Cash-Flow Statement

A cash-flow statement is an essential financial document that provides a detailed overview of the cash inflows and outflows of a business during a specific period. It helps stakeholders understand how cash is generated and used, which is crucial for assessing the liquidity and financial health of the company. Here's a breakdown of its key components and purposes:

Components of a Cash-Flow Statement

1. **Operating Activities:**

• Inflows: Cash receipts from sales of goods and services, receipts from royalties, fees, commissions, and other revenue.
• Outflows: Cash payments to suppliers for goods and services, payments to and on behalf of employees, payments for other operating expenses, interest payments, and income tax payments.

2. **Investing Activities:**

• Inflows: Cash receipts from the sale of property, plant, and equipment, sale of investment securities, and repayment of loans.
• Outflows: Cash payments to acquire property, plant, and equipment, purchase investment securities, and make loans.

3. **Financing Activities:**

• Inflows: Cash receipts from issuing shares, borrowing through loans, and other forms of financing.
• Outflows: Cash repayments of amounts borrowed, payments of dividends, and payments for repurchasing shares.

Objectives or Uses of Cash Flow Statement:

(1) Useful for short term financial planning: A cash-flow statement provides information for planning the short-term financial needs of the firm. Since it ideas information regarding the sources and utilisation of cash during a period, it becomes easier for the management to assess whether it will have adequate cash to day-to-day expenses and pay the trade payables in time, whether it will have cash to pay the long-term loans and interest thereon and whether it has huge cash to pay for the purchase of fixed assets or not.

(2) Useful in preparing the cash budget: A cash flow statement prepared for future period is helpful in preparing a cash budget. It informs the management the surplus or deficit periods of cash, i.e., in which months the receipts of cash be in excess of payments and in which months the payments will be in excess of receipts. It helps in planning the investment of surplus cash in short-term investments to plan short-term credit in advance for deficit periods.

(3) Comparison with cash budget: A cash budget is prepared at the commencement of the year, whereas a cash flow statement is prepared at the end of the year.

A comparison between the two helps in ascertaining the extent to which the financial resources of the firm have been generated and used according to the plan. issues of variances between the figures of two statements can be analyzed and proper corrective measures may be taken.

(4) Study of the trend of cash receipt and payment: A cash flow statement reveals the speed at which the cash is being generated from trade receivables, inventory and other current assets and the speed at which the current abilities are being paid. It enables the management to assess the true position of the in future.

(5) It Explains the Deviations of Cash from Earnings: A firm may earn huge profits yet it may have paucity of cash or when it suffered a loss it may still have plenty of cash. A Cash flow statement explains the reasons for it.

(6) Helpful in ascertaining Cash Flow from Various Activities Separately: A Cash flow statement aims at highlighting the Cash flow from operating, investing and financing activities separately. It indicates how much cash has been generated or used in these activities.

(7) Helpful in Making Dividend Decisions: The amount of dividend must be deposited in a separate 'Dividend Bank A/c' within 5 days of the declaration of such dividend. Hence the management takes the help of cash flow statement to ascertain the position of cash generated from operating activities which can be used for payment of dividend.

(8) Test for the Managerial Decisions: It is a general rule that fixed assets should be purchased from funds raised from long-term sources like issue of shares, debentures, long-term loans etc. and these should be repaid out of cash generated from operating activities. The cash flow statement shows whether this policy has been properly followed by the management or not.

(9) Useful to Outsiders: Cash flow statement helps the investors. Debenture holders, bankers, lenders, supplier's of credit etc. to analyse the financial position of the enterprise and they can take proper decisions on the basis of such analysis.

Limitations of Cash-Flow Statement:

(1) Not suitable for Judging the Liquidity: It does not present true picture of the liquidity of a firm because the liquidity does not depend upon cash alone. Liquidity also depends upon those assets which can be converted into cash easily. Exclusion of these assets obstructs the true reporting of the ability of the firm to meet its liabilities when they become due for payment.

