

# Difference between cash balance and profit reports example

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### - Difference between cash balance and profit

Lily runs a flower arranging business but is unaware of the accounting and finance aspects of it. Her friend has prepared the financial statements for her, and she would like to know it in detail. From the information given, it is seen that Lily has enough cash on hand. Hence she supplies the services on credit and makes payment in cash. She is also planning to purchase a vehicle and make the payments in cash. The source of additional cash is given which is an inheritance of money. Hence, she has decided to put them in good use for her business.

There is a difference between net cash flow and net profit for the quarter. The reason is that a net profit takes into account all the cash and non-cash activities while cash flow only considers the inflow and outflow of cash from the business. The net profit for the quarter is \$9200 while the net cash flow is \$ (12900). This shows a vast difference. Cash flow is the net inflow or outflow of money from the financing, investing and operating activities. Net profit is the balance that remains with the business after all the expenses are paid off. It also takes into consideration expenses like depreciation. Hence, cash flow and net revenue will always show a difference. A cash budget helps maintain the cash flow of the business.

The net cash flow shows the financial stability of the business and the net profit shows the amount earned during the year after deduction of all the expenses from the revenue earned. Cash flow can be balanced using a cash budget. The various cash payment and receipts eventually reflect on the net income of the business. All the cash payments are expenses of the business. What remains is the net profit.

- What the projected income statement shows about the profitability of the business

The projected income statement is a pro forma statement of revenue which shows the income and the expenses on a probability basis. The projected income statement shows the estimated income and expenses of the business. It shows the net income or loss that the business will earn if it earns a particular revenue. The statement shows an income of \$9200 which is an expected amount if the revenue as per the statement is generated. It shows that the business will earn profits, and it is financially sound. It is easy to learn about a business by studying its projected statements. They show the liquidity position of the business as well as the financial stability. The projected statements also reflect the future stages of the business. They show the revenue expected to be earned as well as the expenses that could be incurred.

- What the cash flow forecast reveals about the business

The cash flow reveals that the business does not have enough cash on hand at the end of the quarter. Lily will find it difficult to make payments in cash due to the negative cash balance. The cash flow statement reveals that Lily's business would not be financially stable due to lack of cash. One can learn about the financial stability of a business by reading the cash flow statement. The negative cash balance is caused due to her drawings and purchase of a vehicle by cash. If one of the items is controlled, the business will not suffer on a negative cash balance. The cash flow statement also shows the various activities where cash has been spent. It separately shows the operating, investing and financing activities in detail. Lily has spent a

large sum in investing activities and lastly has withdrawn a large sum as her drawings. This shows an excess withdrawal of cash during the quarter. Lily might also have difficulty in making salary payment as well as payments to suppliers. The cash invested by her into the business is from inheritance though which she wants to expand the business.

#### (iv) Conclusions and recommendations

I would like to advise Lily to purchase a vehicle by a bank payment or on an installment basis. If that is not possible, she could try to reduce her drawings until there is enough cash in the cash account. Due to drawings and the cash purchase of a vehicle, there runs a negative cash balance. I would like to advise her to stay safe on the cash balance because it might affect the stability of the business. If there is not adequate cash balance, it will not be possible to make cash payments to suppliers and it could affect the business. Preparing a cash budget will help her estimate the cash expenses and also adjust her major expenses according to it. Cash budget provides an insight into the inflow and outflow of cash and will help Lily maintain enough cash on hand at the end of the quarter.

A good understanding of the financial statements is extremely important for Lily. She should then plan to expand her business with the inherited money. Managing the cash will help her earn revenue and make the most of the cash available. Another way is to ask the customers to make payments in cash instead of credit. This will keep the money rolling in the business, and she would not have to suffer from a negative cash balance.

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