

PART III

INTERPRETATION OF CASH FLOW STATEMENT, RATIO ANALYSIS AND BANK RECONCILIATION STATEMENT



Cashflow Statement

LEARNING OBJECTIVES

After going through this chapter, students will be able to:

- Explain how to prepare, analyze and interpret a statement of cash flows.
- Discuss the importance of cash flow information for estimate the future performance for making the best decision for the company.
- Ascertain the top of management of organization in order to make the effective decision by analyzing the operating, investing and financing activities of business.

INTRODUCTION

The purpose of the statements of cash flow is to report cash receipts (inflows) and cash payments (outflows) during the period. This includes separately identifying the cash flows related to operating, investing and financing activities. The statement of cash flows does more than simply report changes in cash. It is the detailed disclosure of individual cash flows that makes this statement useful to users. Information in this statement helps users answer question such as follows:

- a. How does a company obtain its cash?
- b. Where does a company spend its cash?
- c. What explains the change in the cash balance?

The statement of cash flows addresses important questions such as these by summarizing, classifying and reporting a company's cash inflows and cash outflows for each period.

IMPORTANCE OF CASH FLOW

Information about cash flows can influence decision makers in important ways. For example, we look more favorably at a company that is financing its expenditures with cash from operations than one that does by selling its asset. Information from the cash flows help users decide whether a company has enough cash to pay its existing debts as they mature. It is also relied upon to evaluate a company's ability to meet unexpected obligations and pursue unexpected opportunities. External information users especially want to access a company's ability to take advantage of new business opportunities. Internal users such as managers and shareholders use cash flows information to plan day to day operating activities and make long term investment decision.

CLASSIFICATION OF CASH FLOW

- a. Operating activities - includes those transactions and events that determine net income. Examples are the production and the purchase of merchandise, the sale of goods and services to customers and the expenditures to administer the business
- b. Investing activities - generally includes those transactions and events that affect long term asset. For example, the purchase and sale of long term asset. They also include the purchase and sale of short term investment in the securities in other entities other than cash equivalents and trading securities and lending and collecting money for notes receivables.
- c. Financing activities - include those transactions and events that affect long term liabilities and equity. Examples are obtaining cash from issuing debts and repaying the amount borrowed, receiving cash from or distributing cash to owners.