(2) Possibility of Window-dressing: The possibility of window-dressing higher in case of cash position in comparison to the working capital position of a firm The cash balance can be easily manoeuvred by postponing purchases and other payments and by rapidly collecting cash from trade receivables before the balance sheet date. Hence, a fund-flow statement presents a more realistic picture that cash-flow statement.

(3) It ignores non-cash transaction: Cash-flow statement ignores non-cash transactions like purchase of fixed assets by issuing shares or debentures, conversion of debentures into shares, issue of bonus shares etc. Hence, the true position of an enterprise cannot be judged by cash-flow statement.

(4) It ignores the actual concept of accounting: It is prepared on cash b
ad hence ignores one of the basic concepts of accounting, namely accrual concept

(5) No substitute for an Income Statement: A Cash Flow Statement is not a substitute of Income Statement which takes into account both cash and non-cash items. Therefore, net cash flow does not mean net income of the business.

Solved Example

Example Data

- Opening Cash Balance: Rs 10,000

Cash Flows from Operating Activities:

- Cash received from customers: Rs 50,000
- Cash paid to suppliers and employees: Rs 30,000
- Interest paid: Rs 2,000
- Income taxes paid: Rs 3,000

Cash Flows from Investing Activities:

- Purchase of equipment: Rs 5,000
- Sale of investments: Rs 3,000

Cash Flows from Financing Activities:
- Proceeds from issuing shares: Rs 10,000
- Repayment of bank loan: Rs 7,000
- Dividends paid: Rs 1,000

Cash-Flow Statement

Cash Flows from Operating Activities
Cash received from customers = Rs 50,000
Less: Cash paid to suppliers and employees = Rs 30,000
Less: Interest paid = Rs 2,000
Less: Income taxes paid = Rs 3,000
Net cash provided by operating activities = Rs 50,000 – Rs 30,000 – Rs 2,000 – Rs 3,000 = Rs 15,000

Cash Flows from Investing Activities
Cash from sale of investments = Rs 3,000
Less: Purchase of equipment = Rs 5,000
Net cash used in investing activities= Rs 3,000 - Rs 5,000 = – \$2,000

Cash Flows from Financing Activities
Net cash provided by financing activities = Rs 10,000 - Rs 7,000 - Rs 1,000 = Rs 2,000
Proceeds from issuing shares = Rs10,000
Less: Repayment of bank loan = Rs 7,000
Less: Dividends paid = Rs 1,000

Net cash provided by financing activities=\$10,000−\$7,000−\$1,000=\$2,000

Summary of Cash Flows
Net increase in cash = Rs 15,000 - Rs 2,000 + Rs 2,000 = Rs 15,000
Add: Opening cash balance = Rs 10,000
Closing cash balance = Rs 15,000 + Rs 10,000 = Rs 25,000
Net increase in cash=\$15,000−\$2,000+\$2,000=\$15,000

Add: Opening cash balance = Rs 10,000
Closing cash balance = Rs 15,000 + Rs 10,000 = Rs 25,000

Cash-Flow Statement for the Year
Cash Flows from Operating Activities:
- Cash received from customers: Rs 50,000

- Cash paid to suppliers and employees: (Rs 30,000)
- Interest paid: (Rs 2,000)
- Income taxes paid: (Rs 3,000)

Net cash provided by operating activities: $15,000

Cash Flows from Investing Activities:

- Sale of investments: Rs 3,000
- Purchase of equipment: (Rs 5,000)

Net cash used in investing activities: (Rs 2,000)

Cash Flows from Financing Activities:

- Proceeds from issuing shares: Rs 10,000
- Repayment of bank loan: (Rs 7,000)
- Dividends paid: (Rs 1,000)

Net cash provided by financing activities: $2,000

Net Increase in Cash: Rs 15,000
Add: Opening Cash Balance: Rs 10,000
Closing Cash Balance: Rs 25,000

This simple example illustrates how a cash-flow statement summarizes the inflows and outflows of cash, leading to the net change in the cash position of the company over the period.