
Net of Depreciation and/or Amortization

Nonperforming (Nonworking) Assets

Long Term Receivables
Plant & Equipment

Less Accumulated Deprec./Amortization ( )
Net of Depreciation and/or Amortization
TOTAL ASSETS

LIABILITIES

Current Liabilities

Accounts Payable
Accrued Payroll
Accrued Taxes on Payroll
Accrued Other Taxes
Short Term Debt
Current Portion/Long Term Debt
Other Payables
Total Current Liabilities

Long Term Liabilities

Long Term Debt
Other Long Term Liabilities
Total Long Term Liabilities

Total Liabilities

OWNER/SHAREHOLDER EQUITY

Common Stock
Retained Earnings
(Less Distributed/Payable Income) ( )
TOTAL OWNERS EQUITY

TOTAL LIABILITIES & OWNERS EQUITY

Managing Your Business
Statement of Changes in Financial Position
Article XI in a Series of XIV

- **Sources of Cash**
- Operations
- Items Increasing Cash
- Items Decreasing Cash
- Financing & Other
- Applications of Cash
- Increase/(Decrease) in Cash
- Net Change in Working Capital

Also referred to as ***Source and Application of Funds***, this financial document summarizes one's cash related activities as it relates to the Profit and Loss Statement and Balance Sheet. This portion of the statement really reflects how you are receiving and applying (using) your working capital. It is a ***cash flow statement*** that shows where your cash came from and where it went. It is important to think in terms of the **use of working capital** when compiling and reading this document.

Source of Cash

The ***source of funds*** can be any category that **increases your cash position**. In other words, regardless if one is working with one's own or someone else's money, it is a plus - a source. Sources of cash come from many areas. It is important to differentiate between day to day ***operations*** and other sources of cash that are usually infrequent or at least not a part of the day-to day operations, which can be categorized as ***financing and other sources***. This allows the manager to focus on recurring and frequent financial activity in order to cover the daily operations' financial requirements with sufficient working capital.

OPERATIONS

Items Increasing Cash

The cash flow statement starts with the retained earnings line, which is carried forward from the P & L Statement. Then one adds ***Items Increasing Cash***, such as depreciation (you get to deduct this from taxes, so it increases your cash position), increase in accounts payable or other liabilities such as wages or taxes owed, or an increase in notes payable (remember, you are working with someone else's money!). These are items that increase one's cash position.

Items Decreasing Cash

Also, in the day to day operations, an enterprise usually extends credit in the form of accounts receivable (A/R). The A/R invoice represents a cost of production in the form of raw materials, wages and other inputs and includes the cost of overhead plus a reasonable profit. You have yet to collect for this money that is "out of pocket". If you are increasing your accounts receivable, you are, in effect, lending money to your customers. Or, if you purchase inventory, which, by its descriptive term, sits until it is used or processed, you do not increase cash. Instead it decreases working capital. And since it directly relates to your operations, these items must be deducted from your cash position under operations. Increases in Accounts Receivable (A/R) and Inventory are ***items decreasing cash***. The difference between the two is added to the Retained Earnings balance at the top of the column and the sum represents your ***cash from operations***.

Financing & Other Sources of Cash
Other sources of cash can be from ***financing***, such as income from lenders, sale of stock, sale of investments or collection of notes receivable (you have financed someone else and are now collecting the principal and interest). ***Reduction of other assets*** are additional sources of cash (you have freed up cash from a nonliquid source), but usually are distinguishable from the day to day operations. The sum of the cash from operations and the cash from financing and other sources represent all the sources of cash to the enterprise.

APPLICATIONS of CASH
If one is spending money (the **application of funds**), it is a negative - an outgo of funds (deducted from your financial condition or situation) - and appears in the next portion of the document. ***Applications of cash*** consist of payments that <u>are typically infrequent and not related to the day to day operations</u>, or they would be included up in the Operations part of the Statement under Items Decreasing Cash. This includes the repayment of loans, whether they are short term or long term, principally because they are artificial (financing) sources of funds as opposed to operational sources of funds.

Purchases or <u>increases</u> in assets are an application or use of funds, also. Again, because they are not a normal conduct of business on a day to day basis, they are not included in the Operations part of the Statement under Items Decreasing Cash. All of the nonoperational items that represent ***applications of cash*** are totaled and carried over to the right side of the Statement in line with the ***Total Cash From Operations and Financing***.

INCREASE (DECREASE) IN CASH
Once the Total of Applications of Cash are deducted from the Total Cash from Operations and Financing, the difference is an increase in Cash if the difference is positive or a (Decrease) if the difference is a negative.

Then the ***Change in Cash Balance*** is taken into account. The Beginning Cash Balance of cash on hand or in the bank (petty cash or cash in the register - not to be confused with Retained Earnings) is deducted from the Ending Cash Balance and the difference is carried over to the right side of the Statement.

