Annex D

A CESO AND WUSC PROGRAM

Mongolia:
Enhancing Resource Management through Institutional Transformation

Cash-flow Management Workshop

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May 2018

Workshop Outline

1. Review of Business Planning
2. Financial statements as part of a Business plan
3. Understanding and using Financial statements
4. Managing Cash-flow
5. Budgeting
6. Practical exercises –historical review, present situation, projections and budgeting

MERIT – access to the mining supply chain

Mining companies will require:

- Quality
- Quantity
- Timeliness

SMEs need well-developed business planning skills to meet these requirements

Business Plan sections

- Introduction
- Current Position
- Competitive Advantage
- Growth
- Marketing
- Operations
- Financial
- Human Resources (people)
- *Social Responsibility*
- *E-Business*

Financial Statements

1. Statement of Assets and Liabilities (**Balance Sheet**) - What the business owns and how much it owes
2. **Income statement** – How much money is being made and spent
3. Statement of changes in financial position (**Cash-Flow statement**) – Where money came from and where it went
4. **Statement of retained earnings** – The amount of money kept in the company by the owners

Balance Sheet

ABC Co.
Balance Sheet
As at March 31, 2012
($ 000's)

Assets		**Liabilities & shareholders' equity**	
Cash	5	Accounts payable	20
Accounts receivable	55	Credit card debt	5
Inventory	50	Bank operating credit	25
Pre-paid expenses	10	Accrued expenses	10
		Taxes payable	5
		Current portion of long-term debt	5
Current asset	120	Current liabilities	70
Vehicles	15	Bank debt	70
Equipment	50	Other long term notes payable	60
Land and buildings	100		
Investments	5	Long-term liabilities	130
Patents/goodwill	10		
Fixed assets	180	Total liabilities	200
		Equity from common shares	25
		Equity from preferred shares	25
		Retained earnings	50
		Total shareholders' equity	100
Total assets	300	**Total liabilities and shareholders' equity**	300

Balance Sheet

- Describes the assets, liabilities and equity/net worth at a particular moment in time
- Assets are usually listed as current and fixed
- Liabilities are listed listed as current and long term
- Owners equity or net worth

Balance Sheet - continued

Evaluating assets: cost versus current value

- **Historical cost method** – goods and services are recorded at the amount actually paid
- **Current value method** – goods and services are recorded at their estimated market value at the time the Balance Sheet is prepared
- Historical cost method is the preferred method for accounting purposes

Income Statement- Manufacturer

ABC Co.
Income statement
For the 3 month period ending March 31, 2012
($ 000's)

Revenue			100
Less:	Direct costs (variable)		
	Cost of goods sold (COGS)		-35
	• Labour expense	20	
	• Raw materials expense/inputs	10	
	• Amortization expense	5	
	Gross margin		65
Less:	Indirect costs (fixed and semi-variable)		
	Operating expenses/SG&A		-25
	• Selling	15	
	• General	5	
	• Administration	5	
	Operating income/EBIT		40
Less:	Other costs		-10
	• Interest expense	8	
	• One-time expenses/(revenue)		
	• Relocation expenses	5	
	• Gain on asset sale	-3	
	Earnings before tax (EBT)		30
Less:	Taxes		-10
	Net profit/earnings after tax (EAT)		20

Income Statement- Wholesale/Retail

ABC Co.
Income statement
For the 3 month period ending March 31, 2012
($ 000's)

Revenue		100
Less:	Direct costs (variable)	
	Cost of sales (COS)	-35
	• Cost to acquire	
	Gross margin	65
Less:	Indirect costs (fixed and semi-variable)	
	Operating expenses/SG&A	-25
	Operating income/EBIT	40
Less:	Other costs	-10
	Earnings before tax (EBT)	30
Less:	Taxes	-10
	Net profit/earnings after tax (EAT)	20

Income and expense statement

- Record revenue and expenses over a time period (usually one year)
- Cash basis - revenue and expenses reported in the time period they were received or paid
- Accrual basis – revenue is recorded when a sale is made—whether or not cash is received at the time. Similarly, expenses are recorded when goods and services purchased are received, not when they are paid for

Accrual and cash-based accounting

When recording revenues

- If a small delivery business provides $2,500 worth of services on a given day, cash-based accounting will not record those sales until the customers actually pay

- Accrual-based accounting would record the $2,500 as revenue right away

Accrual and cash-based accounting

When recording expenses

- If a small delivery business got a fuel bill for $1,000, cash-based accounting would record the expense when the bill is paid
- Accrual-based accounting would record the expense the moment the bill arrived.

