# The Statement of Cash Flows

Purpose of a statement of cash flows:
To provide information about the cash inflows and outflows of an entity during a period.
To summarize the operating, investing, and financing activities of the business.

The cash flow statement helps users to assess a company's liquidity, financial flexibility, operating capabilities, and risk.

The statement of cash flows is useful because it provides answers to the following important questions:
Where did cash come from?
What was cash used for?
What was the change in the cash balance?

Specifically, the information in a statement of cash flows, if used with information in the other financial statements, helps external users to assess:

1. A company's ability to generate positive future net cash flows,
2. A company's ability to meet its obligations and pay dividends,
3. A company's need for external financing,
4. The reasons for differences between a company's net income and associated cash receipts and payments, and
5. Both the cash and noncash aspects of a company's financing and investing transactions.

# CASH FLOW STATEMENT

A statement of cash flows contains information about the flows of cash into and out of a company, and the uses to which the cash is put. The statement is comprised of three sections, in which are presented the cash flows that occurred during the reporting period relating to the following:

1. Operations
2. Investing activities
3. Financing activities

The statement of cash flows is part of the financial statements, and as such is heavily reviewed by the users of the financial statements.

Cash flow statement is a statement which shows the sources of cash inflow and uses of cash out-flow of the business concern during a particular period of time. It is the statement, which involves only short-term financial position of the business concern. Cash flow statement provides a summary of operating, investment and financing cash flows and reconciles them with changes in its cash and cash equivalents such as marketable securities.

1. Cash flow statement is the report showing sources and uses of cash.
2. Cash flow statement explains the inflow and out flow of cash during the particular period.
3. The main objective of the cash flow statement is to show the causes of changes in cash between two balance sheet dates.
4. Cash flow statement indicates the factors contributing to the reduction of cash balance in spite of increase in profit and vice-versa.
5. In a cash flow statement only cash receipt and payments are recorded.
6. Cash flow statement starts with opening cash balance and ends with closing cash balance.

**Explain the differences between a cash budget and a cash flow statement.**

☐ A cash budget is a forecast whereas a cash flow statement is an historical document

☐ A cash budget not required as a standard; a cash flow statement is required as a standard

☐ A cash budget is used for planning and control purposes(internal); a cash- flow statement is used to report to all stakeholders (external)

☐ A cash budget Jan be prepared frequently e.g. weekly, monthly or semi-annually; a cash-flow statement is prepared yearly (at end of accounting period)

☐ A cash budget Jan be customized according to needs of a business; a cash-flow statement is prepared only in accordance with standard format .

**Explain why a cash flow statement is important to shareholders.**

Cash flow statements are important to shareholders because they show:

- the ability of a business to generate cash internally
- How much cash has been raised externally
- the causes of change in liquidity or cash inflows cash outflows
- Viability whether business can generate cash to service finance, pay tax and maintain its fixed assets going concern
- stability of business reliance upon internal sources external sources for financing
- profitability and liquidity reconciled as shareholders Jan confuse profitability with liquidity
- indication of future cash flows ; capital investment (expansion of activities) and its effect on future cash flows.

**Explain how cash flow statements differ from cash budgets.**

| Cash Flow Statement | Cash Budget |
|---|---|
| ☐ Based on historical data | Based on future plans |
| ☐ An account of the directors' | For internal use stewardship of funds |
| ☐ Cannot (legally) be manipulated Management | Can be adjusted to reflect policy |
| ☐ A requirement for companies | Desirable for management purposes |
| ☐ Produced annually | Can be prepared for any period |
| ☐ Presented in a standard format | No formal lay-out is required |

**Explain how a company can make a loss but still have an increase in cash.**

General discussion of the differences between cash and profit:

Timing differences – profits are recorded in the profit and loss account when the transaction is made but the cash may not be received for some time.

Other payments – payments for fixed assets result in cash leaving the business but do not reduce profit.

Other receipts – share issues or loans received will increase cash but are not shown in the profit and loss account.

Non-cash items – provisions are made in the profit and loss account that do not involve the movement of cash e.g. depreciation.

