

Example of essay on cash flow statement

[Business](#), [Company](#)



(a) Discuss the need for a cash flow statement such as that given for JIJPlc; Cash flow statement analysis is helpful to management in the generation and utilization of cash in the most efficient way. Efficient utilization of cash helps management in its objective of wealth maximisation. The cash flow statement helps in identifying the strength of cash generation in the various activities such as operations, financing, and investing. It helps trace the source of cash received and how it is disbursed. For To be a healthy firm, cash should come from operations. The cash flow statement is also an indicator of efficiency in cash management of the firm. Financial policies and cash position can be inferred from the statement. The management is able to know the amount of funds generation and the sources of funds. By coming to know cash will be surplus or deficit, the management can arrange to meet the deficit or invest the surplus funds. The cash flow statement also shows the movement of firm's cash. When comparing with the cash budget, it helps identification of the extent of compliance with the forecast and deviations in the actual working of the firm from the forecast figures. The statement is also useful in assessing trend analysis within the firm and inter-firm comparative analysis for the purpose of competitive analysis. Funds flow statement is similar to cash flow statement, but they are for different purposes. The funds flow statement adopts the accrual basis of accounting system whereas the cash flow statement follows cash basis accounting system. The figures on accrual basis are converted to cash basis before preparing the cash flow statement. While funds flow statements helps the assessment of long term fund position, cash flow statements help in the assessment of short term cash position, liquidity, cash generation capacity

and repayment capacity of the firm. While funds flow revolves around a wider understanding of the working capital position on the whole, cash flow statement is concerned with the flow of cash of the firm. As such, it is narrower and stringent in the assessment of the cash generation capacity of the firm. In funds flow, changes in current assets and current liabilities are adjusted in the working capital changes, whereas the cash flow statement, cash generated from operating activities are adjusted with the changes in current assets and current liabilities. The technique of the preparation is to start with the opening balances in cash and bank and reconciling them to the closing balances of the cash and bank balances,, and (b) Explain and illustrate each of the terms displayed upon the statement.

Cash inflows from operating activities to a business are from sales collections, interest received, and dividend received. Cash outflow are payment to suppliers, payment of interest, tax payment, and payment for operating expense. Cash from operations is computed by adding to the net profit, the amount of decrease in current assets, increase in current liabilities and by deducting from the resultant amount, the increase in current assets, and decrease in current liabilities. It must be noted that an increase in current assets and decrease in current assets will not appear at the same time. Both are mentioned here to indicate that any decrease in current assets should be added, and increase should be deducted. Similarly, the opposite effect will be applicable in respect of current liabilities.

Cash flows from operating activities: This represents profit before tax £ 80 m. To this are added, depreciation, loss on sale of plant and interest expense £ 75 m, 10 £ m and £ 30 m respectively. These are adjustment entries and

are not actual cash outgo and hence are added back. The resulting figure of £ 195 m represents gross operating profit. To this figure, £ 195 m representing decrease in inventory £ 100 m is added. Decrease in inventory represents incoming of cash and hence added to the gross operating profit arrived at. Further, £ 20 m and £ 33 m representing an increase in receivables and decrease in payables are deducted since both the items represent cash outgo. Increase in receivables represents funds outgo by way of credit sales and decrease in payables represents funds outgo by way of payments to creditors for goods bought on credit. The resulting figure of £ 242 m represents cash generated from operations. From this interest paid and tax paid are deducted for £ 30 m £ 12 m respectively as they again represent cash outgo. The resulting figure of £ 200 m is the net cash generated from operating activities. This figure is the income from the company's revenue transaction and is the source of real strength as it represents the firm's earning in cash.

Cash flows from investing activities are capital transactions which might from borrowings or share capital newly issued. The company has received £ 50 m as proceeds from the sale of plant which was a capital asset. The company has also spent £ 265 m on non-current assets which can be plant and equipment or investments. The net cash used in investing activities is £ 215 m i. e., £ 265 m spent for non-current assets and £ 50 m received from the sale of plant. This is a deficit figure and must have been met from cash from operations or capital transactions i. e net cash received from financing activities. This year the company has received £ 600 m as proceeds from the issue of share capital. £ 200 m has been paid as a repayment of loan notes

and £ 45 m paid as dividends. Thus £ 245 m represents cash outgo from the surplus capital transactions of £ 600. Thus, remaining surplus cash £ 355 m is shown as net cash generated from financing activities. Thus, surplus cash from operating activities £ 200 and financing activities £ 355 amounts to a total sum of £ 555 m. If this is adjusted against the net cash outgo £ 215 m from investment activities, the resulting figure is a net increase in cash of £ 340. This is verified as correct by adding it to the opening cash balance i. e £ 40 m as overdraft as on 1 Oct 2013 which tallies with the surplus cash position as at 30 September 2014 . (c)Discuss the overall cash position of the business.

The overall cash position of the business is good. The cash from operating activities is £ 195 m and the dividend £ 40 m has been paid out of profits only. The firm has surplus cash of £ 355 from capital transactions also. Thus, the net increase in cash of £ 355 m represents a comfortable cash position for the firm. It can meet additional urgent purchase requirements without availing overdraft or from credit purchases at an extra cost. The bank overdraft can also be repaid from the available surplus funds. Cash management is one aspect of the treasury function. If a company has a cash reserve, it was once considered that the manager has done a good job and not seen as a symptom of inefficiency. Today this is the case. While cash position must ensure liquidity, funds should not be kept idle and therefore invested in short-term investments that can be en-cashed on demand to meet unforeseen requirements. The cash flow statement is prepared primarily to ensure firm's ability to remain solvent and grow

References

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