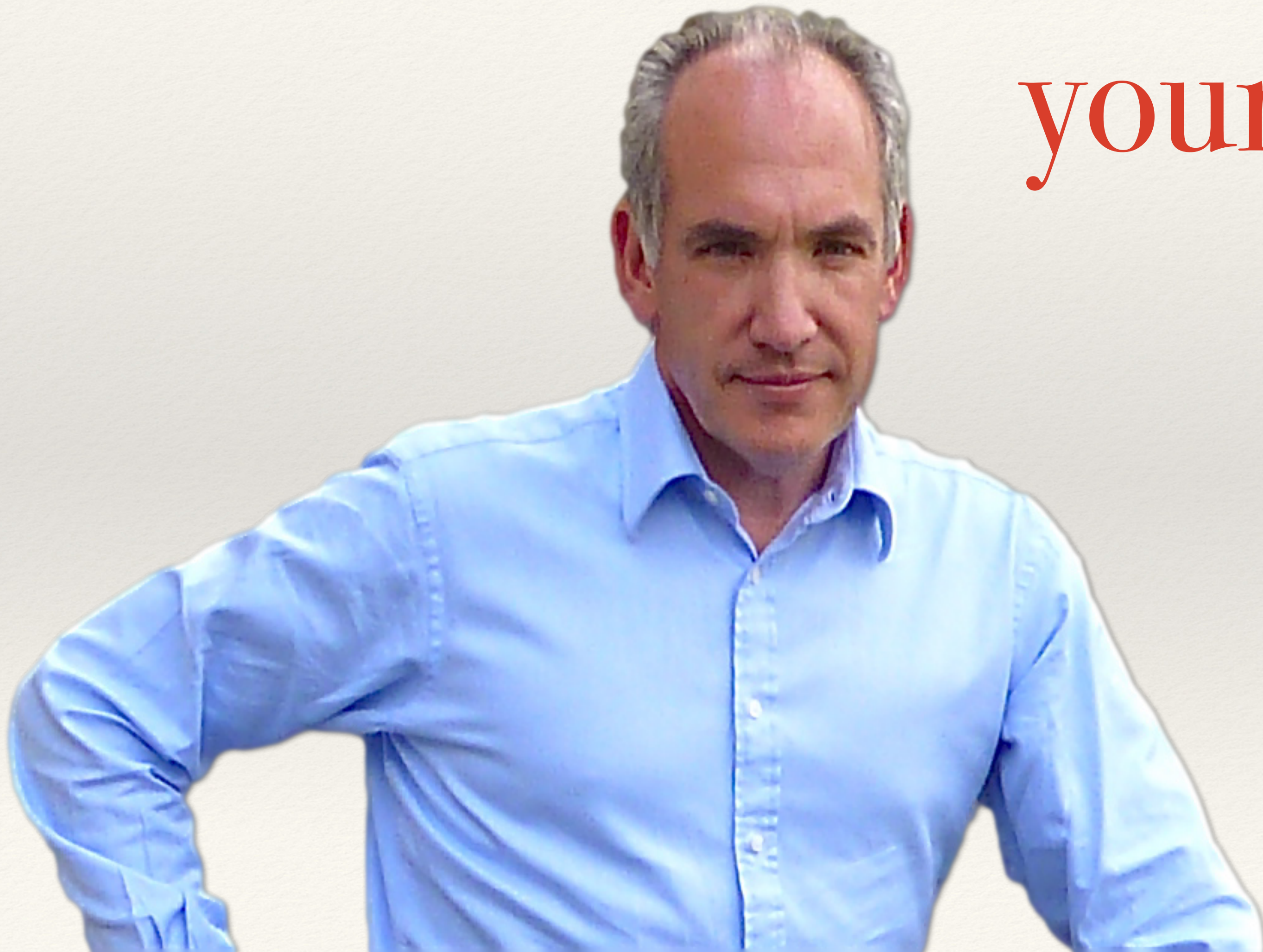


The best way to link your Three Financial Statements



The best way to link your Three Financial Statements

- ❖ The purpose of a Three Statement financial model is to ensure that as assumptions flow through the model, the model makes the correct financial adjustments and continues to provide a financial model of the business

The best way to link your Three Financial Statements

- ❖ The statements in the financial model must be correctly connected so that changes in the Income Statement are reflected correctly in the Balance Sheet and the Cash Flow Statement
- ❖ Critically, your Balance Sheet must always balance.

