



# Statement of Cash Flows

**M B G Wimalarathna**

(FCA, FCMA, MCIM, FMAAT, MCPM)(MBA-PIM/USJ)

# Introduction

Statement of cash flows clearly denotes **cash inflows** and **outflows** of the entity and end result of **net cash position** for the given particular period of time.

Cash is the **most liquid current asset** of the entity which carries significant level of importance (as well as risk) in operational activities. (Cash refers cash in hand & cash equivalents)

An entity could take following actions to enhance/improve cash position.

- Enhance cash revenue (expansion/diversifications)
- Expedite/enhance collection from trade debtors
- Reduce unnecessary cash investment in stocks and other STCA
- Sale of (**idle**) assets
- Seek low cost sources of finance (both ST & LT)
- Control Operational & maintenance expenditures (not cut or minimize)
- Defer capital expenditures (has to manage; tradeoff)
- Maximum utilization of creditors' support (ethically)

Management of cash is pivotal for the success of an entity. Users will basically assist/analyze following by perusing cash flow statement.

- ❑ Ability to generate cash. (now and future)
- ❑ Ability to meet financial commitments/obligations including settlement of borrowings & dividends.
- ❑ Sources of cash generation and their nature.
- ❑ Ability to obtain external finance.

# Statement of Cash Flows : Format

Cash flow statement is a key element which represents overall sets of financial statement. Hence, format of the cash flow statement is also governed by the accounting standards.

Cash flow statement can prepare & present either in Direct or Indirect method.

Generally, cash flows will be presented by categorizing in to following 03 areas.

## 1. Operating Activities

Cash inflows/outflows from major/key operational activities.

Receipts from customers (trade debtors)	xxxx
Payments to suppliers (trade creditors)	(xx)
Payments of other expenditures (utility)	(xx)
Inflows/(Outflows)	<u>xx/(xx)</u>

## 2. Investing Activities

Presenting cash inflows & outflows from investing activities which mainly comprised with movement (addition/disposal) of NCA.

Cash inflows from NCA	xxxx
Cash outflows from NCA	<u>(xx)</u>
Net cash inflow/(outflow)	<u>xx/(xx)</u>

## 3. Financing Activities

Depicts cash inflows & outflows with the affect of changing the composition of NCL. (including equity)

Cash inflows from NCL	xxxx
Cash outflows from NCL	<u>(xx)</u>
Net cash inflow/(outflow)	<u>xx/(xx)</u>

# Summary

Area	Cash inflows	Cash outflows	Link to other statements
Operating activities	<ul style="list-style-type: none"><li>• Receipts from customers</li><li>• Interest received</li><li>• Dividends received</li></ul>	<ul style="list-style-type: none"><li>• Payments to suppliers and employees</li><li>• Interest paid</li><li>• Taxes paid</li></ul>	Revenue and expenses items in the income statement
Investing activities	<ul style="list-style-type: none"><li>• Sale of property, plant and equipment</li><li>• Receipt of loan payments</li><li>• Sale of equity in other entities</li></ul>	<ul style="list-style-type: none"><li>• Purchase of property, plant and equipment</li><li>• Purchase of equity in other entities</li></ul>	Assets in the balance sheet
Financing activities	<ul style="list-style-type: none"><li>• Borrowing cash</li><li>• Proceeds from issuing shares</li></ul>	<ul style="list-style-type: none"><li>• Repaying borrowed cash</li><li>• Payments to acquire or redeem the entity's shares</li><li>• Payment of dividends</li></ul>	Liabilities in the balance sheet

# Presentation of Cash Flow Statement

In conclusion, cash flow statement denotes following in the given order.

- Net cash flow from operating activities.
- Net cash flow from investing activities.
- Net cash flow from financing activities.
- Total cash flow at the period end.
- Cash balance at the beginning of the period.
- Cash balance at the end of the period.

# Profitability Vs Cash flows

Reconciliation of cash flows from operational activities with the operating profit of an entity for a particular period shall basically be considered in this task.

Operating profit differs from operational cash flows due to following reasons.

- Accrual Vs Cash concept.
- Non - cash items available.
- Working capital increase/decrease.

Hence, under indirect method, this need to be adjusts at the beginning of cash flow statement within the operational activities category.



# Points to Note

Generally, perusal of cash flow statement communicates following alarming / warning signals to users/management/decision makers.

- Cash received < Cash paid.
- Operating cash outflow.
- Cash receipts from customers < Cash payments to Suppliers.
- Cash from operating activities < Operating Profit. (not same as others)
- Inflows from investing activities are inconsistent.
- Proceeds from borrowings > Repayment of borrowings.

# Ratio Analysis : Cash Flow Statement

Commonly applicable ratios;

Ratio	Calculation
Cash adequacy ratio	$\frac{\text{Cash from operating Activities}}{\text{Capital expenditure} + \text{Dividends paid}}$
Cash flow ratio (liquidity)	$\frac{\text{Cash from operating activities}}{\text{Current liabilities}}$
Debt coverage ratio (solvency)	$\frac{\text{Non-current liabilities}}{\text{Cash from operating activities}}$
Cash flow to sales ratio (profitability)	$\frac{\text{Cash from operating activities}}{\text{Net sales}}$