

# **CASH AND FINANCIAL MANAGEMENT**

## **STUDY TEXT**

**Qualifications and Credit Framework**

**Q2022**

This Study Text supports study for the following AAT qualifications:

AAT Level 4 Diploma in Professional Accounting

AAT Diploma in Professional Accounting at SCQF Level 8

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## STUDY TEXT

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# INTRODUCTION

## HOW TO USE THESE MATERIALS

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chance of success in your AAT assessments.

They contain a number of features to help you in the study process.

The sections on the Unit Guide, the Assessment and Study Skills should be read before you commence your studies.

They are designed to familiarise you with the nature and content of the assessment and to give you tips on how best to approach your studies.

## STUDY TEXT

This Study Text has been specially prepared for the revised AAT qualification introduced in 2022.

It is written in a practical and interactive style:

- key terms and concepts are clearly defined
- all topics are illustrated with practical examples with clearly worked solutions based on sample tasks provided by the AAT in the new examining style
- frequent activities throughout the chapters ensure that what you have learnt is regularly reinforced
- 'pitfalls' and 'examination tips' help you avoid commonly made mistakes and help you focus on what is required to perform well in your examination
- 'Test your understanding' activities are included within each chapter to apply your learning and develop your understanding.

### ICONS

The study chapters include the following icons throughout.

They are designed to assist you in your studies by identifying key definitions and the points at which you can test yourself on the knowledge gained.



#### Definition

These sections explain important areas of Knowledge which must be understood and reproduced in an assessment.



#### Example

The illustrative examples can be used to help develop an understanding of topics before attempting the activity exercises.



#### Test your understanding

These are exercises which give the opportunity to assess your understanding of all the assessment areas.



#### Foundation activities

These are questions to help ground your knowledge and consolidate your understanding on areas you're finding tricky.



#### Extension activities

These questions are for if you're feeling confident or wish to develop your higher level skills.

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Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

# Cash and profit

## Introduction

This chapter demonstrates how important cash is to a business. It looks at how cash differs from profit.

### ASSESSMENT CRITERIA

Types of cash receipts and payments (1.1)  
Reconcile profit with movement in cash (1.2)  
Cash movements of non-current assets (1.4)

### CONTENTS

- 1 Types of cash flow
- 2 Cash flow versus profit
- 3 Calculating cash flows
- 4 Reconciling profit to cash flow

# 1

## Types of cash flow

### 1.1 The importance of cash flow

The term **cash** in this unit is used to describe bank account balances as well as coins and notes; and cash payments include cheque payments, BACS, direct debits and standing orders.

The majority of businesses will wish to make a profit. This means that, over a period of time, revenue needs to exceed costs. However, even if the business is making a profit, it must also have **cash funds** available to pay suppliers, employees and other expenses when due.

### 1.2 Types of cash flow

There are different types of cash flow that a business is likely to have:

- Regular receipts and payments such as sales, purchases and expenses.
- Receipts and payments of a long-term nature, known as capital receipts and payments, such as the raising of share capital or the purchase of non-current assets.
- Payments made to the owners of a business either in the form of drawings for a sole trader or partnership or dividends for a company.
- Other costs such as the payment of taxes to the government.
- Unusual or exceptional receipts or payments, for example, cash received from the sale of a non-current asset.

A business will have different types of receipts and payments. The typical types of cash flows that you will come across are described below.

### 1.3 Cash inflows

- **Regular revenue receipts** for a business will be cash sales and cash from customers that have purchased goods on credit.
- **Capital receipts** will include cash raised by issuing shares or raising a loan.
- Other types of capital cash inflow such as the proceeds from the sale of non-current assets, a tax refund or the receipt of government grants. These are likely to be **irregular cash inflows**.

### 1.4 Cash outflows

- **Regular revenue payments** will include payments for cash purchases, cash paid to payables, wage payments, payment of bills, and cash payments of expenses.
- **Capital payments** could include the repayment of loans or the purchase of non-current assets. When new non-current assets are purchased this may be for a large sum on just one date or it may take the form of regular payments if, for example, the asset is acquired under a lease or hire purchase agreement.
- Businesses will also be likely to make payments for corporation tax, VAT and PAYE. These may be regular such as the monthly PAYE payments or one-off payments each year such as the annual payment of corporation tax.
- Payments will also be made to providers of finance such as dividends to shareholders and interest payments to banks and other providers of finance. The timing of these payments will vary but, for example, companies usually pay any dividend twice a year; a small interim dividend during the year and a larger final dividend after the year end.
- Finally, in a sole trader's business or a partnership, there may be either regular or irregular payments made to the owner or partners in the form of drawings.

### 1.5 Exceptional cash flows

The cash flows described above are the normal, everyday types of cash flows that most businesses will have. However in some cases there will also be exceptional cash flows which are **not part of normal business** operations.

- Exceptional cash outflows might include payment of legal damages or redundancy costs.
- Exceptional cash inflows might include items such as receipts from an insurance company for damaged inventory.



### Test your understanding 1

Cash receipts and payments take many different forms but they can be broadly categorised into regular, capital, exceptional and drawings.

Complete the table by selecting the correct description from the list of options below to match the type of cash receipt or cash payment (not all options need to be used).

Type of receipt or payment	Description
Irregular receipts	
Capital payment	
Regular revenue receipt	
Exceptional payment	
Exceptional receipt	
Regular revenue payment	
Annual disbursement	
Drawings	

**Options:**

- A Payment of electricity bill
- B Receipt from an insurance claim
- C Proceeds from the disposal of non-current assets
- D Payments made to the owners of the business
- E Lease new machinery
- F Pay corporation tax for the year
- G Payment of a redundancy package
- H Customer paying their debt



**3.3 Cash receipts from receivables****Example**

Opening receivables are £10,000 and closing receivables are £14,000. Revenue for the period has been £12,000. Assuming that all the sales were on credit. How much cash has been received from receivables in the period?

**Solution**

To calculate the cash received in relation to sales it is possible to use the trade receivables control account:

Trade receivables			
Opening balance	10,000	<b>Cash received</b>	<b>8,000</b>
Sales	12,000	Closing balance	14,000
	22,000		22,000
	22,000		22,000

Instead of using a T account:

$$\begin{aligned}
 \text{Cash received} &= \text{sales} + \text{opening balance} - \text{closing balance} \\
 &= 12,000 + 10,000 - 14,000 \\
 &= 8,000
 \end{aligned}$$



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