The best way to link your Three Financial Statements

- ❖ You will be familiar with accounting standards and principles and the use of accrual accounting to enable a true and fair picture of the business to be built up in the financial statements

The best way to link your Three Financial Statements

- ❖ This means that revenue recognition timing, matching and accruals make the Income Statement very different to the Cash Flow
- ❖ It also means that the Balance Sheet needs to reflect these accounting entries
- ❖ The Balance Sheet can subsequently be used to formulate the Cash Flow Statement

The best way to link your Three Financial Statements

- ❖ We start by creating our Revenues and Expenses in the Income Statement...

| |
|-----------------------|
| |
| Financial year ending |
| Revenue |
| Operating costs |
| Gross profit |
| Depreciation |
| Net interest cost |
| Profit before tax |
| Corporate tax expense |
| Profit after tax |
| Dividends |
| Retained earnings |

| |
|------------------------------|
| Financial year ending |
| Non-current assets |
| property plant and equipment |
| total |
| Current assets |
| inventories |
| trade and other receivables |
| cash and cash equivalents |
| total |
| Total assets |
| Capital and reserves |
| share capital |
| retained earnings |
| total |
| Non-current liabilities |
| senior debt |
| total |
| Current liabilities |
| overdraft |
| trade and other payables |
| tax payable |
| total |
| Total equity and liabilities |

| |
|---|
| Financial year ending |
| Operating activities |
| revenue |
| operating costs |
| working capital |
| corporate taxes paid |
| Cash flows from operating activities |
| Investing Activities |
| proceeds from sale of plant and equipment |
| purchase of plant and equipment |
| Cash flows from investing activities |
| Financing activities |
| Interest |
| received on cash balances |
| paid on overdraft (cash shortfall) |
| total |
| Senior debt |
| interest paid |
| drawdowns/(repayments) |
| total |
| Shareholders |
| issue of share capital |
| dividends paid |
| total |
| Cash flows from financing activities |
| Net change in cash and cash equivalents |

The best way to link your Three Financial Statements

- ❖ The Retained Earnings feed into the Retained Earnings on the Balance Sheet

| | | |
|-----------------------|------------------------------|---|
| | Financial year ending | Financial year ending |
| Revenue | Non-current assets | Operating activities |
| Operating costs | property plant and equipment | revenue |
| | total | operating costs |
| Gross profit | Current assets | working capital |
| | inventories | corporate taxes paid |
| Depreciation | trade and other receivables | |
| Net interest cost | cash and cash equivalents | Cash flows from operating activities |
| | total | Investing Activities |
| Profit before tax | Total assets | proceeds from sale of plant and equipment |
| Corporate tax expense | Capital and reserves | purchase of plant and equipment |
| Profit after tax | share capital | Cash flows from investing activities |
| Dividends | retained earnings | Financing activities |
| Retained earnings | total | Interest |
| | Non-current liabilities | received on cash balances |
| | senior debt | paid on overdraft (cash shortfall) |
| | total | total |
| | Current liabilities | Senior debt |
| | overdraft | interest paid |
| | trade and other payables | drawdowns/(repayments) |
| | tax payable | total |
| | total | Shareholders |
| | Total equity and liabilities | issue of share capital |
| | | dividends paid |
| | | total |
| | | Cash flows from financing activities |
| | | Net change in cash and cash equivalents |