**Explanation of how a company can make a loss and still increase cash balance:**

Non-cash items - provisions for depreciation or bad debts will reduce the profit figure but have no effect on cash for example.
Timing differences:
the company may have recorded purchases but not paid for them yet for example.
Other receipts: The company may have issued shares or taken out loans during the year and these will increase the cash balance but not affect the profit figure for example.

**Discuss the extent to which cash is more significant for business survival than profit.**

Cash is essential for short term survival. Without cash, a business may not be able to meet its liabilities and therefore may lose profit or even be forced into liquidation by its creditors. Also the business may not be able to pay dividends and hence lose the confidence of shareholders.

Profit is needed for long term survival to ensure that funds are generated to enable the business to invest and to pay dividends to shareholders.

**Explain to what extent a cash flow statement is essential in judging the financial performance of a company.**

*Focus on cash*
The cash flow statement focuses on cash. Cash is the lifeblood of a business. It is possible for a business to survive for a significant period of time whilst making losses: however, without cash a business can fail quickly.

Profit can be distorted, but cash is more difficult to manipulate.
Cash is also seen as being a more certain figure and harder to manipulate, therefore it may be seen as a more accurate measurement of business success or failure. Profit can be distorted because decisions need to be made about: Examples such as recognition of sales distinguishing between capital and revenue expenditure depreciation.

*Profit is significant*

Investors are interested in profit as this is the source of dividends and significant for the long term survival of the business.

*Judgment:* The cash flow statement is important in judging the financial performance of the business - it shows:

- ☐ liquidity
- ☐ solvency
- ☐ financial adaptability.

However, the remaining statements also show significant information e.g. profits/losses and assets and liabilities.

**Explain why public companies publish cash flow statements.**

☐ Cash flow statements are published to comply with FRS1.

☐ Cash flow statements provide information that is not contained in the profit and loss account and balance sheet. They are necessary to provide a fuller understanding of business performance.

☐ Cash is seen as a more certain figure than profit as it is easier to verify and less subject to estimation plus example.

☐ Cash flow statements focus on cash, which is essential to the short-term survival of business.

☐ They show the uses of finance.

☐ They show the sources of finance — internal and external and long and short term; they show how much cash is generated from trading and how much from other sources.

☐ This allows the users of accounts to make more informed judgments about business performance.

Q.no 1 The statement of financial position of Zink Pink lee plc as at 31 December 2015 and 31 December 2016 abstract were as follows:
The following information is available.

| | 31 December 2015 £ | 31 December 2016 £ |
|---|---|---|
| Current assets | | |
| Inventories | 15466 | 16194 |
| Trade and other receivables | 2941 | 2432 |
| Cash and cash equivalents | 2765 | 2987 |
| | 21172 | 21613 |
| Current liabilities | | |
| Trade and other payables | 3570 | 3594 |
| Taxation due | 2278 | 1765 |
| Proposed ordinary dividends | 3000 | 2000 |
| | 8848 | 7359 |

Additional information:
1. Net operating profit after interest was £ 27680.
2. Interest charges on the overdraft for the year were £ 145.
3. a bank loan for £ 15000 at 12% interest, repayable in 3 years, was received on 1 May 2016.
4. Depreciation is charged only on assets in the books at the year end.
5. Machine bought on 1 January 2015 had a net book value of £ 60000at 31 December 2015. And was still in the books at 31 December 2016. Depreciation is charged at the rate of 25% per year, using the straight line method.
6. Computers were bought for £ 3600 on 1 July 2015, with an expected life of 2 years. Depreciation is charged for the fraction of the year that the asset is held.
7. on 1 October 2016, a motor van with a net book value of £ 12000 was sold for £ 13500.
8. on 2 December 2016, furniture with a net book value of £1800 was sold for £ 990.

