

FINANCIAL FOUNDATIONS

An Educational Ebook Series for Small Business Owners

BOOK 11

How to Calculate Cash Flow

Calculate cash flow clearly and use it to guide decisions.



TLC Business Solutions · Expert Bookkeeping & Accounting Services

How to Calculate Cash Flow

FINANCIAL
FOUNDATIONS

A TLC BUSINESS
SOLUTIONS
EDUCATIONAL SERIES



CHAPTER 16

How to Calculate Cash Flow *(Without a Finance Degree)*

*A simple, practical guide to cash flow
calculation
for small business owners.*

TLC Business

How to Calculate Cash Flow

CHAPTER 16

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How to Calculate Cash Flow

41 - INTRODUCTION

Cash Flow Made Simple

Cash flow sounds like a term reserved for CFOs and finance professors. It isn't. At its heart, calculating cash flow is just **tracking movement** — money that comes in and money that goes out.

If you have ever balanced a checkbook, watched a tipping jar fill up, or wondered where last month's deposit went, you already understand cash flow. The only new skill is naming the pieces and writing them down on purpose.

Here is the idea in one sentence: **cash flow is the movement of money in and out of your business over a period of time.** Every dollar that arrives — from customer payments, loan proceeds, or your own contributions — and every dollar that leaves — for rent, payroll, inventory, loan payments, and taxes — tells the real-time story of your business's financial health.

WHY IT MATTERS

Profit tells you whether your business *should* work. Cash flow tells you whether your business *actually* works right now. A business can be profitable on paper and still run out of money to make payroll next Friday. That gap is what this chapter helps you close.

Throughout this chapter we will keep the language plain and the steps practical. No accounting degree required — just a willingness to look honestly at the numbers you already have.

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92 - METHODS

The Direct Method vs. The Indirect Method

Accountants build a formal cash flow statement in one of two accepted ways. You do not need to memorize either, but you will hear the names, so here is a plain-language overview.

The Direct Method

The direct method lists your **actual cash received** and **actual cash paid**, category by category, much like a detailed checkbook register. It is intuitive and easy to read — you see the real dollars moving. The catch: most accounting software does not generate it automatically, so it is rarely used in formal reporting.

The Indirect Method

The indirect method starts with the **net income** from your income statement (your profit) and then adjusts it back to cash. It adds back non-cash expenses like depreciation, and adjusts for changes in working capital — for example, an increase in accounts receivable or inventory means cash is tied up and gets subtracted; an increase in accounts payable means you have held onto cash and gets added.

FOR THE SMALL BUSINESS OWNER

The indirect method is what QuickBooks, Xero, and most accounting packages produce automatically, so it is what you will see in your reports. But when you are calculating cash flow yourself — by hand or in a spreadsheet — the **direct, cash-in-and-cash-out approach** is the most practical starting point. That is exactly what the next section gives you.

Both methods arrive at the same destination: your *net change in cash* for the period. They simply take different roads to get there. Use whichever one your tools support — and use the simple formula below to sanity-check the result.

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99 - THE FORMULA

A Simple 3-Step Formula for Small Business Owners

Strip away the accounting vocabulary and cash flow comes down to one formula you can run on the back of an envelope:

THE CASH FLOW FORMULA

Starting Cash + Cash In - Cash Out = Ending Cash

That ending cash becomes next period's starting cash — the cycle repeats.

1

STARTING CASH

Write down exactly what was in your business bank account at the *start* of the period (a week, a month, or a quarter).

2

CASH IN

Add every dollar that came in: customer payments, loan proceeds, owner contributions, interest earned, refunds received.

3

CASH OUT

Subtract every dollar that left: vendor payments, payroll, rent, loan *principal*, owner draws, taxes, asset purchases.

A Worked Example

Say your boutique started June with \$12,000 in the bank. Here is what the month looked like:

CASH IN	AMOUNT
Customer sales collected	\$18,500
Loan proceeds (equipment)	\$5,000
Total Cash In	\$23,500

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CASH OUT	AMOUNT
Inventory purchases	\$7,200
Payroll & payroll taxes	\$6,400
Rent & utilities	\$3,100
Loan principal payment	\$1,000
Owner's draw	\$2,000
Total Cash Out	\$19,700

PLUS: IT IN

Starting Cash \$12,000 + Cash In \$23,500 - Cash Out \$19,700 = Ending Cash \$15,800.

Your bank balance should now read about \$15,800. If it does not, the difference is your next investigation — usually an unrecorded transaction or a payment that has not cleared yet.

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04 - WATCH-OUT

Identifying the “Hidden Drains” on Your Cash

This is the single biggest source of confusion for business owners, so read it twice: **profit and cash are not the same thing**. Your income statement reports *expenses*. Your bank account reports *movement*. Several things drain cash without ever appearing as an expense on your income statement. We call them the hidden drains.

1. Loan Principal Payments

When you make a loan payment, only the *interest* portion is an expense on your income statement. The *principal* portion reduces a liability on your balance sheet — it is not an expense — yet it still leaves your bank account. This is why a business can show a healthy profit and still feel cash-poor every month.

2. Owner’s Draws & Distributions

Taking money out of the business for personal use reduces your equity, not your expenses. The cash is gone, but your income statement never records a thing. For owners who treat the business account like a personal ATM, this drain is the silent budget-killer.

3. Asset Purchases

Buying a delivery van, a new oven, or a laptop is not an expense — it becomes an asset on your balance sheet (depreciated over time). But the cash left the building the day you wrote the check. Big equipment buys can drain months of reserves in a single afternoon.

4. Inventory Buildup & Prepaid Expenses

Cash tied up in unsold inventory, or paid ahead for insurance and subscriptions, is cash that has moved out without yet matching an expense. It will eventually show up, but in the meantime it is locked away.

