

محاضرة (11)

❖ Analysis Implications of Cash Flows

• Uses of Cash Flow Statement/importance of Cash Flow Statement استخدامات

وأهمية كشف التدفق النقدي

a) **Short-term Planning of Business** التخطيط قصير الأجل للأعمال

It is helpful in the short-term planning of the business unit by indicating in advance as to how much funds are needed in future, how much of these funds can be raised internally and how much should be arranged from outside etc.

b) **Useful in Internal Financial Management** مفيدة في الإدارة المالية الداخلية

Since Cash-flow statement reveals the amount of cash inflow from operations (and not income from operations), it will be helpful in internal financial management either in liquidity of a plant or any other fixed asset or in devising the dividend policy of the business unit.

c) **Useful in Capital Budgeting Decisions** مفيدة في قرارات الموازنة الرأسمالية

It is helpful in taking capital budgeting decisions by indicating the availability of funds or otherwise during the period under consideration.

d) **Focusing on Trend of Movement** التركيز على اتجاه الحركة

1) The cash flow statement prepared for a particular accounting year when compared with the budget already prepared for that year would indicate to what extent the sources of business unit were raised and applied in consonance with the budget.

2) In short, this comparison would facilitate focusing on trend of movement that would have gone undetected otherwise.

e) **Planning in Replacement of Outdated Assets** التخطيط لاستبدال الموجودات القديمة

It is helpful to management in planning replacement of outdated assets and in formulating dividend policies.

f) **Useful to Financial Analyst** مفيدة للمحلل المالي

It explains to the financial analyst, the reason why the business unit has run out of money, despite the fact that the unit has made a profit, or it has surplus of cash despite the fact that the business has incurred a loss.

g) Movement of Cash حركة النقدية

It discloses the movement of cash.

• **Limitations of Cash Flow Statement** محددات كشف التدفق النقدي

- 1) When the business unit extends sales on credit basis and takes into consideration all prepaid and accrued items, there would be an increase in the working capital. But all the same, equating the net income of the business unit to mere cash flow would not proper and accurate, since a large number of "non cash" items would affect the net income of the unit ultimately.
- 2) In all business concerns, fixed assets involve cash payments in the year of installation and depreciation thereon are charged against operating income every year. By this the net income moves away from net cash flow. Thus, to equate the net operating income with the net cash flow into the business is highly improper technique.
- 3) It can be very easily manipulated by the management by postponing purchases and other payment.

❖ **The various Cash Flow Activities**

a) Cash Flow from Operating Activities التدفق النقدي من الأنشطة التشغيلية

1. The cash flows generated from major revenue producing activities of the entities are covered under this head.
2. Cash Flow from operating activities shows the extent to which the operations of the enterprise have generated sufficient cash to maintain the Operating Capability to pay dividend, repay loans and make new investments.

التدفقات النقدية من الأنشطة التشغيلية تبين المدى الذي يمكن أن تنشأ فيه عمليات المنشأة النقدية الكافية للحفاظ على القدرة التشغيلية على دفع الأرباح ، وتسديد القروض وإجراء استثمارات جديدة.

3. Examples of Cash Flow from Operating Activities

- (1) Cash receipts from sale of goods and services.
- (2) Cash receipts from royalties, fees, commission etc.
- (3) Cash payments to employees.
- (4) Cash payments or refunds of income tax.
- (5) Cash receipts and payments relating to future contracts, forward contract etc.

b) Cash Flow from Investing Activities التدفق النقدي من الأنشطة الاستثمارية

1. These are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

2. This represents the extent to which the expenditures have been made for resources intended to generate future incomes and cash flows.

3. Examples of Cash Flow from Investing Activities

- (1) Cash payments for purchase of fixed assets.
- (2) Cash receipts from sale of fixed assets.
- (3) Cash payments for purchase of shares/debentures in other entities.
- (4) Loans and advances given to third parties.
- (5) Repayment of loans given.

c) Cash Flow from Financing Activities التدفق النقدي من الأنشطة التمويلية

1. Financing activities are the activities that result in changes in the size and composition of the owner's capital and borrowings of the enterprise.
2. Separate disclosure is important because it is useful in predicting claims in future cash flows by providers of funds.

3. Examples of Cash Flow from Financing Activities :

- (1) Cash receipts from issue of share capital.
- (2) Cash receipts from issue of debentures, loans (short or long term).
- (3) Cash repayments of amounts borrowed.
- (4) Cash payment to redeem preference shares.

❖ Preparing the Statement of Cash Flows إعداد كشف التدفق النقدي

Unlike the major financial statements, cash flow statement is not prepared from the adjusted trial balance. The information to prepare this statement usually comes from three sources:

- 1) Current income statement data help the reader determine the amount of cash provided or used by operations during the period.
- 2) Selected transactions data from the general ledger provide additional detailed information needed to determine how cash was provided or used during the period.
- 3) Comparative balance sheets provide the amount of the changes in assets, liabilities, and equities from the beginning to the end of the period.

(1) Direct Method الطريقة المباشرة

The direct method reports cash receipts and cash disbursements from operating activities. The difference between these two amounts in the net cash flow from operating activities. In other words, the direct method deducts from operating cash receipts the operating cash disbursements. The direct method results in the presentation of a condensed cash receipts and cash disbursements statement.