Required:
The statement of cash flows for Zink Pink lee plc clearly show the net cash from operating activities section.

| | £ | £ |
|---|---|---|
| **Cash flow from operating activities** | | |
| Profit from operations | | |
| Add: Depreciation on non-current assets | | |
| Add: Loss on sale of non-current assets | | |
| Less: Profit on sale of non-current assets | | |
| **Operating cash flow before working capital changes** | | |
| | | |
| | | |
| | | |
| | | |
| | | |
| **Cash generated from operations** | | |
| Less interest paid | | |
| Less tax paid | | |
| **Net cash from operating activities** | | |

Q.no 2 The statement of financial position of Blue Square plc as at 31 March 2015 and 31 March 2016 were as follows:

| | 31 March 2015 £ | 31 March 2016 £ |
|---|---|---|
| **Non-current Assets** | | |
| Property, plant and equipment at cost | 600000 | 660000 |
| Provision for depreciation | 200000 | 215000 |
| Property, plant and equipment carry over | 400000 | 445000 |
| **Current Assets** | | |
| Inventories | 59800 | 50200 |
| Trade and Other receivables | 25200 | 25800 |
| Cash and cash equivalents | 4000 | 1000 |
| | 89000 | 77000 |
| **Total Assets** | 489000 | 522000 |
| **EQUITY AND LIABILITIES** | | |
| **Equity & Reserves** | | |
| Share capital – Ordinary shares of £1 | 200000 | 300000 |
| 9% Preference shares of £1 each | 80000 | |
| Retained earnings | 63400 | 44800 |
| general reserve | 25000 | 55000 |
| | 368400 | 399800 |
| **Non-current Liabilities** | | |
| 16% Debenture | 50000 | 50000 |
| **Current Liabilities** | | |
| Trade and Other payables | 45000 | 39000 |
| Current Tax payable | 17000 | 23000 |
| proposed dividends | 8600 | 10200 |
| | 70600 | 72200 |
| Total Equity and Liabilities | 489000 | 522000 |

Additional information:

i. On 1 April 2015, machinery which cost £ 30000, with a book value of £25000, was sold for £ 19000.
ii. a £90000 extension to the building was build and paid for during the year.
iii. Interest on the bank overdraft for the year was £ 3800.
iv. profit after interest but before tax for the year ended 31 March 2016 was £56600
calculate the net cash flow from operating activities.

Q.no 3. The statement of financial position moonlight plc as at 1 January 2015 and 31 December 2015 were as follows:

| | 1 January 2015 | 31 December 2015 |
|---|---|---|
| | £ | £ |
| **Non-current Assets** | | |
| Property, plant and equipment | | |
| buildings | 2300000 | 2160000 |
| machinery | 400000 | 390000 |
| furniture | 100000 | 80000 |
| investments | 200000 | 200000 |
| Property, plant and equipment carry over | 3000000 | 2830000 |
| **Current Assets** | | |
| Inventories | 85000 | 97000 |
| Trade and Other receivables | 66000 | 81000 |
| Cash and cash equivalents | 1000 | 45000 |
| | 152000 | 223000 |
| **Total Assets** | 3152000 | 3053000 |
| **EQUITY AND LIABILITIES** | | |
| **Equity & Reserves** | | |
| Share capital – Ordinary shares of £1 | 1750000 | 1850000 |
| 10% Preference shares of £1 each | 250000 | 250000 |
| General reserve | 30000 | 30000 |
| retained earnings | 237000 | 4000 |
| | 2267000 | 2134000 |
| **Non-current Liabilities** | | |
| 15% Bank Loan | 750000 | 850000 |
| **Current Liabilities** | | |
| Trade and Other payables | 74000 | 54000 |
| Current Tax payable | 26000 | |
| proposed dividends | 35000 | 15000 |
| | 135000 | 69000 |
| Total Equity and Liabilities | 3152000 | 3053000 |

On 27 December 2015 furniture costing 40000 was purchased. No depreciation is to be provided on this new furniture for the year ended 31 December 2015.
Interest on the overdraft for the year was £1000.
Net operating loss (178000)
calculate the net cash flow from operating activities.