Net Change in Working Capital represents the sum of Retained Earnings and Total Cash From Operations and Financing, minus the Application of Cash and then plus (or minus) the Change in Cash Balance.

The format can vary somewhat, but it always begins with the net income or retained earnings from your Income & Expense Statement (P & L Statement) and then shows adjustments to your cash position. And it ends with an increase or decrease in your cash position. This is why it is called a ***Statement of Changes in Financial Position*** or ***Cash Flow Statement***. The next page is an exhibit of such a statement.

Template for Agribusiness
STATEMENT of CHANGES IN FINANCIAL POSITION
For
[Company Name]
Ending [Date]

SOURCES of CASH - Increase (Decrease)

Operations

Net Income After Taxes (Retained Earnings) ______

Add Items Increasing Cash (+)

Depreciation
Increase in Accounts Payable
Increase in Other Payables
Increase in Accrued Liabilities ______

Deduct Items Decreasing Cash (-)

Increase in Accounts Receivable
Increase in Inventory ______
( )

Cash From Operations ______

Financing & Other

Sale of Stock
Proceeds from Short Term Loans
Proceeds from Long Term Loans
Sale of Investments
Collection of Notes Receivable
Reduction of Other Current Assets
Reduction of Other Assets ______

Total Cash From Operations & Financing ______

APPLICATIONS of CASH - Decrease (Increase)

Payment of Dividends
Purchases of Fixed Assets
Repayment of Short Term Loans
Repayment of Long Term Loans
Purchase of Investments
Increase in Notes Receivable
Increase in Other Current Assets
Increase in Other Assets ______

Total Applications of Cash (______)

INCREASE (DECREASE) IN CASH ______

CHANGE IN CASH BALANCE

Ending Cash Balance
Beginning Cash Balance ______

______

Net Change in Working Capital ______

Managing Your Business
Glossary of Terms
Article XIII in a Series of XIV

Accounting	The recording, summarizing, reporting and interpreting of financial transactions
Accounting Equation	Total assets equal liabilities plus capital
Accounts Payable	Invoices to be paid as part of the normal course of business
Accounts Receivable	Debts owed to your company, usually from sales on credit
Accrual Accounting	The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information. Revenues are recognized in the period earned and expenses are recognized in the period incurred in the process of generating revenues
Accumulated Depreciation	(*called book value*) Total accumulated depreciation reduces the beginning value of assets. Each month's accumulated balance is the same as last month's balance plus current month's depreciation
Acid Test Ratio	The ratio of the sum of cash, receivables and marketable securities to current liabilities. This is a test of a company's ability to meet its immediate cash requirements
Amortization	The periodic expense attributed to the decline in usefulness of an intangible asset, such as leasehold improvements, goodwill, organization costs, etc. or the allocation of bond premium or discount over the life of the bond issue
Amortization (Bank Term)	The period over which a loan is repaid in equal monthly payments of interest and principle
Annual Percentage Rate	The annual finance charge; the annual costs of the loan expressed as a percentage of the principle amount
Appraisal	A professional estimate of the value of property.
Assets	The property owned by the company. This includes cash, accounts receivable, inventory, fixed assets and intangible assets such as goodwill and rights to patents
Asset-Liability Management	The joint planning and management of assets and liabilities so that maturities, liquidity and interest rates will produce a desired level of income
Asset Turnover	Sales divided by total assets. Important for comparison over time and to other companies in the same industry
Audit	An examination of the financial books and records of an organization according to professional standards
Balance	The amount owed, unpaid or outstanding
Balance Sheet	A financial statement listing the assets, liabilities, and owners'

	equity (net worth) of the company as of a specific date
Board of Directors	Individuals elected by shareholders to establish corporate management policies. Not generally involved in the day-to-day management of the business
Book Value	The value of an asset as shown in the accounting records
Break-Even Analysis	A financial schedule listing sales, fixed costs and variable costs from which contribution margins, break-even volumes and the amounts above/(below) break-even volumes are calculated
Break-Even Point	The point at which the total income from a service or product equals its total cost
Budget Statement	A financial statement detailing management's plan for sales and expenses for a period of time
Capital	The rights (equity) of the owners in a business enterprise. Capital represents net worth, as well as ownership in an enterprise. Capital can be measured by the excess of assets over liabilities. It is also known as equity
Capital Expenditure	Spending on capital assets such as land, buildings and machinery and equipment (also called fixed assets)
Cash	The bank balance, or checking account balance or real cash in bills and coins. Cash is money that has immediate purchasing power
Cash Flow	The difference between cash coming in and cash going out
Cash Flow Statement	See Statement of Changes in Financial Position
Cash Management	A program that ensures that the amount and timing of cash inflow is equal to or greater than cash outflow
Collateral	Something of value (assets) pledged in return for loans in order to ensure loan repayment
Collection Period Days	Also called ***Days Sales Outstanding*** or DSO. The average number of days that pass between delivering an invoice and receiving the money. The formula is: DSO = (Average Accounts receivable balance) / (average credit sales per day)/365
Commissions	Payments made to salespersons, brokers, etc. for sales performances. Usually calculated on the gross margin in order to ensure a target gross profit as in: Gross margin multiplied by the commissions percentage
Commissions (Bank Term)	An assumed percentage used to calculate commissions expense as the product of this percentage multiplied by gross margin
Common Stock	An equity security that represents ownership in a corporation. This is the first security a corporation issues to raise capital

