



SECTION - 2

CASH FLOW ANALYSIS

This Section includes

- **Cash flow analysis**
- **Purpose**
- **Format for cash flow analysis**
- **Preparation of cash flow statement**

2.1 CASH FLOW ANALYSIS

2.1.1 Cash Flow Statement reports the cash receipts and cash payments of an organization during a particular period.

2.1.2 Cash Flow Analysis aims to answer the following questions:

1. Why my company has not increased the dividend despite 50% growth in the profit? Where the profit has gone?
2. Is it a good company to lend money since several big companies delay their payment of interest and principal?
3. What the company has done with the money it raised through equity and debt for expansion? Have they used the money exactly for the expansion?

Accounting statements fail to give a clear reply to all these questions and hence the need to analyse cash flow for answers to above questions.

2.2 PURPOSE

2.2.1 The various purposes of Cash Flow Analysis are given below:

1. Accounting statements conceal more than what they reveal to the readers who are not familiar with the accounting system; Cash flow statement is free from such complexities.
2. Accounting statements are prepared on the basis of accrual and hence the profit figure shown in the P & L account is only an expected profit; Cash Profit computed under the Cash Flow statement is a realized profit of the year.
3. Readers of the cash flow statement can know the sources and uses of cash and also study whether the firm has adequate cash to meet some of its liabilities.

2.2.2 Importance of Cash Flow Analysis to Investors:

“Corporate earnings reports communicate, at best, only part of the story. And, their most critical omission - in recognition that insufficient cash resources are a major cause of corporate problems



particularly in inflationary times - is their failure to speak to a corporation's cash position. Indeed, in my view, cash flow from operations is a better measure of performance than earnings-per-share. What should be considered is more revealing analytical concepts of cash flow or cash-flow-per-share, which reflect the total cash earnings available to management, - that is earnings before expenses such as depreciation and amortization are deducted. An even more sophisticated - and, in my opinion, more informative - analytical tool is free cash flow which considers cash flow after deducting such spiraling corporate costs as capital expenditures".- Harold Williams (a former chairman of the SEC).

2.2.3 Importance of Cash Flow Analysis to Lenders:

"Banks lend cash to their clients, collect interest in cash, and require debt repayment in cash. Nothing less, just cash. Financial statements, however, usually are prepared on an accrual basis, not on a cash basis. And projections? Same thing. Projected net income, not projected cash income. Yet, cash repays loans. Therefore, we are compelled to shift our focus if we truly wish to assess our client's ability to pay interest and repay debt. We must turn our attention to cash, working through the roadblocks thrown up by accrual accounting, to properly evaluate the creditworthiness of our client". (RMA Uniform Credit Analysis, Philadelphia, Robert Morris Associates, 1982).

2.3 FORMAT FOR CASH FLOW ANALYSIS

2.3.1 The format for cash flow analysis is given below:

Activities	Cash Inflow	Cash Outflow
Operating Activities		
Investment Activities		
Financing Activities		

2.3.2 Cash flow from Operating Activities:

1. Cash Generated from Operations
 - Cash Receipts from Customers
 - **Less:** Cash paid to suppliers & other operating expenses
 - Less: Interest Paid
 - Less: Income Tax Paid
2. Cash flow from extraordinary Items
 - Less: Extraordinary Items
3. Net Cash from / used in operating activities

2.3.3 Cash flow from Investment Activities:

1. Loan and Advances
2. Interest & Dividend Received



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3. Proceeds on sale of investments
 4. Proceeds on sale of fixed assets
 5. Less:
 - Purchase of fixed assets
 - Investments in subsidiaries
 - Investments in trade investments
 - Loans and Advances repaid
 - Investments on Current Assets
- 2.3.4 Cash flow from Financing Activities:
1. Proceeds from issue of Share Capital
 2. Proceeds from Long-term Borrowings
 3. Less:
 - Repayment of Loans
 - Dividend Paid
- 2.3.5 Legal Requirements:
1. Clause 32 of Listing Agreement between the company and Stock Exchange has been amended and listed companies are now required to provide Cash Flow Statement along with Balance Sheet and Profit & Loss Account. The format provided in the Listing Agreement is accounting oriented and of little use to ordinary readers.
 2. IAS - 7 has recommended a simple Cash Flow Format

