

# [Case study on statement of cash flows case 4](https://assignbuster.com/case-study-on-statement-of-cash-flows-case-4/)

[Business](https://assignbuster.com/essay-subjects/business/), [Company](https://assignbuster.com/essay-subjects/business/company/)

## Direct versus Indirect Methods of Preparing a Statement of Cash Flow

There is a difference between the direct and indirect methods of preparing a statement of cash flow. In the direct method of preparing a statement of cash flow, the cash flows are listed in the operations part of a cash flow statement. The cash flows that result from operations is in the form of cash paid to suppliers, customer collections, and the money paid to employees among others. In this section, the cash that is paid for interest and income tax is also reported. The direct method of preparing cash flow statements is problematic for many companies. The problems that arises when the direct method is used in the preparation of cash flow statements is that many companies do not store the information that is needed for preparing statements of cash flow in a form that is required by the use of the direct method (Benedicto, 2008).
Unlike the direct methods, the indirect method adjusts the net income in order to transform the income from an accrual into a cash basis that can be used in this method. It is noteworthy that many companies that use accrual accounting tend to credit sales and cash sales together. The indirect method requires one to add all the non-cash expenses that include the loss provision for all the accounts receivable, amortization, losses emanating from the sale of fixed assets and depreciation. The net income is also adjusted for the changes that that occur between the beginning account balances and ending account balances in the current assets section. This adjustment excluded the current liabilities and cash for that period (Benedicto, 2008).

## Cash Flow from Operating Activities versus Cash Flow from Investing Activities

Cash flow emanating from operating activities describes the money that a company generates from its core business activities. The cash flow that emanates from the operating activities of the company is a very potent indicator of the situation in a company. The value of this cash flow illustrates the ability of lack or inability of the firm to make profits. Even though the cash flow that emanates from the operating activities of a company indicates the ability or inability of the company to make a profit, other components in the statement of cash flow should also be considered so as to have a clearer and complete situational analysis of the health of the company (Benedicto, 2008).
There is a tendency to misconstrue the cash flow that emanates from investing activities to mean the money generated by a company from the various investments made by the company. While this is the meaning derived from literary decoding the name, the accountants who are tasked with filling out the balance sheets of corporate organizations have a different meaning. The cash flow emanating from investing activities does not entail the investments in shares or stock bought in another company or government or municipal bonds acquired by the company. Instead, the cash flow emanating from investing activities refers to the money that is generated or spent in purchasing or selling long-term assets that are owned by the company (Benedicto, 2008).

## Cash Flow Statement versus Income Statement in terms of Net Income and Cash at the End of the Year

The statement of cash flow and income statement are not very different. They both indicate the performance of the company in a particular period of time. However, a difference exists in that the income statement unlike the statement of cash flow takes into consideration accounting items that are non-cash such as depreciation. The statement of cash flow does not consider any accounting items that are not cash, by that reporting the actual money that generated by the company within the specified period (Benedicto, 2008). The fact that the statement of cash flow does not report accounting items that are not cash serves as the main difference. This translates to differences in cash at the end of the year as well as the net income of the company. This is best illustrated using an example. In the case a given company whose financial year ends on the thirty-first day of December earns revenue in that month but allows the customers to make the payments within a period of thirty days, it is expected that the cash emanating from the revenue generated in December will be received in the month of January. The net income in the income statement prepared in the month of December will increase because of the amount of revenue. This is because this non-cash accounting item can be reported in the income statement. However, the net cash flow in the statement of cash flow prepared in the month of December will not increase because the statement of cash flow does not report non-cash accounting items. In this case, the income statement will report more cash at the year’s end compared to the statement of cash flow.

## Income Statement versus Statement of Cash Flows

It is noteworthy that the two financial statements are prepared for different reasons. The differences in the two financial statements make them uniquely important for their different functions. For instance, the fact that the statement of cash flow does not report non-cash accounting items means that it gives the accurate financial situation in terms of inflows and outflows at the time of its preparation (Benedicto, 2008). Conversely, the income statement highlights the revenue earned even thought this revenue has not been received by the organization in terms of cash. These two types of information are valuable to a business. However, in order to establish which of the two financial statements is better, it is necessary to determine which of the tow financial statements gives the most ‘ accurate’ financial situation of the of the organization at the time the financial statement is prepared (Benedicto, 2008). In this respect, the statement of cash flows edges the income statement because it highlights the liquidity of the business. The statement of cash flows indicates the ability of the business to not only fund its operations, but also pay its debts. The cash at the year’s end in the statement of cash flow indicates the actual cash received by the company (Benedicto, 2008).

## Samsung and Apple’s Statement of Cash Flows

Source: (Yahoo Finance, 2015).
Key: Numbers in parenthesis represent negative numbers
As shown in Table 1 above, Samsung has more cash flow from the company’s operating activities compared to Apple Inc. This means that the company gets more income from its core activities when compared to Apple Inc. Another difference is that the cash flow from the investing activities is bigger for Samsung compared to Apple Inc. This is irrespective of the fact that both companies have posted negative numbers. Thirdly, the cash flow from the financing activities of Samsung is bigger compared to that of Apple Inc. Finally, in the three years that have been considered, Samsung has posted a larger cash equivalents and change in cash in two of the years compared to Apple Inc (Yahoo Finance, 2015).

## References

Benedicto, S. (2008). Introduction to financial accounting. Madrid. IE Business School
Edwards, J. & Hermanson, R. (2007). Accounting Principles: A Business Perspective. Volume 1 Financial Accounting. The Global Text Project. Retrieved from www. saylor. org/site/wp-content//Accounting-Principles-Vol.-1. pdf
Yahoo Finance. (2015). Apple Inc. (AAPL). Retrieved from https://finance. yahoo. com/ q/cf? s= AAPL+Cash+Flow&annual
Yahoo Finance. (2015). Samsung Electronics Co. Ltd. (005930. KS). Retrieved from http://finance. yahoo. com/q/cf? s= 005930. KS+Cash+Flow&annual