

Chapter 3

PRE-ASSESSMENT & POST-ASSESSMENT

Cash Flow Statement (CFS)

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What I Need to Know

This chapter will discuss:

- The components and structure of a Cash Flow Statement(CFS) and its preparation.

After going through this chapter, you are expected to:

1. Discuss the components and structure of a CFS
2. Prepare a Cash Flow Statement

What I Know

PRE-ASSESSMENT. Choose the letter of the best answer. Write the chosen letter on a separate sheet of paper.

1. What is a Cash Flow Statement?
 - a. A specific list of the manager's expenses.
 - b. A document that lists all the transactions of the business.
 - c. A list that shows the money goes out of but not in a business.
 - d. A report that shows how money moves through an organization.
2. Which of the following shows an inflow movement of cash?
 - a. Advertising Expense
 - b. Interests from bank deposits
 - c. Cash paid to suppliers
 - d. Payment of Income tax
3. The cash inflow and outflow activities arising from the normal operations of the business.

a. Investing	c. Operating
b. Financing	d. Supplemental
4. Transactions that arise from the purchase and sale of property and other company assets with the intention of attaining future benefits.

a. Investing	c. Operating
b. Financing	d. Supplemental
5. A financing activity that shows outflow of cash.

- a. Payment of bank loan
 - b. Purchase of equipment
 - c. Cash paid for advertising
 - d. Collection of accounts receivable
6. What part of the Cash Flow Statement will be affected from the proceeds from the sale of an equipment used in the business?
- a. Investing
 - b. Financing
 - c. Operating
 - d. Supplemental
7. A decrease in the balance of Accounts Payable affects which business activity?
- a. Investing
 - b. Financing
 - c. Operating
 - d. Supplemental
8. Which is an Operating Activity?
- a. Payment of Loan
 - b. Collection of accounts receivable
 - c. Purchases of Company Equipment
 - d. Gain from the sale of company service vehicle
9. Which is NOT a Cash Flow activity?
- a. Collection from sale of building
 - b. Collection of accounts receivable
 - c. Forecasting uncollectible accounts
 - d. Rent received from lease of a business property
10. The ending balance of the Cash Flow Statement will be used as the amount of cash in which Financial Statement?
- a. Notes to Financial Statement
 - b. Statement of Financial Position
 - c. Statement of Comprehensive Income
 - d. Statement of Changes in Owner's Equity

After completing the module on the Statement of Financial Position (SFP),

Statement of Comprehensive Income (SCI), Statement of Changes in Equity (SCE), we will now look into another financial statement that describes the movement of cash in a company, the Cash Flow Statement.

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**Discuss the Statement of Cash Flow:
Components, Structure and its Preparation**

What's In

Have you ever thought of the relationship between the statement of financial position, statement of comprehensive income and cash flow statement? Is there a possible connection between the amount of cash in the statement of financial position and the ending balance of a cash flow statement? Is it possible for a business to have a great deal of cash even if it is experiencing a net loss? I hope you will find the answers to all of these questions after completing this module.

What's New

Do you appreciate receiving money? Whether you acquired it from allowances, pay for a job done, or gift from loved ones, money has an important role one's life. The question is, what do you do when you received all that money? How do you spend it? Do you prioritize and organize your spending?

Step One. Let's start by measuring how you plan for your money. Knowing what you should do will help you keep it in practice. It will not always be easy but it will be worth it. Assess your Income and Spending Options.

INCOME OPTIONS

Name two to four ways you can realistically generate more cash. (Think of your skills and talents that other people might need?)

OPTION #1	OPTION #3
OPTION #2	OPTION #4

SPENDING OPTIONS

Recall the expenses you make, and try to answer the following questions to determine if there are spending leaks.

What do I wish I'd done with that money instead?	Will it take me longer to achieve my financial goals now?
How can I reduce the impact of my decision?	What will I do from making the same mistake?

The impact of your decisions greatly affects how you experiences life. As a student, you can think of ways to bring in more cash than just by waiting for your allowances. You can also watch out for the expenses you make by creating wise decisions on how you spend your money.

The basics of maximizing your money comes down to -Cash flow.The money flowing into your pocket as income and flowing out as expenses or debts. Maintaining a balanced cashflow is essential.

Step Two. Measure your current financial status by completing the Cash Flow statement below.

Personal Cash Flow

1. Make a list of the different sources on how you acquire money and instances on how you spend your money.
2. Compute your monthly allowances and deduct the amount you spend from your allowances.
3. Associate the allowance with cash inflows and spending with cash outflows.