4. The statements of Financial position of Skyline ltd as at 31 December 2012 and 31 December 2013 were as follows:

| | 31 December 2012 £ | 31 December 2013 £ |
|---|---|---|
| **ASSETS** | | |
| **Non-current assets at cost** | 1 108 000 | 1 206 500 |
| provision for depreciation | 265 000 | 225 000 |
| Non-current assets carry over | 843 000 | 981 500 |
| | | |
| **Current Assets** | | |
| Inventories | 359 000 | 378 000 |
| Trade and Other receivables | 56 000 | 59 500 |
| Cash and cash equivalents | 202 000 | 247 000 |
| | 617 000 | 684 500 |
| | | |
| **Total Assets** | **1460 000** | **1 666 000** |
| | | |
| **EQUITY AND LIABILITIES** | | |
| **Equity & Reserves** | | |
| Share capital – Ordinary shares of £1 | 500 000 | 600 000 |
| 6% Preference shares of £1 each | 200 000 | 200 000 |
| Share premium | 150 000 | 200 000 |
| retained earnings | 300 500 | 317 000 |
| **Total capital and reserves** | 1 150 500 | 1 317 000 |
| | | |
| **Non-current Liabilities** | | |
| **7% Debentures 2018** | | 125 000 |
| Bank Loan | 87 500 | |
| | 87 500 | 125 000 |
| | | |
| **Current Liabilities** | | |
| Trade and Other payables | 161 500 | 173 500 |
| Current Tax payable | 60 500 | 50 500 |
| | 222 000 | 224 000 |
| | | |
| **Total Equity and Liabilities** | **1460 000** | **1 666 000** |

**Additional information:**

1. Machinery costing £ 129 000 was sold for £27 000 on 1 April 2013. The book value of the machinery was £20 500.

2. Property was purchased for £227 500 on 1 May 2013.

3. An issue of 100 000 £1 Ordinary shares at a premium of 50 pence per share was made on 31 March 2013.

4. Ordinary shareholders received the following dividends in the year:
    - final dividend for 2012 of 4 pence per share on 22 January 2013
    - an interim dividend of 2 pence per share on 26 July 2013

5. Preference shareholders received their dividends in full during the year.

6. On 1 January 2013 the bank loan of £87 500 was paid off.

7. On 1 May 2013 a £125 000 7% debenture was issued, with interest to be paid in two equal half-yearly payments.

8. Operating profit before tax for the year ended 31 December 2013 was £111 000.

**Required:**
(a) Prepare a cash flow statement for the year ended 31 December 2013 for Skyline ltd in accordance with International Accounting Standard (IAS) 7 Cash Flow Statements (revised).

(b) Evaluate the raising of capital for a plc by issuing a debenture instead of taking out a bank loan.

5.

Torrent plc's income statement for the year ended 31 December 2010 and the statements of financial position as at 31 December 2009 and 2010 are as follows:

**Income statement for the year ended 31 December 2010**

| | £m |
|---|---|
| Revenue | 623 |
| Cost of sales | (353) |
| **Gross profit** | 270 |
| Distribution expenses | (71) |
| Administrative expenses | (30) |
| Rental income | 27 |
| **Operating profit** | 196 |
| Interest payable | (26) |
| **Profit before taxation** | 170 |
| Taxation | (36) |
| **Profit for the year** | 134 |

**Statements of financial position as at 31 December 2009 and 2010**

| | *2009* | *2010* |
|---|---|---|
| | *£m* | *£m* |
| **ASSETS** | | |
| **Non-current assets** | | |
| *Property, plant and equipment* | | |
| Land and buildings | 310 | 310 |
| Plant and machinery | 325 | 314 |
| | 635 | 624 |
| **Current assets** | | |
| Inventories | 41 | 35 |
| Trade receivables | 139 | 145 |
| | 180 | 180 |
| **Total assets** | 815 | 804 |

| | | |
|---|---|---|
| **EQUITY AND LIABILITIES** | | |
| **Equity** | | |
| Called-up ordinary share capital | 200 | 300 |
| Share premium account | 40 | – |
| Revaluation reserve | 69 | 9 |
| Retained earnings | 123 | 197 |
| | 432 | 506 |
| **Non-current liabilities** | | |
| Borrowings – loan notes | 250 | 150 |
| **Current liabilities** | | |
| Borrowings (all bank overdraft) | 56 | 89 |
| Trade payables | 54 | 41 |
| Taxation | 23 | 18 |
| | 133 | 148 |
| **Total equity and liabilities** | 815 | 804 |

During 2010, the business spent £67 million on additional plant and machinery. There were no other non-current asset acquisitions or disposals.

