



Cash Flow Statement: A Theoretical Study in Research

Abstract

An analysis of cash flows is useful for short-run planning; many researcher or manager has used cash flow as tools to know reliable cash flow for the immediate future. In this paper, researcher has studied theoretical explanation of cash flow statement. Researcher used published article, books and other web site to know basic concept of cash flow statement (CFS). It has separate concept and theory as per usefulness to researcher and company manager. CFS is a broad analysis of the cash account. It is developed in own way. This paper contains concept, structure and its usefulness in research.

Key factor: *Cash flow statement, financial statement.*

Introduction:

Cash is working in business like blood in body. Cash plays most important part in corporate decision. CFS is a statement like fund flow statement. A CFS focus to transactions which are directly impacted on cash or cash equipment. It classifies the inflow and outflow of cash and cash equipment between two term's balance sheets. CFS explains the changes in cash position between the two periods. This paper contains theoretical study of CFS. Study is based on review of research paper, books etc. to examine concept and uses of CFS.

Objectives:

To know concept of cash flow statement;

To know uses of cash flow statement;

CFS in Various Researches:

An Audit Manager, of United General Accounting Office, George A. Gustafson (1963) studied on working paper for preparation of cash flow statement and illustrative presentation of CFS. George has also written on same paper in 1964 also. William A. Paton, Professor of Accounting and of Economics, Emeritus, in University of Michigan, (1963) wrote on 'The "Cash-flow" Illusion' for explanation of fund flow statement with illustration. Wayne Corcoran (1965) studied on preparation of funds and cash flow statements. Germain Boer (1967) wrote on Cash Flow Statements- Fast to preparation of cash flow statements with guidelines. Rujoub and others (1995) have studied on uses of cash flow ratio to predict business failures and presented various ratios regarding cash flow for hypotheses test. Gay D. Serway and Gustave J. Rath (1972) prepared project for Plan Hospital Expansion by using CFS. Ashwinpaul C. Sondhi and other (1988) have also studied FAS 95 and Security Analysis of Cash Flow. Up to the date, paper prepared by researcher, there are so many studies are done using CFS.

Accounting Standard-3:¹

Cash-flow statement gives information about the cash inflow and outflow of the company for suggested period. The cash-flow statement is maintained on the basis of Accounting Standard-3 (Revised) which is issued by the Institute of Chartered Accountants of India (ICAI). The ICAI issued Accounting Standard 3 (AS-13) in June 1981. In June 1995, The Securities and Exchange Board of India (SEBI) has introduced amended clause 32 that the every listed company has compulsory

¹ The information is taken from 'Indian Accounting Standard-3' from ICAI.

submits of cash flow statement in prescribed steps; cash flow from operating activities, investing activities and financing activities. In 1997, ICAI revised AS-3 revised again. Latest AS-3 is revised on 1-4-2001. Cash-flow is classified in three parts; Operating activities, Investing activities and Financing activities. Few topics highlighted as per AS-3.

Terms:

Cash means cash balance and cash deposited in bank.

Cash equivalent means highly liquid investments which is immediately convertible into amounts of cash and which are subject to a significant risk of changes in value within short term.

Cash flows are inflows and outflows of cash and cash equivalents.

Operating activities includes the principal revenue and manufacturing activities of the company and other activities which are not related to investing or financing activities.

Investing activities are the procurement and disposal of fixed assets and investments which does not includes in cash equivalents.

Financial activities consists changes in the value of the owners' capital fund including preference share capital and borrowed funds.

Presentation of a Cash Flow Statement:

AS-3 has not prescribed any special format to preparation of CFS. CFS should represent cash inflows and outflows during the period classified as operating, investing and financing activities.

Operating Activities:

Operating activities including following transactions for Cash flows.

- Cash incomes from the operating activities, royalties, fees, commissions and other revenues.
- Cash paid to trade payables, services providers.
- Cash receipt and payment as premium and claim as well as on re-insurance and other policy benefits, relating to futures contracts, forward contracts, option contracts and swap contracts for trading purposes.
- Cash payments or refunds in respect of income taxes excepted if specifically identified with financing and investing activities.
- For finance institutions, securities and loans may hold for dealing or trading purposes, in this case the securities and loans are inventories. Hence, cash flows arising from trading securities are treated as operating activities. Similarly, cash advances and loans to customers made by financial enterprises are usually classified as operating activities.

