Operating Cycle Work Sheet

Most businesses cannot finance the operating cycle with accounts payable financing alone so working capital financing—in the form of net profits or borrowed funds--is needed to cover the shortfall. In the operating cycle, accounts receivable are analyzed by the number of days it takes to collect an account. Inventory is analyzed by the average number of days it takes to turn over the sale of a product (from the day it comes in your door to the point it is converted to cash or an account receivable). Accounts payable are analyzed by the number of days it takes to pay a supplier invoice.

From the operating cycle, you can also determine the dollars required to support one day of accounts receivable and inventory and the dollars provided by a day of accounts payable. Let's consider ABC Clothing's operating cycle (see below): Had the company maintained accounts receivable at Year 1 levels in Year 2, it would have freed up $20,500 in cash flow ($4,110 x 5 days). Likewise, the 10-day improvement in inventory management in Year 2 enhanced cash flow by $28,770 ($2,877 x 10 days).

ABC Clothing Inc.

	Year 1	Year 2
Accounts Receivable Days	30	35
Inventory Days	90	80
Operating Cycle	120	115
Accounts Payable Days	-32	-29
Days To Be Financed	88	86
Purchases	$935,000	$1,095,000
$ Per Day Accounts Receivable	$2,740	$4,110
$ Per Day Inventory	$2,055	$2,877
$ Per Day Accounts Payable	$2,562	$3,000

* Calculations are as follows:

Accounts Receivable Days = (Accounts Receivable x 365)/Sales

Inventory Days = (Inventory x 365)/Cost of Goods Sold

Accounts Payable Days = (Accounts Payable x 365)/Purchases

Purchases = Cost of Goods Sold + Ending Inventory - Beginning Inventory

$ Per Day Accounts Receivable = 1/365 x Sales

$ Per Day Inventory = 1/365 x Cost of Goods Sold

$ Per Day Accounts Payable = 1/365 x Purchases

Now that you've seen how it's done, here's an Operating Cycle Work Sheet you can use in your own business.

	Year 1	**Year 2**
Accounts Receivable Days		
Inventory Days		
Operating Cycle		
Accounts Payable Days		
Days To Be Financed		
Purchases	$	$
$ Per Day Accounts Receivable	$	$
$ Per Day Inventory	$	$
$ Per Day Accounts Payable	$	$

* Calculations are as follows:

Accounts Receivable Days = (Accounts Receivable x 365)/Sales

Inventory Days = (Inventory x 365)/Cost of Goods Sold

Accounts Payable Days = (Accounts Payable x 365)/Purchases

Purchases = Cost of Goods Sold + Ending Inventory - Beginning Inventory

$ Per Day Accounts Receivable = 1/365 x Sales

$ Per Day Inventory = 1/365 x Cost of Goods Sold

$ Per Day Accounts Payable = 1/365 x Purchases