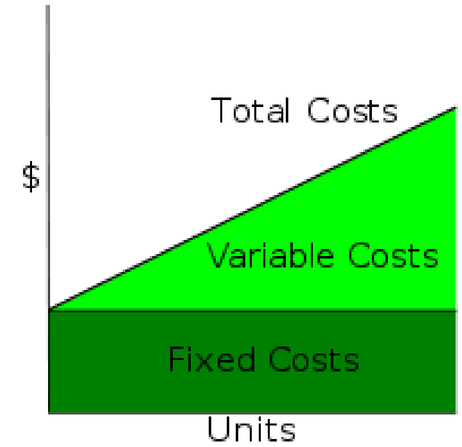
Accrual and cash-based accounting

- The cash method is used predominantly in farming where long periods of time can elapse between the time bills are actually paid and revenues are received. It is also used in small cash-based businesses

- While the accrual method is more complex, it is the most frequently used method because it better matches the timing of revenues and expenses, yielding better management insights

Direct (variable) costs

- Variable costs rise when sales and production go up and they fall when sales and production volumes go down
- Variable costs are the expenses a business incurs directly to make a product or service, or buy a wholesale product for resale
- It is important for business owners to understand the dynamics of these costs so they can stay competitive



Direct costs : Cost of goods sold (COGS)

- The cost of goods sold (COGS) is the sum of all direct costs associated with **manufacturing** a product
- It typically includes money spent on raw materials and labour as well as amortization expenses
- Managers use cost of goods sold to determine the value of units in inventory
- Taken as a percentage of revenue, the cost of goods sold also determines manufacturing efficiency

Direct costs : Cost of sales (COS)

- Cost of sales (COS) indicates how much a retail or wholesale business spends on the products it purchases from suppliers for resale
- It is used only by companies that do not manufacture their own products for sale
- Managers use the cost of sales to assign value to units in inventory
- As a percentage of revenue, cost of sales determines purchasing efficiency

Direct Costs – Amortization (Depreciation cost)

- Amortization expenses account for the cost of long-term assets over the lifetime of their use

- The Tax Department sets annual limits on how much of a long-term asset's cost can be amortized in a given year

Indirect Costs (fixed/overhead) - *operating* expenses

- Selling, general and administrative expenses (SG&A)-are the costs of running a business
- Include rent and utility costs, marketing expenditures, computer equipment and employee benefits
- They do not fluctuate directly with manufacturing or purchase volumes
- They do not directly contribute to the making of a product or delivery of a service