The best way to link your Three Financial Statements

- ❖ Depreciation on the Balance Sheet is deducted in the Income Statement

| | | |
|-----------------------|------------------------------|---|
| | Financial year ending | Financial year ending |
| Revenue | Non-current assets | Operating activities |
| Operating costs | property plant and equipment | revenue |
| | | operating costs |
| Gross profit | Current assets | working capital |
| Depreciation | inventories | corporate taxes paid |
| Net interest cost | trade and other receivables | |
| | cash and cash equivalents | Cash flows from operating activities |
| Profit before tax | total | |
| Corporate tax expense | Total assets | Investing Activities |
| Profit after tax | Capital and reserves | proceeds from sale of plant and equipment |
| Dividends | share capital | purchase of plant and equipment |
| Retained earnings | retained earnings | |
| | total | Cash flows from investing activities |
| | Non-current liabilities | Financing activities |
| | senior debt | Interest |
| | total | received on cash balances |
| | Current liabilities | paid on overdraft (cash shortfall) |
| | overdraft | total |
| | trade and other payables | Senior debt |
| | tax payable | interest paid |
| | total | drawdowns/(repayments) |
| | | total |
| | | Shareholders |
| | | issue of share capital |
| | | dividends paid |
| | | total |
| | Total equity and liabilities | Cash flows from financing activities |
| | | Net change in cash and cash equivalents |

The best way to link your Three Financial Statements

- ❖ And added back in the Cash Flow Statement before arriving at Cash from Operations
- ❖ This is calculated in the Fixed Asset schedule

| | | |
|-----------------------|------------------------------|---|
| Financial year ending | Financial year ending | Financial year ending |
| Revenue | Non-current assets | Operating activities |
| Operating costs | property plant and equipment | revenue |
| Gross profit | Current assets | operating costs |
| Depreciation | inventories | working capital |
| Net interest cost | trade and other receivables | Cash flows from operating activities |
| Profit before tax | cash and cash equivalents | Investing Activities |
| Corporate tax expense | total | proceeds from sale of plant and equipment |
| Profit after tax | Total assets | purchase of plant and equipment |
| Dividends | Capital and reserves | Cash flows from investing activities |
| Retained earnings | share capital | Financing activities |
| | retained earnings | Interest |
| | total | received on cash balances |
| | Non-current liabilities | paid on overdraft (cash shortfall) |
| | senior debt | total |
| | total | Senior debt |
| | Current liabilities | interest paid |
| | overdraft | drawdowns/(repayments) |
| | trade and other payables | total |
| | tax payable | Shareholders |
| | total | issue of share capital |
| | | dividends paid |
| | | total |
| | | Cash flows from financing activities |
| | | Net change in cash and cash equivalents |
| | Total equity and liabilities | |

The best way to link your Three Financial Statements

- ❖ Capex feeds back into the PPE on the Balance Sheet

| | | |
|-----------------------|-----------------------|---|
| | Financial year ending | |
| Revenue | | Operating activities revenue |
| Operating costs | | operating costs |
| Gross profit | | working capital |
| Depreciation | | corporate taxes paid |
| Net interest cost | | Cash flows from operating activities |
| Profit before tax | | Investing Activities |
| Corporate tax expense | | proceeds from sale of plant and equipment |
| Profit after tax | | purchase of plant and equipment |
| Dividends | | Cash flows from investing activities |
| Retained earnings | | Financing activities |
| | | Interest |
| | | received on cash balances |
| | | paid on overdraft (cash shortfall) |
| | | total |
| | | Senior debt |
| | | interest paid |
| | | drawdowns/(repayments) |
| | | total |
| | | Shareholders |
| | | issue of share capital |
| | | dividends paid |
| | | total |
| | | Cash flows from financing activities |
| | | Net change in cash and cash equivalents |

| |
|------------------------------|
| Financial year ending |
| property plant and equipment |
| Current assets |
| inventories |
| trade and other receivables |
| cash and cash equivalents |
| total |
| Total assets |
| Capital and reserves |
| share capital |
| retained earnings |
| total |
| Non-current liabilities |
| senior debt |
| total |
| Current liabilities |
| overdraft |
| trade and other payables |
| tax payable |
| total |
| Total equity and liabilities |

| |
|---|
| Financial year ending |
| Operating activities |
| revenue |
| operating costs |
| working capital |
| corporate taxes paid |
| Cash flows from operating activities |
| Investing Activities |
| proceeds from sale of plant and equipment |
| purchase of plant and equipment |
| Cash flows from investing activities |
| Financing activities |
| Interest |
| received on cash balances |
| paid on overdraft (cash shortfall) |
| total |
| Senior debt |
| interest paid |
| drawdowns/(repayments) |
| total |
| Shareholders |
| issue of share capital |
| dividends paid |
| total |
| Cash flows from financing activities |
| Net change in cash and cash equivalents |