Analysis	by product line
Impaired Capital	Invested capital that is not worth the full amount of the original investment
Income Statement	Also called an ***income and expense statement*** or ***profit and loss statement***. A summary of revenues and expenses of a business entity for a specific period of time
Interest	The price, interest and other finance costs paid for the use of money, usually expressed as a percentage
Interest Expense	Interest is paid on debts and interest expense is deducted from profits as expenses.
Interest Rate	The percentage rate charged for a loan, plus fees, calculated on the principal balance owed, for the time the money has been used
Internal Controls	Checks and balances built into policies and business procedures for the purpose of protecting the organization against error and fraud
Inventory	Raw Materials, Goods in Process, Finished Goods, Manufacturing Supplies or Expense Supplies (lubricants, petrol, etc.) to be used to manufacture goods
Investment	Anything that is acquired for the purposes of producing income or a profit
Job Costing	Keeping a record of all costs associated with performing a specific job or project for a customer; Accounting programs with job cost capabilities keep track of all materials and services purchased to perform a job. A company may choose to pass on these costs to the customer on a cost-plus basis or simply keep track of those costs as a basis for bidding or making estimates on future projects.
Letter of Intent	Letter acknowledging a commitment to sign when agreed upon terms and conditions are met
Liabilities	Accounts or debts that the business owes others which are divided into current and long-term debt
Limited Partnership	A form of business organization in which one or more of the partners is liable only to the extent of the amount of dollars each has invested. Limited partners are not involved in management decisions, but do enjoy direct flow-through of income and expenses.
Line Item	An entry as it appears on a separate line on a financial statement
Line of Credit	A pre-approved cash amount that a lender is making available to a borrower.
Liquidity	The ability to turn assets into cash quickly and easily

Liquidity Management	The process of ensuring that demand for funds is met
Loan Application	A form used for recording information required to determine whether a borrower will be granted a loan
Loan contract	A legally binding agreement between two or more parties that details the terms and conditions of a loan
Long Term Assets	Assets like machinery and equipment that are expected to last more than one year, which in turn are depreciated over terms of more than one year.
Long Term Interest Rate	The interest and fees charged on long-term debt; This is usually lower than the rate charged on short-term debt.
Long Term Liabilities	This is the same as long-term loans. Most companies call a debt long term when it is on terms of one year or more.
MACRS	Modified Accelerated Cost Recovery System. This is the depreciation system usually defined by taxing agencies.
Marginal Cost	The unit cost of a product. The formula for determining marginal cost is Marginal Cost equals the Change in Cost divided by the change in Overhead.
Margin	The difference between income and expenses, expressed in monetary or percentage terms
Market Share	The percentage of the total available customer base captured by a company
Materials	Included in the cost of sales. These are just not any materials, but materials involved in the production (growing, manufacturing or assembly) of goods for sale.
Maturity	The date when a loan or financial instrument is due
Milestone	A particular business achievement by which a company can be judged
Mission Statement	A statement of an enterprises purpose
Net Cash Flow	This is the change in cash position, an increase or decrease in cash balance.
Net Profit	The operating income less taxes and interest. The same as earnings, or net income
Net Worth	This is the same as assets minus liabilities, and the same as total equity.
Operating Expenses	Also called ***general and administrative expense*** or ***overhead***. Expenses of the business that are not directly associated with the making, production or providing of the goods or services to include administration, technical, and selling expense