NAME OF STUDENT Cash Flow Statement For the Month Ended _____	
Cash Inflows	
Cash Outflows	
Net Increase/decrease in cash	
Cash Beginning (Balance from last month)	
Cash End (cash on hand)	

What is It

How did you feel while doing the activity above? Where you able to compute how much cash you have at the end of the month? If the result is negative, ask yourself, where do you get the difference since cash cannot be negative? Do you have any liabilities from your classmates, friends or relatives? In the same manner, it is probable that a business may have ample amount of cash even with a net loss.

Cash is one of the most important resource of an organization. Without cash, it would be very hard for a business to survive, because cash is essential for its operation and growth.

There are many ways in which a business earns and spends its cash.

1. A business **earns** cash through: (INFLOWS)
 - Sales of products or service
 - Asset sales
 - Loan or credit card proceeds
 - Owner investments

2. A business **spends** cash through: (OUTFLOWS)

- Business expenditures
- Loan or credit card principal payments
- Owner withdrawals
- Asset purchases

These inflows and outflows are classified into three main group of business activity.

A. **Operating Activities**- These are transactions that relate to how a business earns money on a day-to-day basis. Primarily, cash inflows are made every time customers buy their products or avail of their services; cash outflows are made when the business pay employees, utilities, suppliers, taxes, and other sales and business expenditure activities.

B. **Investing Activities**- Investing activities come from the sale (receipts) and purchase (payments) of non-current assets, businesses, and securities used for the maintenance of and additions to support/expand the company's operation and competitiveness in the future.

C. **Financing Activities**- the cash inflows (receipts) and outflows (payments) from financing activities come from entering into loans to avail more cash or to pay long-term debts; owner's additional investments and withdrawals; issuing stocks and paying out dividends and similar transactions.

Naturally, it is desirable for a business to be generating a big portion of its cash inflow from operating activities, as this would mean positive sign in terms of growth in sale of goods and services. Without which, investing and financing for the growth of the business will not be feasible.

Notice that not all transactions involve cash, like making a sale or purchase on account (no cash receipts/payments made at the time of the transaction), and thus, have no impact on cash flow. To analyze a company's cash flow, the focus will be on transactions involving actual exchanges of cash.

Activity 1. COMPONENTS OF CFS. Classify the following as to the 3 main business activities. Write OPERATING, INVESTING, FINANCING or NON-CASH on the blanks. Three items were done for illustration.

- | | |
|---|---------------------------------------|
| <u>Financing</u> 1. Payment of Bank Loan | _____ 6. Owner's Drawings |
| <u>Operating</u> 2. Collection from Customers | _____ 7. Payment of Accounts' payable |
| _____ 3. Purchase of Supplies | _____ 8. Estimated Doubtful Accounts |
| <u>Investing</u> 4. Proceeds from Sale of truck | _____ 9. Payment of Tax |
| _____ 5. Payment of Worker's salaries | _____ 10. Purchase of Building |

Aside from learning how to classify transactions into the three main components of a business activity, you have to understand that each transaction also brings corresponding effects on these three main business components. That is why, you also have to analyze the behavior of each transaction.

Remember the normal balances of accounts discussed in FABM1? Cash is an asset and the normal balance for assets is debit. Therefore, transactions that debit cash adds to the company's cash balance while transactions where cash is credited would mean making payments and decreases cash.



In the case of an Inflow, it means more cash is added to the business, therefore, the effect of the transaction is positive in terms of increasing the amount of cash on hand of the company.

Example: Service Business

TRANSACTION	ACTIVITY	EFFECT
1.Cash received for service rendered	Operating	(+)
*Reason	*It is under the normal income generating activity of a business	*More cash is added into the business

In the case of an Outflow, cash on hand is dispensed out of the business, therefore, the effect of the transaction is negative in terms of the decrease in the amount of cash held by the company.

Example: Service Business

TRANSACTION	ACTIVITY	EFFECT
1. Purchase of Equipment	Investing	(-)
*Reason	*Purchase was made to support the operation of the business/to make service more efficient.	*Cash was decreased due to payment for the equipment.

Activity 2. EFFECTS OF TRANSACTIONS ON EACH COMPONENT.

Sarbast’s Company had the following transactions on December 31, 2018. Write the cash flow activity of the following transactions and indicate their effect on each activity. Three items were done for illustration.