The best way to link your Three Financial Statements

- ❖ Working Capital changes relate to the Current Assets and Current Liabilities on the Balance Sheet
- ❖ They are connected to Revenues and Expenses in the Income Statement but adjusted in the Cash Flow Statement to reflect the actual cash paid or received

The best way to link your Three Financial Statements

- ❖ Revenues and Operating Costs affect the Receivables and Payable on the Balance Sheet

| | | |
|-----------------------|------------------------------|---|
| Financial year ending | Financial year ending | Financial year ending |
| Revenue | Non-current assets | Operating activities |
| Operating costs | property plant and equipment | revenue |
| Gross profit | total | working capital |
| Depreciation | Current assets | corporate taxes paid |
| Net interest cost | trade and other receivables | Cash flows from operating activities |
| Profit before tax | total | Investing Activities |
| Corporate tax expense | Total assets | proceeds from sale of plant and equipment |
| Profit after tax | Capital and reserves | purchase of plant and equipment |
| Dividends | share capital | Cash flows from investing activities |
| Retained earnings | retained earnings | Financing activities |
| | total | Interest |
| | Non-current liabilities | received on cash balances |
| | senior debt | paid on overdraft (cash shortfall) |
| | total | total |
| | Current liabilities | Senior debt |
| | trade and other payables | interest paid |
| | total | drawdowns/(repayments) |
| | Total equity and liabilities | total |
| | | Shareholders |
| | | issue of share capital |
| | | dividends paid |
| | | total |
| | | Cash flows from financing activities |
| | | Net change in cash and cash equivalents |

The best way to link your Three Financial Statements

- ❖ Changes in Working Capital from one period to the next are reflected in the Cash Flow Statement
- ❖ You have to think about this in terms of sources and uses of cash...

The best way to link your Three Financial Statements

- ❖ Accounts Payable - Money you owe to your suppliers
 - ❖ If Accounts Payable go down - you have paid your suppliers - its a use of cash
 - ❖ If they go up - they have extended you credit - its a source of cash
- ❖ Accounts Receivable - Money you are owed by your customers
 - ❖ If Accounts Receivable go down - you have been paid by your customers - its a source of cash
 - ❖ If they go up - you have extended credit to your customers - its a use of cash

The best way to link your Three Financial Statements

- ❖ Understanding sources and uses of cash is critical to ensuring that your cash flow statement correctly reflects whether cash is increasing or decreasing and the working capital changes are one area where this can be confusing.

The best way to link your Three Financial Statements

- ❖ Financing is next
- ❖ You may need a debt schedule to record all interest payments and maturities
- ❖ Interest payments are a frequent source of circularity and have to be handled carefully.

The best way to link your Three Financial Statements

- ❖ Interest expenses start on the Income Statement

- ❖ The Debt balance is on the Balance Sheet

| Financial year ending |
|-----------------------|
| Revenue |
| Operating costs |
| Gross profit |
| Depreciation |
| Net interest cost |
| Profit before tax |
| Corporate tax expense |
| Profit after tax |
| Dividends |
| Retained earnings |

| Financial year ending |
|------------------------------|
| Non-current assets |
| property plant and equipment |
| total |
| Current assets |
| inventories |
| trade and other receivables |
| cash and cash equivalents |
| total |
| Total assets |
| Capital and reserves |
| share capital |
| retained earnings |
| total |
| Senior debt |
| total |
| Current liabilities |
| overdraft |
| trade and other payables |
| tax payable |
| total |
| Total equity and liabilities |

| Financial year ending |
|---|
| Operating activities |
| revenue |
| operating costs |
| working capital |
| corporate taxes paid |
| Cash flows from operating activities |
| Investing Activities |
| proceeds from sale of plant and equipment |
| purchase of plant and equipment |
| Cash flows from investing activities |
| Financing activities |
| Interest |
| received on cash balances |
| paid on overdraft (cash shortfall) |
| total |
| Senior debt |
| interest paid |
| drawdowns/(repayments) |
| total |
| Shareholders |
| issue of share capital |
| dividends paid |
| total |
| Cash flows from financing activities |
| Net change in cash and cash equivalents |

