Module 3 cash flow estimation bhs427 health care finance (aug2014-1) (slp)

Health & Medicine

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Cash Flow Estimation Cash Flow Estimation The concept of cash flow estimation revolves around the assessment of any and all kindsof investment decisions done in an organization. It is seen as a means to ensure that all the parameters of a business or project are covered and dealt with to forecast the business's or project's value. There are various steps needed to ensure that there is proper estimation of cash in and/or out of the organization. The first would be to estimate the current income of the business. This provides forecast into the net income of the business, and also earnings after the payment of taxes. Secondly, the business needs to look at some of the investments made by the organization in terms of creating future growth. Failure to outlay the investments made by the organization may result in the investments being categorized as capital expenditures (Damodaran, 2011). In the estimation of cash flows, certain advantages and disadvantages may arise from the entire process. Cash flow estimation is seen as a means of attaining an organization's value or rate of return (Juhász, 2011). Cash flows in and out of an organization's projects are often used as inputs in various financial models, which in turn, assist an organization in determining the overall value placed on certain projects. Also, a business's liquidity can be determined through cash flow estimation. It is imperative for businesses to find out if there is the availability of cash at hand, regardless of whether the business or organization is making profits from its operations. Cash flow estimations may forecast if the business is likely to fail, especially if they predict a shortage of cash in the business. Furthermore, cash flows are often used to assess the worth of income generated from certain projects (Damodaran, 2011).

What this implies is that some of the projects carried out by organizations or businesses may fail to bring in the required or intended organizational targets, which means they may be of low quality. Cash flows provide the intended forecast to prevent long-term investments in such projects, which means that most organizations are capable of conducting operations that are composed of large cash items often considered high quality. Lastly, cash flows determine the risks involved with certain projects. Negative earnings need to be identified in cash flow estimations because they tend to become problematic at the end of a financial period. In this case, earnings need to be adjusted to reflect the effects of the accounting management. When an organization’s or business’s earnings tend to be on the negative side or are abnormally low, it is impractical to get into the base year of a business’s operations with that figure (Damodaran, 2011).

Cash flow estimation and its valuation techniques will try to work with the numbers present and somehow bring them into the positive spectrum of the business operations. Sometimes, valuation may occur even if the earnings are positive. This is done when they tend to be lower than expected. The principles in cash flow estimation are; consistency, separation, post-tax, and incremental principles. The consistency principle dictates that there is consistency between the cash flow and rates of discount. This is to allow the proper valuation of cash in and out of the organization. The post-tax principle requires that forecasts be carried out after tax. What this suggests is that it is only after taxation that proper values of a project can be projected. The principle of separation requires cash flows be divided into two, namely; financing and investment sides. This is probably done to ensure that the

organization identifies where all the cash is going (FMW, 2013).

The final principle is the incremental principle. This principle implies that a project is only plausible if it strives to increase total profit, and not just the total cost (FMW, 2013). Organizations in the health care sector can use cash flow estimation depending on the nature of their operations, for example; the purchase of new hospital equipment. The additional expenses and costs can be added into the estimation forecasts (Edwards, 2010). This can allow the hospital's administration to find any possible cut backs that are required so as to reduce the overall costs incurred.

References

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