Operating Working Capital	This is accounts receivable plus inventory less accounts payable. This is the component of working capital that relates to the operations of the company. Cash, investments and current portion of long term debt tend to be more financing related than operational in nature.
Paid-In Capital	Real money paid into the company as investments. This is not to be confused with par value of stock, or market value of stock. This is actual money paid into the company as equity investments by owners.
Partnership	A form of business organization in which two or more individuals manage the business and are equally and personally liable for the debts of the business
Plant & Equipment	This is the same as ***long-term assets***, or ***fixed assets***, or ***capital assets***.
Pricing	The decision that sets the terms of exchange between a buyer and a seller
Principal	The original loan amount without interest or other charges
Private Placement	A conditional offering or securities that allows a company to issue unregistered securities
Policies & Procedures	Specific directions to carry out company goals, policies and procedures
Product Development	Costs incurred in development of new products: salaries, equipment, test equipment, prototypes, research and development, etc.
Profit	The excess of the selling price over all the costs and expenses incurred in making a sale
Quick Ratio	See Acid Test Ratio.
Ratio	A method of showing a relationship between two numbers or sets of numbers
Ratio Analysis	Comparison of significant numbers from the financial statements, such as current ratio, net quick, return on investment, etc. for decision-making
Receivable Turnover	Sales on credit for an accounting period divided by the average accounts receivables balance
Refinance	An agreement to revise the existing debt by incurring new debt that incorporates or pays off an existing debt
Reserves	Special allocations of capital that usually take three forms. *Statutory* reserves are maintained by banks. *Monetary* reserves are allocated to various accounts to protect against depreciation of assets or bad-debt losses. *Liquidity* reserves are funds held to guarantee the availability of funds to meet expected claims, including Bad Debt Reserves, Reserves for Quality Claims, etc.
Retained Earnings	The total accumulated earnings, which have been retained as

	capital and have not been allocated to a specific purpose and not paid out as dividends to the owners. Also known as undivided earnings. When retained earnings are negative, the company has accumulated losses.
Return On Assets	Net profit divided by total assets. A measure of profitability
Return On Investment (ROI)	Net profit divided by net worth or total equity - yet another measure of profitability
Return On Sales	Net profits divided by sales, another measure of profitability
Sales Break-Even	The sales volume at which costs are exactly equal to sales. The exact formula is: **Fixed Costs/(1-(Unit Variable Cost/Unit Price))**
Sales On Credit	Sales on credit are sales made on account, shipments against invoices to be paid later.
Security	A promise of some value pledged to ensure loan repayment. Security may be provided by collateral or a personal guarantee.
Settlement	The striking of a balance between two or more parties having mutual dealings with one another. Also, the payment of a debt balance by the debtor to the creditor
Shares	Legal instrument(s) received by persons, institutions or legal entities in return for capital invested by them into a corporation or bank
Short Term	Normally used to distinguish between short-term and long-term, when referring to assets or liabilities. Definitions vary because different companies and accountants handle this in different ways. Accounts payable is always a short-term liability, and cash accounts receivable and inventory are always **Short-term Assets** Most companies call any debt of less than one year term short-term debt. Assets that depreciate over more than one year (e.g., plant and equipment) are usually long-term assets.
Short Term Assets	Cash, securities, bank accounts, accounts receivable, inventory, business equipment - assets that last less than one year are expensed or consumed
Social Costs	Costs that are incurred over and above the gross payroll one pays an employee as ***fringe benefits***. These may consist of items such as vacation, health benefits and pensions. This is also referred to as ***payroll burden***.
Sole Proprietorship	A form of business organization in which a single owner has total control over his or her own business and makes all the management decisions
Solvency	The ability to repay all debts
Standard	A measure of comparison; includes numbers, ratios or percentages

Straight Line Depreciation	A method of depreciating an asset evenly over its useful life. The depreciation amount is calculated by dividing the depreciable value by its useful life. The depreciable value is the purchase price of the asset minus any salvage or scrap value the asset will have at the end of its life.
Strategic Partnerships	An agreement with another company to undertake business endeavors together or on each other's behalf; can be for financing, sales, marketing, distribution, or other activities. Check governing laws for restraints concerning this issue.
Taxes Payable	Taxes owed but not yet paid
Template	A predefined "program" or document that contains labels, formulas and other elements so that all you need to do is enter your data in the correct places
Trademark	A word, phrase, symbol or design, or combination thereof, which identifies and distinguishes the source of the goods or services of one party from those of others.
Trend	A series of repeated results showing a pattern
Trend Analysis	A comparison of results from different time periods in order to identify a pattern
Unit Variable Cost	The specific labor and materials associated with a single unit of goods sold. Does not include general overhead
Units Break-Even	The unit sales volume at which the fixed and variable costs are exactly equal to sales. The formula is: **UBE = Fixed costs/(Unit Price-Unit Variable cost)**
Variable costs	These are costs that vary directly with sales volume. Examples would include: production labor, material, sales commissions, and warranty expense.
Variable Interest Rate	A rate which may be changed due to changes in the cost of capital, financial market conditions or bank rates
Variable Rate Loan	A type of loan where the interest rate is tied to a general index, allowing the rate to be adjusted to changes in the market
Variance	The difference between the budgeted or planned amount and the actual amount
Venture Capitalist	Individual or firm who invests money in new enterprises
Working Capital	Current assets less current liabilities; see Operating Working Capital
Write-Off	The process or the result of discounting or writing down accounts or notes receivable or payable