There was no share issue for cash during the year. The interest payable expense was equal in amount to the cash outflow. A dividend of £60 million was paid.

**Required:**
Prepare the statement of cash flows for Torrent plc for the year ended 31 December 2010.

6. The relevant information from the financial statements of Dido plc for last year is as follows:

| | *£m* |
|---|---|
| Profit before taxation (after interest) | 122 |
| Depreciation charged in arriving at profit before taxation | 34 |
| Interest expense | 6 |
| | |
| At the beginning of the year: | |
| Inventories | 15 |
| Trade receivables | 24 |
| Trade payables | 18 |
| | |
| At the end of the year: | |
| Inventories | 17 |
| Trade receivables | 21 |
| Trade payables | 19 |

The following further information is available about payments during last year:

| | *£m* |
|---|---|
| Taxation paid | 32 |
| Interest paid | 5 |
| Dividends paid | 9 |

Required: Calculate net cash flow from operating activities.

7. The relevant information from the financial statements of Pluto plc for last year is as follows:

| | *£m* |
|---|---|
| Profit before taxation (after interest) | 165 |
| Depreciation charged in arriving at operating profit | 41 |
| Interest expense | 21 |
| | |
| At the beginning of the year: | |
| Inventories | 22 |
| Trade receivables | 18 |
| Trade payables | 15 |
| | |
| At the end of the year: | |
| Inventories | 23 |
| Trade receivables | 21 |
| Trade payables | 17 |

The following further information is available about payments during last year:

| | *£m* |
|---|---|
| Taxation paid | 49 |
| Interest paid | 25 |
| Dividends paid | 28 |

What figure should appear in the statement of cash flows for 'Cash flows from operating activities'?

8. The Statements of Financial Position of Larnaca Distributors plc at 31 March 2012 and 31 March 2013 were as follows:

| | 31 March 2012 | 31 March 2013 |
|---|---|---|
| | £ | £ |
| **Non-current Assets** | | |
| Property, plant and equipment at cost | 1200 000 | 1080 000 |
| Provision for depreciation | 600 000 | 582 000 |
| Property, plant and equipment carry over | 600 000 | 498 000 |
| **Current Assets** | | |
| Inventories | 484 500 | 519 000 |
| Trade and Other receivables | 295 500 | 318 000 |
| Cash and cash equivalents | 115 500 | 106 500 |
| Total current assets | 895 500 | 943 500 |
| **Total Assets** | 1495 500 | 1441 500 |
| **EQUITY AND LIABILITIES** | | |
| **Equity & Reserves** | | |
| Share capital – Ordinary shares of £1 | 750 000 | 825 000 |
| Retained earnings | 270 000 | 208 500 |
| | 1020 000 | 1033 500 |
| **Non-current Liabilities** | | |
| 8% Debenture 2017 | 120 000 | |
| **Current Liabilities** | | |
| Trade and Other payables | 328 500 | 405 000 |
| Current Tax payable | 27 000 | 3 000 |
| | 355 500 | 408 000 |
| **Total Equity and Liabilities** | 1495 500 | 1441 500 |

**Additional information:**
1. Motor vans bought for £ 210 000 were sold for £54 000 on 1 April 2012. The carry over (net book) value of these motor vans was £ 63 000.

2. Computers were bought for £90 000 on 1 April 2012 and are expected to last for three years, with no residual value.

3. At 15 May 2012 a final dividend of 5 pence (£0.05) per share was paid to shareholders.

4. An issue of 75 000 £1 Ordinary shares at par was made on 1 October 2012. All shares were purchased and have been fully paid.