Transaction	Amount	Operating/ Investing/ Financing	+ inflow - outflow
1.Payment of Bank Loan	\$45,000	Financing	- outflow
2. Collection from Customers	175,000	Operating	+ inflow
3.Purchase of Supplies	46,000		
4.Proceeds from Sale of truck	295,000	Investing	+ inflow
5.Payment of Worker’s salaries	65,000		
6.Owner’s Drawings	15,000		
7.Payment of Accounts’ payable	9,500		
8. Estimated Doubtful Accounts	2,500		
9.Payment of Tax	6,300		
10.Purchase of Equipment	150,000		

Preparing a Cash Flow Statement

Knowing where cash is coming from and going to is a must for business owners in order to make sound decision for their company, like, whether to expand or invest in a new business venture. Understanding the inflows and outflows of cash is essential as it reflects the condition of the business. To have a clear view on how these conditions are generated, the Statement of Cash Flow is prepared.

Cash Flow Statement Defined:

The SCF reports cash flow transactions during an accounting period classified by operating, investing and financing activities. It shows how much cash enter (inflows) and how much cash is spent (outflows) by the company. It reflects how the amount of cash a business has at present and how it changes over time.

All that matters in the preparation of a cash flow statement is the movement of cash within the business. This includes all cash earnings or payments, and cash received as proceeds from loans and cash used to pay loans within a specific time.

Structure of the Cash Flow Statement

The CFS is mainly comprised of three core components based on activity and other supplemental sections:

Operating Activities Investing Activities Financing Activities

Heading- It lists the name of a particular company, the cash flow statement and the date/accounting period. Specifically, For the (period) ended (date).

Net increase/decrease in Cash – The amount of change in cash whether it is an increase or decrease for the current period. It is the total change brought by the result of operating, investing and financing activities. (TG)

Beginning Cash Balance – The balance of the cash account at the beginning of the accounting period. (TG) This is the amount of cash in the previous year's Statement of Financial Position or the ending cash balance of the preceding cash flow statement.

Ending Cash Balance – The balance of the cash account at the end of the accounting period computed using the beginning balance plus the net change in cash for the current period. (TG)

There are two ways to prepare a CFS, the direct and indirect approach. The **direct approach** focuses on gross cash inflow and outflow that arises naturally through the business activities, thus, providing a much transparent view on how cash moves through the business.

The **indirect approach** reconciles the net income/loss of the company with the total cash flows generated/used in operating activities by adjusting the net income/loss for the effects of non-cash transactions. (DGSL, 2015).

For this module, we will focus on the Direct Approach.

Steps in the Preparation of Cash Flow Statement (Direct Approach)

1. Classify available business transactions into the three main components of operating, investing and financing.
2. Add all inflows and subtract all outflows to arrive with the amount of net cash flow per component/activity.
3. Add the net cash flow balances per component/activity to get the net increase/decrease in cash any given time period.
4. Add the amount of cash beginning to arrive with the amount of cash end.

INVESTING ACTIVITIES	
<u>Cash Inflows</u>	<u>Cash Outflows</u>
FINANCING ACTIVITIES	
<u>Cash Inflows</u>	<u>Cash Outflows</u>

2. Find the ending balances of each activity.

Operating Activity _____
Investing Activity _____
Financing Activity _____

3. Assume that the beginning cash balance is \$81,000, determine Ekhlas’s ending cash balance for the month. _____

Independent Assessment. PREPARATION OF CASH FLOW STATEMENT.

Perform the indicated instructions.

- A. Using the information from Activity 2, Sarbast’s Company, determine the following:
 - a. Net Cash Flow from Operating Activities
 - b. Net Cash Flow from Investing Activities
 - c. Net Cash Flow from Financing Activities
 - d. Net Increase/Decrease in Cash

- B. Assuming that the amount of Cash beginning is \$350,000.00, compute for the ending cash balance of Sarbast’s Company on December 31, 2021.

- C. Prepare a Cash Flow Statement for Sarbast’s Company.

HEADING →			
OPERATING → ACTIVITIES			
INVESTING → ACTIVITIES			
FINANCING → ACTIVITIES			

NET INCREASE → IN CASH			
ENDING → BALANCE			

What I Can Do

I. Perform the indicated instructions.

Abdullah store had the following transactions during the year: Cash

Received

Sale of goods \$1,500,000

Sold equipment 100,000

Cash Paid

Purchase of goods 900,000

Paid utilities 300,000

Paid rent 100,000

Owner withdraws investment 100,000

- A. Determine the Net Cash Flow from Operating, Investing and Financing Activities.
- B. Compute for the Net Increase/Decrease in Cash.
- C. Assuming that the amount of Cash beginning is \$120,000.00, compute for the ending cash balance of Abdullah Store on December 31, 2021.
- D. Prepare a Cash Flow Statement for Abdullah store.