Cash-flow Statement

Cash Flow Forecast													
Month	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
Sales	$9.51	$6.52	$8.80	$8.95	$8.48	$6.94	$8.62	$8.14	$8.08	$9.25	$10.47	$10.87	$104.62
Cost of Sales	$5.28	$3.70	$5.02	$3.92	$3.71	$3.03	$3.62	$3.42	$3.39	$5.11	$5.78	$5.99	$51.96
Cash Inflow													
Cash from sales	$10.51	$7.22	$9.74	$9.90	$9.37	$7.66	$9.53	$9.00	$8.93	$10.23	$11.57	$12.01	$115.67
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Total Cash Inflow	$10.51	$7.22	$9.74	$9.90	$9.37	$7.66	$9.53	$9.00	$8.93	$10.23	$11.57	$12.01	$115.67
Cash Outflow													
													$0.00
Direct labour wages	$1.71	$1.54	$1.25	$1.25	$1.54	$1.54	$0.73	$1.87	$1.54	$1.38	$1.54	$1.06	$16.97
Paid for social insurance organization	$0.43		$0.39	$0.32	$0.36	$0.35	$0.43	$0.66	$0.39	$0.35	$0.39	$0.27	$4.34
Inventory purchases	$4.09	$6.65	$7.38	$3.91	$4.60	$3.28	$2.19	$8.94	$4.39	$5.65	$4.88	$6.93	$62.88
Repairs and maintenance	$1.47	$2.38	$1.68	$1.20	$0.75	$0.31	$0.25	$0.56	$0.31	$1.02	$1.80	$1.08	$12.81
All tax paid										$1.32			$1.32
Other expenses	$0.68	$0.68	$0.12	$1.24	$3.80	$0.15		$0.82	$0.18	$0.89	$0.21	$0.14	$8.91
Purchase of equipment and other			$0.53										$0.53
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Total Cash Outflow	$8.37	$11.26	$11.36	$7.92	$11.04	$5.63	$3.61	$12.85	$6.82	$10.61	$8.83	$9.47	
Cash Flow Surplus / Deficit	$2.14	-$4.05	-$1.62	$1.98	-$1.68	$2.04	$5.93	-$3.85	$2.12	-$0.39	$2.74	$2.54	
Opening Bank Balance	$5.36	$7.50	$3.45	$1.83	$3.81	$2.13	$4.17	$10.10	$6.25	$8.37	$7.98	$10.72	
Closing Bank Balance	$7.50	$3.45	$1.83	$3.81	$2.13	$4.17	$10.10	$6.25	$8.37	$7.98	$10.72	$13.26	

Income tax

- The rules around income tax can be complex
- It is wise to hire an experienced professional accountant to help you steer through the tax laws and understand how they apply in different situations

Cash-flow analysis

- You don’t need fancy software or an excess of detail to plan your cash flow
- Look back and see when you usually have money coming in and flowing out
- If you don’t know exactly when a receivable will come in or if some expenses vary month to month, use an estimate or average

Cash-flow analysis

- Be only as detailed as you need to be
- All you really need to know is – Will we be short or have enough cash this month?
- You can total all your incoming cash in a single lump sum and treat all outgoing cash the same way

Cash-flow analysis

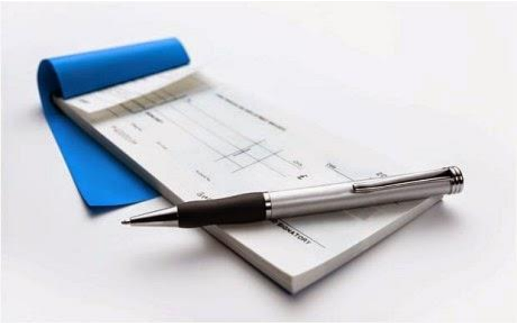
- Choose a timeframe that makes sense for you
- Ideally, you want to look far enough ahead that if you see a tight spot on the horizon, you have enough time to do something about it

How to keep your cash flowing

- Work hard at collecting the money you're owed
- Contact customers often and remind them of their outstanding balance
- Offer pricing discounts to clients who pay early or in cash

How to keep your cash flowing

- Get your clients to pay electronically, cash or by credit card. The money goes into your account instantly, unlike a cheque, which can take weeks to process



How to keep your cash flowing

- Pay your bills at a pace you can manage
- Work this out in advance with suppliers
- Negotiate terms that are sustainable for your business

How to keep your cash flowing

Sell more to your best clients

Good customers are more likely to pay on time, which will also be better for your cash flow

How to keep your cash flowing

- Build good relationships with your customers and suppliers

- Good customer and supplier relationships can help you wring more cash out of your business

How to keep your cash flowing

- You must be firm when it comes to collections
- Entrepreneurs need to be conscientious in pursuing late bills
- Customers have to pay or else you're just financing their business at the cost of your own

How to keep your cash flowing

- Focus on inventory management and product offerings
- If sales are down and inventory turnover is slowing, you have to be aggressive in clearing out stock
- Analyze your product lines to see what's selling and what's just taking up space
- Look to increase sales to help you reduce inventory and weed out unprofitable product lines

