

# **CASH FLOW STATEMENTS**

- To provide information about:
  - o Cash Receipts
  - o Cash Payments
  - o Net Change in **cash** resulting from operating, investing and financing activities
- To reconcile the beginning and ending cash balances
- The statement of cash flows provides answers as to:
  - o Where did the cash come from during the period?
  - o What was the cash used for during the period?
  - o What was the change in the cash balance during the period?
  - o Is the entity generating sufficient cash flows from operations to meet cash requirements?
- Cash flow statements helps investors, creditors and other interested parties to evaluate the following about the entity:
  - o Ability to **generate future cash flows**
  - o Ability to **pay dividends** and **meet obligations**
  - o Reasons for the **difference in profit** and **net cash provided (used) by operating activities**
  - o Cash investing and financing transactions for the period
- **Managers** also find cash flow data an essential input in managing the day-to-day operations of the entity
- Gives the entity information whether the entity will be able to **continue to thrive and invest in new ideas** or whether they will need **external funding** for their investments.
- **Classification of Cash Flows:**
  - o **Operating Activities**
  - o **Investing Activities**
  - o **Financing Activities**

## **Operating Activities**

- The entity's **principal revenue-generating** activities
  - o Sales of goods and services
  - o Activities not classified in investing or financing activities
- Cash inflows and cash outflows arising from the operating activities are a **valuable input** into the **decision-making processes** of internal and external users of the financial information.
- **Positive Cash Flows:** are good indicators that the operations of the business can **generate sufficient cash flows** to **maintain/expand** the current level of operations, repay debt, and pay dividends.
- Insights into the **business viability**
- This source of cash is considered the **best measure** of whether the entity can:
  - o **Generate sufficient cash to continue as a going concern** by paying their debts as they fall due
  - o **Whether there is additional cash for dividends, or expansion.**

- Monitoring **operating cash inflows/outflows** enables management of an entity to assess whether the entity will be able to **finance its future expansions internally** or if additional funds are needed, to decide whether they will be obtained through borrowing (investing) and/or issuing shares (financing).

### Investing Activities

- The **acquisition and disposal** of long-term assets
  - Purchasing and selling NCA
  - Lending Money
  - Collecting Loans
- Cash **outflows** arising from investing activities are an indicator that an entity:
  - Has invested in **NCA** that are intended to generate income
  - Available for **future dividends** to equity investors or expansion

### Financing Activities

- Affects the **size and composition** of contributed equity and borrowing, and include:
  - Obtaining cash from issuing debt
  - Repaying the amounts borrowed
  - Obtaining cash from shareholders
  - Paying dividends to shareholders
  - Buying back shares
- Cash **inflows** arising from financing activities are **useful in predicting future cash outflows** in the form of ***interest to lenders***.

### NON-Cash Activities

- Significant financing and investing activities that **do not affect cash** are not reported in the body of the statement of cash flows, but are reported in the notes.
- These include:
  - Issue of shares to purchase assets
  - Conversion of debt into ordinary shares
  - Issue of debt to purchase assets
  - Exchanges of property, plant & equipment
- This information in the notes, together with the information of the statement of cash flows provides users with a **more comprehensive** picture of the entity's investing activities and how it has financed them.

### Format of the Statement of Cash Flows

- **Operating Activities** are reported using two methods:
  - **Direct**
  - **Indirect**
- **Direct Method:**
  - **Cash Receipts – Cash Payments = Net Cash Provided (Used) by Operating Activities**
- **Indirect Method:**

- Goes from an **accrual basis** to a **cash basis**

Company Name		
Statement of Cash Flows		
Period Covered		
<b>Cash flows from operating activities</b>		
(List of individual items)	<u>XX</u>	
Net cash provided (used) by operating activities		XXX
<b>Cash flows from investing activities</b>		
(List of individual inflows and outflows)	<u>XX</u>	
Net cash provided (used) by investing activities		XXX
<b>Cash flows from financing activities</b>		
(List of individual inflows and outflows)	<u>XX</u>	
Net cash provided (used) by financing activities		<u>XXX</u>
<b>Net increase (decrease) in cash</b>		<u>XXX</u>
<b>Cash at beginning of period</b>	<u>XXX</u>	
<b>Cash at end of period</b>	<u>XXX</u>	