THE LESSON

Track what actually *leaves your bank account*, not just what your income statement calls an expense. When you calculate cash flow using the formula in Section 03, include every one of these hidden drains in your **Cash Out** total. That is the only way the number tells the truth.

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45 - TOOLS

Tools for Tracking: Software Reports or a Spreadsheet

You do not need fancy software to calculate cash flow, but if you already use accounting software, it will do the heavy lifting for you. Here are the two practical paths.

Path A: Use Your Accounting Software

If you use QuickBooks, Xero, or a similar platform, run the **Statement of Cash Flows** (the indirect method, generated automatically from your books). Pair it with a **Cash Flow by Period** or **Banking & Cash** summary report, then reconcile the ending balance to your actual bank statement. If the two match, your books are telling the truth.

- **Statement of Cash Flows** — shows operating, investing, and financing cash activity for the period.
- **Cash Flow Forecast / Projection** — projects the next 4–13 weeks based on expected receipts and payments.
- **Bank Reconciliation report** — confirms your software balance agrees with the bank.

Path B: Build a Simple Spreadsheet

No software? A spreadsheet works just as well. Set up three columns and a running balance, then update it weekly.

DATE	CASH IN	CASH OUT	RUNNING BALANCE
Start of week	—	—	\$12,000
Mon — customer payment	\$3,200	—	\$15,200
Wed — payroll	—	\$4,800	\$10,400
Fri — rent	—	\$2,000	\$8,400

THE GOLDEN RULE

Consistency beats complexity. A five-minute spreadsheet you update every Friday is worth more than a perfect report you never open. Pick the same day each week, sit down with your bank feed, and record what actually moved. Do it for eight weeks and you will see patterns you never noticed before.

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96 - SURVIVAL METRICS

Why Knowing Your “Burn Rate” and “Runway” Matters

Two numbers every owner should know by heart: how fast you are spending cash, and how long your cash will last. Together they tell you whether you are flying comfortably or flying on fumes.

Burn Rate

Your **burn rate** is the average amount of cash your business spends each month. Add up your total Cash Out for the last three months and divide by three. That average monthly spend is your burn rate. If you spent \$18,000, \$21,000, and \$15,000 over the last three months, your burn rate is roughly **\$18,000/month**.

Runway

Your **runway** is how many months you can keep operating at your current burn rate before cash runs out. It is a simple division:

YOUR RUNWAY

$$\text{Cash on Hand} \div \text{Monthly Burn Rate} = \text{Months of Runway}$$

Example: \$54,000 in the bank ÷ \$18,000 monthly burn = 3 months of runway.

WHY IT MATTERS

Knowing your runway turns panic into planning. Three months of runway tells you it is time to act now — accelerate collections, trim spending, or line up financing. Nine months gives you breathing room to grow deliberately. Either way, you are making decisions from a number instead of a feeling. Even profitable businesses should know these two figures, because profitability does not pay the bills — cash does.

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47 · RECAP

Key Takeaways

If you remember nothing else from this chapter, remember these seven points:

- ✓ **Cash flow is simply cash in minus cash out.** It is tracking movement, not finance magic.
- ✓ **Two methods exist** for a formal statement — the indirect method is what your software generates automatically; the direct, cash-in-and-cash-out approach is what you use by hand.
- ✓ **Starting Cash + Cash In – Cash Out = Ending Cash.** That ending cash becomes next period's starting cash.
- ✓ **Profit is not cash.** Watch the hidden drains: loan principal, owner's draws, asset purchases, and inventory buildup all leave your bank without showing up as expenses.
- ✓ **Use your software's Statement of Cash Flows,** or build a simple three-column spreadsheet with a running balance. Reconcile it to your bank statement.
- ✓ **Consistency beats complexity.** Update your numbers the same day every week.
- ✓ **Know your burn rate and runway.** Cash on hand + monthly burn = months of runway. These two figures turn guesswork into planning.

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98 · SERIES CONCLUSION

Mastering Your Financial Foundations

You have reached the final chapter of the **Financial Foundations** series — all sixteen of them. That is no small thing.

Together we have traveled from the balance sheet to the income statement, from debits and credits to cost of goods sold, from cash vs. accrual accounting to the real-world impact of cash flow on your business. You have learned how profit and cash differ, how to improve cash flow, how to spot a client who costs more than they bring in, how GAAP and separation of duties protect you, and how to pay yourself compliantly. Now you know how to calculate the lifeblood of it all — cash flow — without needing a finance degree.

That is the point of this entire series. Financial mastery is not about memorizing formulas or becoming an accountant. It is about **understanding your own numbers well enough to make confident decisions**. When you can read your balance sheet, trust your income statement, and calculate your cash flow, you stop reacting to your business and start *leading* it.

A WORD FROM TENA

For thirty years I have sat across the table from small business owners who felt overwhelmed by their numbers. Every single one of them already had what it took — they just needed the foundations translated into plain language and a reliable system. You now have both. Don't let the knowledge sit on a shelf. Pick one report this week, open it, and look at it honestly. That is how foundations become mastery. I am proud of the work you have done to get here, and the TLC team is ready to walk beside you for whatever comes next.

Tena Wallace

Senior Accountant · TLC Business Solutions, Inc.

Ready to put your foundations to work?

At TLC Business Solutions, our mission is simple: **we help improve cash flow and profitability**. Whether you need a cash flow forecast built for your business, help cleaning up your books, or a steady advisor in your corner, we are here for it.

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Build Your Financial Foundations with TLC

TLC Business Solutions helps small business owners strengthen bookkeeping, accounting, payroll, tax consulting, financial management, and practical decision-making systems so the numbers are clean, useful, and ready for growth.

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