The best way to link your Three Financial Statements

- ❖ Changes in debt principal amounts and interest are reflected in the Cash Flow Statement

| Financial year ending | Financial year ending | Financial year ending |
|-----------------------|--|--|
| Revenue | Non-current assets property plant and equipment total | Operating activities revenue operating costs working capital corporate taxes paid |
| Operating costs | | |
| Gross profit | Current assets inventories trade and other receivables cash and cash equivalents total | Cash flows from operating activities |
| Depreciation | | Investing Activities proceeds from sale of plant and equipment purchase of plant and equipment |
| Net interest cost | Total assets | Cash flows from investing activities |
| Profit before tax | Capital and reserves share capital retained earnings total | Financing activities |
| Corporate tax expense | Non-current liabilities senior debt total | Interest received on cash balances paid on overdraft (cash shortfall) total |
| Profit after tax | Current liabilities overdraft trade and other payables tax payable total | Senior debt interest paid drawdowns/(repayments) total |
| Dividends | Total equity and liabilities | Shareholders issue of share capital dividends paid total |
| Retained earnings | | Cash flows from financing activities |
| | | Net change in cash and cash equivalents |

The best way to link your Three Financial Statements

- ❖ The final step is to link up the Cash
- ❖ Cash from Operations
- ❖ Cash from Investing
- ❖ Cash from Financing
- ❖ = Closing Cash Balance on the Balance Sheet

The best way to link your Three Financial Statements

- ❖ If the model is correctly set up the Balance Sheet will balance

| Financial year ending | Financial year ending | Financial year ending |
|-----------------------|------------------------------|---|
| Revenue | Non-current assets | Operating activities |
| Operating costs | property plant and equipment | revenue |
| | total | operating costs |
| Gross profit | Current assets | working capital |
| Depreciation | inventories | corporate taxes paid |
| Net interest cost | trade and other receivables | Cash flows from operating activities |
| | cash and cash equivalents | Investing Activities |
| | total | proceeds from sale of plant and equipment |
| Profit before tax | Total assets | purchase of plant and equipment |
| Corporate tax expense | Capital and reserves | Cash flows from investing activities |
| Profit after tax | share capital | Financing activities |
| Dividends | retained earnings | Interest |
| Retained earnings | total | received on cash balances |
| | Non-current liabilities | paid on overdraft (cash shortfall) |
| | senior debt | total |
| | total | Senior debt |
| | Current liabilities | interest paid |
| | overdraft | drawdowns/(repayments) |
| | trade and other payables | total |
| | tax payable | Shareholders |
| | total | issue of share capital |
| | | dividends paid |
| | | total |
| | | Cash flows from financing activities |
| | | Net change in cash and cash equivalents |
| | Total equity and liabilities | |

The best way to link your Three Financial Statements

- ❖ In summary...
- ❖ Net income from the Income Statement connects to the Balance Sheet and the Cash Flow
- ❖ Depreciation is added back
- ❖ Capex is deducted from the Cash Flow and is reflected in the Fixed Assets (PP&E) on the Balance Sheet
- ❖ Financing affects the Balance Sheet debt and equity and are reflected in the Financing section of the Cash Flow
- ❖ Interest from the Cash Flow connects to Interest in the Income Statement
- ❖ The Sum of the closing cash balance is derived from the close at the end of last period plus the cash from operations, investing and financing and fed back to the Balance Sheet
- ❖which then balances!

The best way to link your Three Financial Statements