5. At 30 March 2013, an interim dividend of 4 pence (£0.04) per share was paid to all Ordinary shareholders.

6. The £120 000 8% Debenture was repaid on 31 March 2013.

7. Operating profit before tax for the year ended 31 March 2013 was £12 000

**Required:**
(a) Prepare the Statement of Cash Flows for the year ended 31 March 2013 for Larnaca Distributors plc in accordance with International Accounting Standard (IAS) 7 Statements of Cash Flows.

(b) Evaluate the current liquidity position of Larnaca Distributors plc.

9. The Statements of Financial Position of Larnaca Distributors plc at 1 January 2012 and 31 December 2012 were as follows:

| | 1 Jan 2012 | 31 Dec 2012 |
|---|---|---|
| | £ | £ |
| **Non-current Assets** | | |
| Property, plant and equipment at cost | 600000 | 540000 |
| Provision for depreciation | 300000 | 291000 |
| Property, plant and equipment carry over | 300000 | 249000 |
| **Current Assets** | | |
| Inventories | 242250 | 259500 |
| Trade and Other receivables | 147750 | 159000 |
| Cash and cash equivalents | 57750 | 53250 |
| | 447750 | 471750 |
| **Total Assets** | 747750 | 720750 |
| **EQUITY AND LIABILITIES** | | |
| **Equity & Reserves** | | |
| Share capital – Ordinary shares of £1 | 375000 | 412500 |
| Retained earnings | 135000 | 104250 |
| | 510000 | 516750 |
| **Non-current Liabilities** | | |
| 8% Debenture 2017 | 60000 | |
| **Current Liabilities** | | |
| Trade and Other payables | 164250 | 202500 |
| Current Tax payable | 13500 | 1500 |
| | 177750 | 204000 |
| Total Equity and Liabilities | 747750 | 720750 |

**Additional information:**
1. Motor vans bought for £ 105 000 were sold for £27 000 on 1 April 2012. The provision for depreciation account balance show £73 500.

2. Computers were bought for £45 000 on 1 April 2012 and are expected to last for three years, with no residual value.

3. At 15 May 2012 a final dividend of 5 pence (£0.05) per share was paid to shareholders.

4. An issue of 37 500 £1 Ordinary shares at par was made on 1 October 2012. All shares were purchased and have been fully paid.

5. At 30 March 2013, an interim dividend of 4 pence (£0.04) per share was paid to all Ordinary shareholders.

6. The £60 000 8% Debenture was repaid on 31 Dec 2012.

7. Operating profit before tax for the year ended 31 Dec 2012 was £6 000

**Required:**
(a) Prepare the Statement of Cash Flows for the year ended 31 March 2013 for Larnaca Distributors plc in accordance with International Accounting Standard (IAS) 7 Statements of Cash Flows.

Q.No 10. Use the following information to calculate net cash flow from operating activities using indirect method:

| | |
|---|---|
| Net Income | $7,000 |
| Depreciation Expense | 1,000 |
| Increase in Accounts Receivable | 4,400 |
| Increase in Prepaid Rent | 7,000 |
| Decrease in Prepaid Insurance | 1,300 |
| Increase in Accounts Payable | 14,000 |
| Increase in Wages Payable | 1,000 |
| Decrease in Income Tax Payable | 700 |
| Gain on Sale of Equipment | 1,800 |

| Operating activities | |
|---|---|
| **Cash inflow** | **Cash outflow** |
| Cash sales | Cash purchases |
| Cash received from customers | Payment to suppliers |
| Cash received from commission and fees | Cash operating expenses |
| Royalty and other revenues | Payment of wages etc. |
| | Payment of income tax |

| Investing activities | |
|---|---|
| **Cash inflow** | **Cash outflow** |
| Proceedings of non-current assets | Purchase of non-current assets |
| Sale of investment | Purchase of investment |
| Interest received | |
| Dividend received | |
| | |

| Financing activities | |
|---|---|
| **Cash inflow** | **Cash outflow** |
| Issue of shares | Cash repayments of amounts borrowed |
| Issue of debentures in cash | Dividends paid on equity and preference share capital |
| Proceeds from non-current liabilities | |