ASSIGNMENT - 9

WHY ARE WE EXCLUDE CASH WHILE CALCULATING WORKING CAPITAL?

Cash is typically, excluded from the calculation of working capital in certain contents, particularly in more advanced financial analysis, because cash is considered a non-operational asset, while cash in indeed a current asset it doesn't directly contribute to a company's operational efficiency or its ability to generate revenue from core business activities heres a more detailed explanation:

FOCUS ON OPERATIONAL EFFICIENCY:

Working capital measures the efficiency with which a company manages its short-term assets & liabilities tied to its day-to-day operations. Including cash, especially excess cash that is not immediately needed for operations could distort the actual working capital requirements of the business.

For example excess cash setting idle in a bank account doesn't reflect how will the company is managing receivables, inventory or payables which are more closely tried to operational performance.

CASH IS OFTEN A RESIDUAL BALANCE:-

Cash can accumulate for various reasons (profit, financing activities asset sales), & it many not be related to how well the company is managing its working capital cycle. As such, including cash many give an inflated view of liquidity without showing how efficient by the company is running its core operations. Excluding cash helps focus the analysis on receivables, payables & inventory which directly reflect the working capital needed to support the business.

BETTER UNDERSTANDING OF OPERATING LIQUIDITY

When we exclude cash, the resulting calculation (called non-cash working capital) provides a clearer view of the operational liquidity of the company.

This means the analysics focus on has will the campony can cover its short-term obsegations from sales & operations without relying on excess cash resumes.

CASH FLOWS VS WORKING CAPITAL:

Cash is better analyzed in terms of cash flow (such as in a cash flow statement) rather than in working capital. The cash conversion cycle (how long it take to current working capital into cash), is a better metric for understanding how cash is generated from operations, rather than simply including cash in the working capital calculation.

EXAMPLE:

If a company has $500,000 in current assets (including $100,000 in cash) & $300,000 in current liabilities its working capital (using traditional formula) would be.