



Statement of Cash Flows

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1. Definition of SCF

Statement of Cash Flows, also known as Cash Flow Statement, presents the movement in cash flows over the period as classified under operating, investing and financing activities.

2. Basis of Preparation

Statement of Cash Flows presents the movement in cash and cash equivalents over the period.

Cash and cash equivalents generally consist of the following:

- Cash in hand
- Cash at bank
- Short term investments that are highly liquid and involve very low risk of change in value (therefore usually excludes investments in equity instruments)
- Bank overdrafts in cases where they comprise an integral element of the organization's treasury management (e.g. where bank account is allowed to float between a positive and negative balance (i.e. overdraft) as opposed to a bank overdraft facility specifically negotiated for financing a shortfall in funds (in which case the related cash flows will be classified under financing activities).

As income statement and balance sheet are prepared under the accruals basis of accounting, it is necessary to adjust the amounts extracted from these financial statements (e.g. in respect of non cash expenses) in order to present only the movement in cash inflows and outflows during a period.

All cash flows are classified under operating, investing and financing activities as discussed below.

2. Example

Following is an illustrative cash flow statement presented according to the **indirect method** suggested in IAS 7 Statement of Cash Flows:

P & G and J & J			
STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2013			
Cash flows from operating activities	Notes	2017	2018
Profit before tax		40,000	35,000
Adjustments for:		00	00
Depreciation	4	10,000	8,000
Amortization	4	8,000	7,500
Impairment losses	5	12,000	3,000
Bad debts written off	14	500	-
Interest expense	16	800	1,000
Gain on revaluation of investments		(21,000)	-
Interest income	15	(11,000)	(9,500)
Dividend income		(3,000)	(2,500)

Gain on disposal of fixed assets		(1,200)	(1,850)
		35,100	40,650
Working Capital Changes:			
Movement in current assets:			
(Increase) / Decrease in inventory		(1,000)	550
Decrease in trade receivables		3,000	1,400
Movement in current liabilities:			
Increase / (Decrease) in trade payables		2,500	(1,300)
Cash generated from operations		39,600	41,300
Dividend paid		(8,000)	(6,000)
Income tax paid		(12,000)	(10,000)
Net cash from operating activities (A)		19,600	25,300
Cash flows from investing activities			
Capital expenditure	4	(100,000)	(85,000)
Purchase of investments	11	(25,000)	-
Dividend received		5,000	3,000
Interest received		3,500	1,000
Proceeds from disposal of fixed assets		18,000	5,500
Proceeds from disposal of investments		2,500	2,200
Net cash used in investing activities (B)		(96,000)	(73,300)
Cash flows from financing activities			
Issuance of share capital	6	1000,000	-
Bank loan received		-	100,000
Repayment of bank loan		(100,000)	-
Interest expense		(3,600)	(7,400)
Net cash from financing activities (C)		896,400	92,600
Net increase in cash & cash equivalents (A+B+C)		820,000	44,600
Cash and cash equivalents at start of the year		77,600	33,000
Cash and cash equivalents at end of the year	24	897,600	77,600

3. Operating Activities

Cash flow from operating activities presents the movement in cash during an accounting period from the **primary revenue generating** activities of the entity.

For example, operating activities of a hotel will include cash inflows and outflows from the hotel business (e.g. receipts from sales revenue, salaries paid during the year etc), but interest income on a bank deposit shall not be classified as such (i.e. the hotel's interest income shall be presented in investing activities).

Profit before tax as presented in the income statement could be used as a starting point to calculate the cash flows from operating activities.

Following adjustments are required to be made to the profit before tax to arrive at the cash flow from operations:

1. Elimination of non cash expenses (e.g. depreciation, amortization, impairment losses, bad debts written off, etc)
2. Removal of expenses to be classified elsewhere in the cash flow statement (e.g. interest expense should be classified under financing activities)
3. Elimination of non cash income (e.g. gain on revaluation of investments)
4. Removal of income to be presented elsewhere in the cash flow statement (e.g. dividend income and interest income should be classified under investing activities unless in case of for example an investment bank)
5. Working capital changes (e.g. an increase in trade receivables must be deducted to arrive at sales revenue that actually resulted in cash inflow during the period)

4. Investing Activities

Cash flow from investing activities includes the movement in cash flow as a result of the purchase and sale of assets other than those which the entity primarily trades in (e.g. inventory). So for example, in case of a manufacturer of cars, proceeds from the sale of factory plant shall be classified as cash flow from investing activities whereas the cash inflow from the sale of cars shall be presented under the operating activities. Cash flow from investing activities consists primarily of the following:

- Cash outflow expended on the purchase of investments and fixed assets
- Cash inflow from income from investments
- Cash inflow from disposal of investments and fixed assets

5. Financing activities

Cash flow from financing activities includes the movement in cash flow resulting from the following:

- Proceeds from issuance of share capital, debentures & bank loans
- Cash outflow expended on the cost of finance (i.e. dividends and interest expense)
- Cash outflow on the repurchase of share capital and repayment of debentures & loans

6. Purpose & Importance

Statement of cash flows provides important insights about the liquidity and solvency of a company which are vital for survival and growth of any organization. It also enables analysts to use the information about historic cash flows to form projections of future cash flows of an entity (e.g. in NPV analysis) on which to base their economic decisions. By summarizing key changes in financial position during a period, cash flow statement serves to highlight priorities of management. For example, increase in capital expenditure and development costs may indicate a higher increase in future revenue streams whereas a trend of excessive investment in short term investments may suggest lack of viable long term investment opportunities. Furthermore, comparison of the cash flows of different entities may better reveal the relative quality of their earnings since cash flow information is more objective as opposed to the financial performance reflected in income statement which is susceptible to significant variations caused by the adoption of different accounting policies.

References

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