How to keep your cash flowing

- Use debt to protect your working capital
- It's important to avoid paying up front for long-term investments, such as equipment purchases or a building expansion; that will just tie up working capital
- You're better off using debt to finance these

How to keep your cash flowing

- Cut waste and streamline operations
- Boost your company's productivity and profitability by eliminating bottlenecks, overproduction, inefficient equipment and other sources of waste
- Employees are your best source of ideas, so get them involved

Budgeting and Projections

A budget is a plan to:

- Control your finances
- Ensure you can continue to fund your current commitments
- Enable you to make confident financial decisions and meet your objectives
- Ensure you have enough money for your future projects

Benefits of a Business Budget

- Manage your money effectively
- Allocate appropriate resources
- Monitor performance
- Meet your objectives
- Improve decision-making
- Identify problems before they occur
- Plan for the future

Creating a Budget

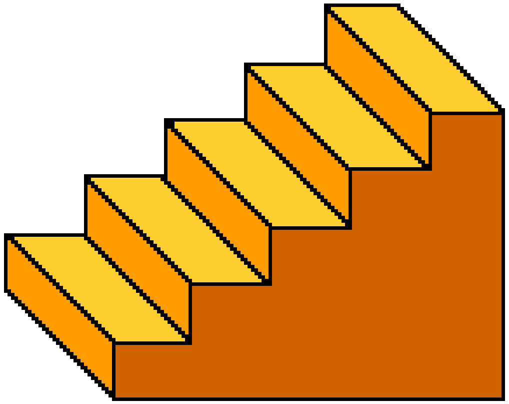
You simply need to work out what you are likely to earn and spend in the budget period

- What are the **projected sales** for the budget period
- What are the **direct costs** of sales
- What are the **fixed costs** or overheads?

Key steps in drawing up a Budget

Make time for budgeting

- If you invest some time in creating a comprehensive and realistic budget, it will be easier to manage and ultimately be more effective



Key steps in drawing up a Budget

Use last year's figures - but only as a guide

- Collect historical information on sales and costs if they are available - these could give you a good indication of likely sales and costs
- Consider what your sales plans are, how your sales resources will be used and any changes in the competitive environment

Key steps in drawing up a Budget

Create realistic budgets

- Use historical information, your business plan and any changes in operations or priorities to budget for overheads and other fixed costs
- Work out the relationship between variable costs and sales and then use your sales forecast to project variable costs
- Make sure your budget contains enough information for you to easily monitor the key drivers of your business

Key steps in drawing up a Budget

Involve the right people

- It's best to ask staff with financial responsibilities to provide you with estimates of figures for your budget
- If you balance their estimates against your own, you will achieve a more realistic budget

What to include in the Budget

- Projected cash flow -your cash budget projects your future cash position on a month-by-month basis

- **Costs** - typically, your business will have three kinds of costs:
  - fixed costs
  - variable costs
  - one-off capital costs

- To forecast your costs, it can help to look at last year's records and contact your suppliers for quotes

What to include in the Budget

- **Revenues** - sales or revenue forecasts are typically based on a combination of your sales history and how effective you expect your future efforts to be

- Using your sales and expenditure forecasts, you can prepare projected profits for the next 12 months. This will enable you to analyse your margins and other key ratios

Using your budget

The three key drivers for most businesses are:

- sales
- costs
- working capital

Any trends towards cash flow problems or falling profitability will show up in these figures when measured against your budgets and forecasts

They can help you spot problems early on if they are calculated on a consistent basis

Review your Budget regularly

Your actual income - each month compare your actual income with your sales budget

- analyse the reasons for any shortfall
- consider the reasons for a particularly high turnover
- compare the timing of your income with your projections and check that they fit

Review your Budget regularly

Your actual expenditure - regularly review your actual expenditure against your budget. This will help you to predict future costs with better reliability

- look at how your fixed costs differed from your budget
- check that your variable costs were in line with your budget
- analyse any reasons for changes in the relationship between costs and turnover
- analyse any differences in the timing of your expenditure

References

- Business Development Bank of Canada https://www.bdc.ca/en/pages/home.aspx
- http://www.infoentrepreneurs.org/en/guides/budgeting-and-business-planning/