#### Preparing the Statement of Cash Flows

- 3 Sources of Information to Prepare the Statement of Cash Flows:
  - Statement of Financial Position (compare this year's and last year's)
  - Current Period's Income Statement
  - Additional Information
- **Operating Activities**, only major classes of operating receipts and payments:
  - **Cash receipts from customers**
  - **Cash receipts from interest/dividends**
  - **Cash payments to suppliers**
  - **Cash payments for operating expenses**
  - **Cash payments for tax**
  - **Cash payments for interest**

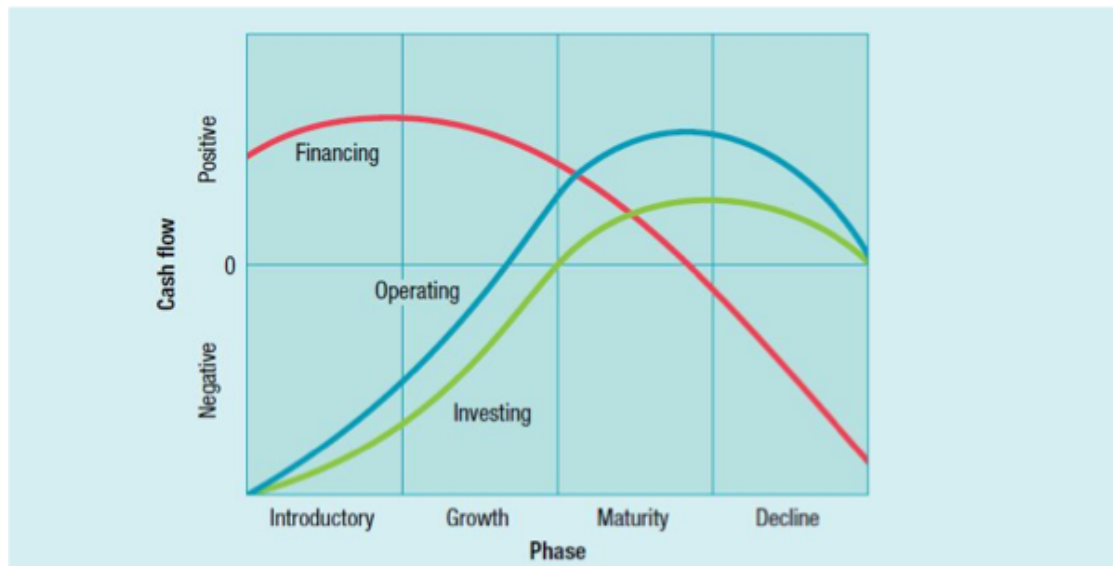
#### Preparing Cash Flow Statement (INDIRECT METHOD)

- **Starts with profit** and converts/reconciles to Net Cash Provided by Operating Activities.
- Adjustments are required:
  - Items affecting **profit** but not cash (e.g. depreciation)
  - Timing differences (e.g. changes to accounts receivables, accounts payable)
  - Items affecting **profit** but are **not operating activities** (e.g. revenue received from sale of land/plant)

Current assets and current liabilities	Adjustments to convert profit to net cash provided by operating activities	
	Add to profit	Deduct from profit
Accounts receivable	Decrease	Increase
Inventory	Decrease	Increase
Prepaid expenses	Decrease	Increase
Accounts payable	Increase	Decrease
Accrued expenses payable	Increase	Decrease

### The Entity Life Cycle

- Phases are:
  - Introductory
  - Growth
  - Maturity
  - Decline



#### Introduction Phase

- Revenues are **LOW**
- Net Income may be **negative (losses)**
- **Negative Cash Flow from operating activities**
- **Negative Cash Flow from investing activities**
- **External Financing (Positive CF from Financing)**

#### Growth Phase

- **Increasing** Revenues
- Net Income becomes **Positive**
- **Increasing** CF from operations
- Continuing **negative** CF from investing
- **Decreasing** positive CF from financing