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# Cashflow Statements

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## Chapter Notes

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## INTRODUCTION

There are three main financial statement for a business. These include

1. Profit and Loss (Income Statement)
2. Balance Sheet (Statement of Financial Position)
3. Cashflow Statement

The Cashflow Statement looks at the future inflow and outflow of a business. This helps a business identify the change in the cash figure from one period to the next.

A Cashflow Statement is used for the following reasons

1. That profit and cash are not equal
2. It helps to identify future cash flows
3. It looks at cash coming in and out of the business
4. It's a good aid for financial planning

## NON-CASH ITEMS

**Non-cash items** <sup>Def</sup> are items in the profit and loss account that affect the net profit, but they do not affect the cash situation.

Examples include

1. depreciation of fixed assets (non-cash expense)
2. increase in bad debt provision (non-cash expense)
3. decrease in bad debt provision (non-cash gain)
4. decrease in goodwill (written off)
5. Profit on the sale of a fixed asset (non-cash gain)
6. Loss on sale of fixed asset (non-cash expense)

Note - Gains and Losses are non-cash adjustments because they correspond to long-term Assets purchased in PRIOR periods.

For example, if you sell a €200 asset for €150, you need to record a Loss of €50 on the Income Statement but you are NOT literally losing €50 in cash in this period!

**CASH GAIN****Cash Gain**

<sup>Def</sup> these are gains which increases both profits and cash

## Examples Included

1. investment income
2. rental income
3. discount received

**ITEMS THAT AFFECT CASH BUT NOT PROFIT.**

The following are some items that affect the cash balance but not the profit and are reasons why cash doesn't always equal profit

1. The purchase of fixed assets decreases cash but does not affect profit.
2. The sale of fixed assets increases cash but does not affect profit.
3. The introduction of capital increases cash but not profit.
4. Drawings reduce cash but has no effect on profit.
5. Loans received or repaid can also be used as an example,
6. as can investments bought or sold.

Usually items that go in the balance sheet do not affect the profit and loss

**PURPOSE OF CASHFLOW FORECASTS**

The following are the reasons for preparing a cashflow statement

1. To show that profits do not always equal cash.
2. To show the cash inflows and outflows during the past year.
3. To help predict future cash flows.
4. To help financial planning.
5. To provide information to assess liquidity/solvency.
6. To comply with legal requirements.
7. To aid application for loans.

**BENEFITS OF PREPARING A CASH FLOW STATEMENT**

The following are some of the benefits of preparing a Cashflow Statement -

1. It shows the cash inflows and outflows during the past year
2. It shows that profits do not always equal cash
3. It aids financial planning/ it is used to predict future cash flows
4. It provides information to assess current liquidity

**WHY PROFIT DOES NOT ALWAYS MEAN AN INCREASE IN CASH.**

The following are some of the reasons why profit doesn't always mean an increase in cash

1. non-cash losses and gains affect profit but not cash
2. purchase and sales of fixed assets affect cash but not profit
3. introduction or withdrawal of capital in cash affects cash but not profit
4. credit sales/purchases affect profit but do not affect cash

**STEPS INVOLVED IN ANSWERING A CASHFLOW STATEMENT**

**Step 1 - identify the change in net cash and net debt**

	Opening Amount (BS)	Closing Amount (BS)	Change
Cash			
Bank			
Net Cash			
Debentures			
Liquid Resources			
Net debt			

Liquid resource - This is an asset that can be converted into cash quickly. For example  
Government securities and bonds

**Step 2 - Calculate the change in Debtors, Stock and creditors**

	Opening Amount (BS)	Closing Amount (BS)	Change	Treat As (Positive/ Negative)
Debtors				
Stock				
Creditors				

**Step 3 - Calculate the amount paid during the year for taxation, dividends and interest**

	Opening amount (due) (if any) (BS)	Amount for this year (P & L)	Less Closing amount (if any) (BS)	Amount Paid
Taxation				
Dividends				
Interest payable				
Interest Received				

**Step 4 - Calculate the changes in fixed assets (Including depreciation)**

	Opening Balance (BS)	Add any additions or changes	Less disposals & depreciation	Closing amounts (BS)
L & B cost				
L & B Dep				
Delivery Van Cost				
Delivery Van Dep				

Note - if there are more than one fixed asset treat them separately

1. Enter the opening and closing balance from the balance sheet
2. Enter the relevant information in the additional information
3. Complete the table with the missing figure

**Step 5 - Calculate the changes in the capital structure of the business**

	<b>Opening amount (BS)</b>	<b>Closing Amount (BS)</b>	<b>Change</b>
Ordinary Share Capital			
Share Premium			
Debentures			
Government Securities			
Investments			

**LAYOUT OF STATEMENTS TO ANSWER A CASHFLOW STATEMENT**

**Abridged Profit and Loss Account of ABC plc for the year ending xx/xx/xx**

1	Operating profit	x	Add 3 and take away 2
2	Investment income	x	See working
3	Debenture interest	x	See working
4	Profit before tax	x	Add 5 and 6
5	Taxation	x	See Question
6	Profit after tax	x	Take 8 away from 7
7	Dividends	x	See Question
8	Retained Profit	x	Taken 10 away form 9
9	Profit and loss balance 01/01/20xx	x	Taken from the Balance Sheet
10	Profit and loss balance 31/12/20xx	x	Taken from the Balance Sheet

Note - Start and the bottom and work upwards to calculate the Operating Profit

Usually this will be given in a 60 mark question

**Reconcile of operating profit to net cash flow from operating activities**

Operating profit	x	From Abridge Profit & Loss
Add Dep Charge	x	Step 4
Loss / Profit on sale of Fixed Asset	x / (x)	From the Question
Add Goodwill	x	Step 4 (or from Question)
Increase / Decrease in provision of Bad Debts	x	From the Question
Increase / Decrease in Debtors	(x) / x	Step 4
Increase / Decrease in Stock	(x) / x	Step 3
Increase / Decrease in Creditors	x / (x)	Step 3
Net cash inflow / (outflow) from operating activities	x	



<b>Cash flow Statement for ABC PLC for the year ended xx/xx/xx</b>
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<b>Operating Activities</b>			
Net cash inflow from operating Activities		x	
<b>Returns on Investment and servicing debt</b>			
Interest Paid	(x)		Step 3
Investment Income (Interest Received)	x	x	
<b>Taxation</b>			
Taxation Paid		(x)	Step 2
<b>Capital Expenditure and Financial Investment</b>			
Purchase to acquire Fixed Assets	(x)		Step 4
Sales from sale of Fixed Assets	x		Step 4
Purchases of investments	(x)		
Sale of investments	x	x	
<b>Equity Dividends Paid Equity</b>			
Dividends paid		(x)	Abridge
<b>Net Cash Inflow / outflow before financing resources</b>		x / (x)	
<b>Management of Liquid Resources</b>			
Purchases of Government Securities		(x)	From BS
<b>Financing</b>			
Financing issue of debentures	x		Step 5
Receipt from shares	x		Step 5
Receipts form share premiums	x	x	Step 5
<b>Increase / Decrease in Cash</b>		x / (x)	Step 1

**Reconciliation of net cash flow to movement in net debt**

Increase / Decrease in Cash	x / (x)	From above
Cash used to purchase liquid resources	x	Step 1
Cash received from debentures	(x)	Step 5
Change in net debt	x	Match Step 1
Net debt 1/1/20xx	x	Match Step 1 (Change)
Net debt 31/12/20xx	x	Match Step 1 (CI Figure)