Assessment

I. True or False: Read the statements and determine whether they are TRUE or FALSE.

- _____ 1. Salary and utility payments are classified under operating activities.
- _____ 2. Payments for the purchase of inventory goods are reported under investing activities.
- _____ 3. Business activities are classified into operating investing and funding activities.
- _____ 4. The ending cash balance of the Cash Flow Statement is equivalent to the cash balance reported on the Statement of Financial Position.
- _____ 5. Payments for bank loans are classified under operating activities.

II. Perform the indicated instructions.

The cash account of Kurdish Company has an ending balance of \$829,937.50, and a list of transactions:

TRANSACTIONS	AMOUNT
Cash collections from customers	\$175,000
Collections from Accounts Receivable	110,000
Future sales forecast	30,000
Purchase of equipment on account	89,000
Supplies estimate	3,000
Additional investment of owner	150,000
Proceeds from sale of furniture	18,000
Income Receivable	52,000
Rent Income	6,000
Interest Income	2,650
Owners drawings	12,700
Utilities expense	15,000

Required: Prepare a Cash Flow Statement on December 31, 2018, after determining the amount of cash for the following components.

1. Net Cash flow from operating, investing and financing activities.
2. Net increase/Decrease in Cash.
3. Cash Balance -beginning

Additional Activities

1. Compute the problem in each card to find the secret word.

A	<u>Operating Activity</u> Cash Collections \$5000 Paid Interest 2,500 Owner's Drawings 500 Sold Equipment 11,000	I	<u>Financing Activity</u> Owner's Drawings \$7,500 Paid Bank Loan 13,500 Paid Accounts Payable 500 Owner's Investment 58,500
O	<u>Financing Activity</u> Cash from loans \$85,000 Interest Income 12,500 Owner's Drawings 5,000 Sold Equipment 11,000	C	<u>Operating Activity</u> Cash Collections \$15,000 Paid Taxes 2,500 Purchase of supplies 3,500 Sold Equipment 11,000
L	<u>Operating Activity</u> Utilities Expense \$7,500 Rent Income 11,500 Owner's Drawings 5,000 Sold Equipment 11,000	G	<u>Investing Activity</u> Sale of Tricycle \$17,500 Rent Income 11,500 Owner's Drawings 5,000 Sold Equipment 11,000
B	<u>Investing Activity</u> Utilities Expense \$7,500 Purchase Furniture 13,500 Owner's Drawings 5,000 Sold Equipment 28,500	K	<u>Operating Activity</u> Salaries expense \$6,500 Rent Income 31,500 Paid Furniture 5,000 Paid Equipment 11,000
N	<u>Financing Activity</u> Utilities Expense \$7,500 Paid Bank Loan 13,500 Paid Accounts Payable 500 Owner's Investment 58,500	Y	<u>Investing Activity</u> Sold Machinery \$16,500 Sold Tricycle 31,500 Paid Furniture 5,000 Paid Equipment 11,000

Answers:

A		I	
O		C	
L		G	
B		K	
N		Y	

SECRET WORD

\$15,000	\$37,500	\$45,000	\$28,500	\$80,000

What I Have Learned

KEYWORDS. Check your understanding by filling in the blanks with the correct answer.

1. _____ is one of the important assets of a company. How it is earned and spent affects the movement of cash within a company. That is why, it is desirable that the bulk of cash inflow come as a result of _____ activities.
2. A _____ narrates the cash that comes in and goes out of a business by summarizing the results of transactions into operating, investing and financing activities. By reflecting on the amount of cash a business has and can generate, managers are able to make feasible/future decisions for the company.
 - a. _____ include sales, business expenditures, and matters about the normal business operation of the company.
 - b. _____ include the sale and purchase of long-term assets to support the normal operation of the company/future benefits.
 - c. _____ include availing and payment of loans, and owner's investments and withdrawals. Thus, it is possible for a company to have ample cash even with a net loss.
3. The two ways to prepare a CFS is through _____ and _____ approach.
4. To determine the _____ balance of a CFS, the net increase/decreased in cash must be determined by computed net cash flow from the three main activities and added to the company's _____ cash balance.