2.4 PREPARATION OF CASH FLOW STATEMENT

- 2.4.1 Cash flow statement is similar to funds flow statement, and it can be as detailed as required. But, extraction of this statement from balance sheet captures the net effect.
- 2.4.2 Cash from operations needs to be explained.
- 2.4.3 Cash from operations:
- Profit for the year +
 - Non-cash expenses+/-
 - *Changes in current assets/current liabilities other than cash*
- 2.4.4 An illustration is given below:

Sundry Debtors	
Opening Balance	10000
Closing Balance	30000
Sales	100000
Cash received from debtors	80000
cost of goods sold	60000



Sundry debtors a/c			
Balance b/ d	10000	Cash	80000
Sales	100000	Closing balance	30000
Total	110000		110000

Profit and loss account			
cost of goods sold	60000	sales	100000
Profit	40000		
Total	100000		100000

Cash form operation	
Profit	40000
-Increase in sundry debtors	-20000
Cash from operation	20000

Cash Flow Statement

Sources of cash	2000	1999
Cash balance in the beginning of the year	54.08	92.51
Reserves & Surplus	502.34	583.52
Depreciation	126.83	-9.07
Write off of Miscellaneous Expenses	0.29	0.01
Add: Dec.in CA & Inc in CL		
Reduction in Inventories		55.88
Reduction in Sundry Debtors	28.86	
Reduction in Loans and Advances		
Increase in Current Liabilities	118.84	48.39
More Provisions made	94.35	218.96
Less: Inc.in CA & Dec in CL		
Increase in Inventories	83.63	
Increase in Sundry Debtors		87.31
Increase in Loans and Advances made	139.39	394.63
Decrease in Current Liabilities		
Reduction in Provisions made		
Cash From Operations	648.49	415.75



Increase Share Capital		
Secured Loans Received during the year	60.50	13.54
Unsecured Loans Received during the year	85.48	77.94
Sale of Fixed Assets		
Conversion of Capital WIP in Fixed Assets	4.68	
Investments realised		
TOTAL CASH INFLOW	853.23	599.74
APPLICATION OF CASH		
Decrease in Share Capital		
Secured Loans discharged		
Unsecured Loans discharged		
Purchases of Fixed Assets	323.95	155.62
Increase in Capital WIP		74.21
Investments made during the year	493.30	315.83
TOTAL CASH OUTFLOW	817.25	545.66
Cash balance at the end of the year	35.98	54.08

2.4.5 Derived Cash Flows:

Derived cash flows
Net Operating Profit + Depreciation EBITDA +/- Changes in current assets/liabilities Operating cash flow - Taxes paid -Interest paid -current portion of long term debt Discretionary cash flow -Dividends paid Cash flow before long-term uses(CBLTU) +/-Net expenditure on fixed assets(PPE) +/-Net expenditure on investments +Non-core income +/- Other long term assets +/- Other long term liabilities +/- Exceptional/extraordinary income or expense Cash flow after investing activities +/- Share capital +/- Long-term debt +/- Short-term debt Cash flow after financing activities =Change in cash

2.4.6 Cash flow analysis (other dimensions):

Net Operating Profit
+ Depreciation
EBITDA
+/- Changes in current assets/liabilities
Operating cash flow
-Taxes paid
Operating free cash flow
-Interest paid
Free cash flow
-Dividends
Residual free cash flow

2.4.7 Key questions with cash flow statements:

1. What is the trend in cash flow from operations?
2. Are the cash from operations adequate for routine and important expenses?
3. Compare operating cash flow with capital expenditure
4. What are the other major cash needs?
5. How are these needs met?
6. Take a balanced view
7. Whether short term and long term funds are balanced properly?