The statement of cash flow using direct method by adjusting each item in the income statement from the accrual basis to cash basis.

توضح الطريقة المباشرة المقبوضات النقدية والمدفوعات النقدية من الأنشطة التشغيلية. الفرق بين هذين المبلغين في صافي التدفق النقدي من عمليات التشغيل. وبعبارة أخرى ، تُطرح الطريقة المباشرة المدفوعات النقدية التشغيلية من المتحصلات النقدية التشغيلية. وينتج عن الطريقة المباشرة عرض كشف موجز بالمقبوضات والمدفوعات النقدية.

Exercise No. 1

The following are the income statement and Comparative Balance sheet for Tiger Company:

Income statement for the year ended December, 31, 2018

Particular	IQD	IQD
Sales		200000
Cost of goods sold	80000	
Operating expenses	30000	110000
Income before income tax		90000
Income tax		15000
Net income		75000

Tiger Company Comparative Balance sheet (Thousands IQD)

Dec., 31/12/2018

Assets	2017	2018	changes	increase/ decrease
Cash	100000	80000	-20000	Decrease
Accounts receivable	50000	90000	+40000	Increase
Furniture	20000	50000	+30000	Increase
Total	170000	220000	+50000	
Liabilities and stockholders' equity				
Accounts payable	40000	25000	-15000	Decrease
Income tax payable	5000	15000	+10000	Increase
Common stock	90000	100000	+10000	Increase
Retained Earnings	35000	80000	+ 45000	Increase
Total	170000	220000	+ 50000	

Additional information:

- 1) The company was declared and paid IQD 30000 as dividend in 2018.
- 2) Common stock of IQD 10000 was issued.

Required: Prepare the statement of cash flow by using **Direct Method**.

Solution:

Working Notes :

- Accounts receivable = 50000 – 90000 = - 40000 Decrease
- Cash receipts from costumers = Revenues - Accounts receivable
= 200000 – 40000 = 160000
- Accounts payable = 40000 – 25000 = 15000 Decrease
- Cash payments to suppliers = 80000 + 15000 = 95000

- Income taxes = 15000 – 10000 = 5000

Tiger Company
Statement of cash flows (Direct method) for the year ended Dec., 31, 2018

Particulars	IQD	IQD
1- Cash flows from operating activities:		
(1) Cash receipts from customers		160000
(2) Cash payments:		
To suppliers	95000	
For operating expenses	30000	
For income taxes	5000	(130000)
Net cash provided by operating activities		30000
2-Cash flows from investing activities:		
Purchase of furniture	(30000)	
Net cash used by investing activities		(30000)
3-Cash flows from financing activities:		
Issuance of common stock	10000	
Payment of cash dividends	(30000)	
Net cash used by financing activities		(20000)
Net increase in cash		(20000)
Cash at the beginning of the period		100000
Cash at the end of the period		80000

(2) Indirect Method الطريقة غير المباشرة

This method starts with net income and converts it to net cash flow from operating activities. In other words, the indirect method adjusts net income by the items that are affected on the net income but not affected on cash.

☞ **Rule:** قاعدة

Increase in current assets and decrease in current liabilities is deducted from net income, Decrease in current assets and increase in current liabilities is added to net income for the purpose of conversion net income to net cash from operating activities.

قاعدة : الزيادة في الموجودات المتداولة والنقص في المطلوبات المتداولة تطرح من صافي الدخل ، والانخفاض في الموجودات المتداولة والزيادة في المطلوبات المتداولة يضاف إلى صافي الدخل لغرض تحويل صافي دخل إلى صافي النقد من الأنشطة التشغيلية.

Exercise No.2

The following information's are abstracted from books Bassam Co. (Amounts in IQD thousands) :

- 1) Net Income was IQD 120000
- 2) Bonds payable increased IQD 50000
- 3) There was a gain on sale of equipment of IQD 20000 (the equipment had a book value of IQD 30000).
- 4) Accounts Receivable decreased IQD 50000
- 5) Accounts Payable decreased IQD 20000
- 6) Prepaid Rent increased IQD 10000
- 7) Dividends totaling IQD 20000 were paid.
- 8) Depreciation was IQD 20000
- 9) Common Stock increased IQD 50000
- 10) Land increased IQD 100000 (purchased land for IQD 100000)
- 11) Beginning cash IQD 10000
- 12) Ending Cash IQD 180000

Required: Prepare the statement of cash flows by using the indirect method.

Solution:

Cash Flow Statement of Bassam Corporation For Year Ending 31/12/2018

Cash from Operations:	(1) IQD	(2) IQD
Net Income	120000	
+ Depreciation	20000	
- Gain on Sale	(20000)	
+ Decrease A/R	50000	
- Decrease A/P	(20000)	
-Increase Prepaid Rent	(10000)	
Total Cash from Operations		140000
Cash from Financing:		
+ Bonds Issued	50000	
-Dividends paid	(20000)	
+Stock Issued	50000	
Total Cash from Financing		80000
Cash from Investing:		
Sale of Equipment	50000	
Purchase of Land	(100000)	
Total cash from Investing		(50000)
Net Increase in Cash Flow		170000
+Beginning Cash		10000
= Ending Cash		180000