

Lecture 12 & 13

Cash Flow Statement

A cash flow statement is regarded as an important indicator of financial performance. It presents information that is not available from the income statement and balance sheet.

Without cash, a business may not be able to meet its debts as they fall due. It could then be put into liquidation, even if it is profitable.

Concept 1

$$\text{Net Profit} = \left[\begin{array}{c} \text{Cash sales} \\ + \\ \text{Credit sales} \end{array} \right] - \left[\begin{array}{c} \text{Cash purchase} \\ + \\ \text{Credit purchase} \end{array} \right] + \left[\begin{array}{c} \text{Cash expense} \\ + \\ \text{Accruals} \\ - \text{Prepayment} \\ - \text{Depreciation} \\ - \text{Doubtful Debt} \\ - \text{Bad Debt} \end{array} \right]$$

Revenue *Expenses* *Expenses*

$$\text{Cash \& Bank} = \underline{\text{Cash sales}} - \underline{\text{Cash purchase}} - \underline{\text{Cash expense}}$$

Implication

Cash is more objective than profit because various estimates (such as depreciation and doubtful debt) have to be made to calculate profit.

Concept 2

The cash movement of all activities of the firm could be illustrated as follows:

Financing Activities: Activities that result in changes in the size and composition of the equity capital and borrowings of the firm.

Investing Activities: Activities like acquisition and disposal of long term assets and other investments

Operating Activities: Key revenue-generating activities of the firm.

Bank & Cash

| | | |
|----------------------------------|--|---|
| <i>Operating Activity</i> | <i>\$ Net profit from operation</i> | <i>\$ To trade creditors</i> |
| | <i>\$ From trade debtors</i> | |
| <i>Investing Activity</i> | <i>\$ From sale of fixed assets</i> | <i>\$ Acquire fixed assets</i> |
| | <i>\$ From sale of investments</i> | <i>\$ Acquire investments</i> |
| <i>Financing Activity</i> | <i>\$ From ordinary shares</i> | <i>\$ For ordinary dividend</i> |
| | <i>\$ From preference shares</i> | <i>\$ For principal + dividend</i> |
| | <i>\$ From long-term liability</i> | |

Presentation

Cash flows from operating activities

| | | |
|--|----------------|--------------|
| Operating Profit (before tax) | | x |
| Adjustment for non-cash flow items | | |
| - Depreciation | | x |
| - Interest paid | | x |
| - (Profit) / loss on disposal | | <u>(x)/x</u> |
| | | x |
| Changes in working capital | | |
| - (Increase) / Decrease in stocks | (x) / x | |
| - (Increase) / Decrease in debtors | (x) / x | |
| - Increase / (Decrease) in creditors | <u>x / (x)</u> | |
| | | <u>x</u> |
| Cash generated from operations | | x |
| - Interest paid | (x) | |
| - Income taxes paid | <u>(x)</u> | |
| | | (x) |
| <i>Net cash generated from / (used in) operating activities x / (x)</i> | | |

Cash flows from investing activities

| | | |
|--|----------|--|
| Purchase of fixed assets | (x) | |
| Proceeds from sale of fixed assets | x | |
| Interest received | x | |
| Dividends received | <u>x</u> | |
| <i>Net cash generated from / (used in) investing activities x / (x)</i> | | |

Cash flows from financing activities

| | | |
|---|-----|--|
| Proceeds from issuance of share capital | x | |
| Share repurchase | (x) | |
| Proceeds from long-term borrowings | x | |
| Repayment of long-term borrowings | (x) | |
| Dividend paid | (x) | |

| | | |
|--|----------|--|
| <i>Net cash generated from / (used in) financing activities x / (x)</i> | | |
| Net increase / (decrease) in cash and cash equivalents | x / (x) | |
| Cash and cash equivalents at beginning of period | x | |
| Cash and cash equivalents at end of period | <u>x</u> | |