Investing Activities:

Investing activities includes following transactions for Cash flows.

- Cash paid to establishment of capital assets (including intangibles), capitalized research and development costs for technology, self-constructed fixed assets, purchase of investment (in shares, securities, warrants or debt instruments) of other companies and share in joint ventures.
- Cash received from sale or disposal of fixed assets, shares, warrants or debt instruments, share in joint ventures and repayment of advances and loans made to third parties.

Financing Activities:

Financing activities consist following transactions for Cash flows.

- Cash received from issuing shares, debentures, loan, notes, bonds and other short or long term borrowings.
- Cash repayments of amounts to shares, debentures, loan etc.

There is no any special format for the presentation of cash flows. A CFS can be presented in either the direct or indirect format. The investing and financing sections will be the same under both formats. However, the operating section will be different as sample given below.

Format of Cash flow statements

(A) The calculation of cash flows from operating activities (Direct method)

Particulars	Amount	
Cash flow from operating activities:		
Cash receipt from customers	
Cash paid to suppliers and employees	(.....)	
Cash generated from operations	
Income tax paid	
Income tax refunds received	(.....)	
Cash flow before extraordinary items	
Proceeds from extraordinary events	
Payment made for extraordinary events	(.....)	
Net cash from operating activities (A)	

(A) The calculation of cash flows from operating activities (Indirect method)

Particulars	Amount	
Cash flow from operating activities:		
Net profit as recorded in profit and loss account	
Add: Tax provision	
Extraordinary expenses	
Less: Extraordinary incomes	(.....)	
Adjustments for:		
Depreciation	
Interest income	
Dividend income	
Interest expenses	(.....)	
Operating profit before changes in working capital	
Increase/decrease in current assets(exempted cash or bank balance)	
Increase/decrease in current Liabilities(exempted bank over draft)	
Cash generated from operations	
Less: Income tax paid	
Add: Income tax refund order	(.....)	
Cash flow before extraordinary events	
Receipt from extraordinary events	
Payment made for extraordinary events	(.....)	
Net cash from operating activities(A)	
Cash flow from investing activities:		
Purchase of fixed assets or/and Investment	
Sale of fixed assets or/and Investment	
Cash flow from investing activities(B)	
Cash flow from financing activities:		
Issue of new shares or debentures	

Loan borrowed
Redemption of preference shares and/or Debentures/Loan	(.....)
Dividend paid	(.....)
Cash flow from financing activities(C)
Net increase or decrease in cash and cash equivalents(A+B+C)
Cash and bank balance at the beginning of the period
Cash and bank balance at the end of the period

Source: financial accounting for management, second edition; oxford university press, page no. 370-375.

CFS in various countries:

In the United States in 1973, the Financial Accounting Standards Board (FASB) defined rules (it made mandatory under US GAAP) to report sources of funds and its utilisation, but 'Funds' is not properly defined. Net working capital might be cash or might be the difference between current assets and current liabilities. In 1970 to 1980, the FASB predicted the usefulness of cash flow statement. In 1987, FASB gives Statement No. 95 (FAS 95); it is compulsory that the company or business unit must present cash flow statements with final account in annual report. In 1992, the International Accounting Standards Board issued International Accounting Standard 7 (IAS 7) regarding Cash Flow Statement, which was affected in 1994 to mandating that the company or business enterprise must present cash flow statements with final account in annual report. US GAAP and IAS 7 have given rules for cash flow statements, which are equal, but some differences found as follow:

IAS	US GAAP
<ul style="list-style-type: none"> • Both cash and cash equivalents changes are included in the cash flow statement. • 'Interest paid up' is to be absorbs in operating activities or in financing activities. • 'Bank overdraft' is to be absorbs in cash equivalents. • Most commonly, indirect method is utilised for preparation of cash flow statement. 	<ul style="list-style-type: none"> • The cash flow statement includes cash alone. • 'Interest paid' to be included in operating activities. • 'Bank overdraft' is treated as financing activities. • When enterprise does with the direct method, an additional schedule must have presented a cash flow statement using the indirect method.

Sources: (https://en.wikipedia.org/wiki/Cash_flow_statement)

In Austria, Belgium, Denmark, France, Germany, Greece, Ireland, Luxembourg, Netherlands, Spain, Sweden, Switzerland and the UK have not any law for preparation of CFS. Other regulatory bodies, like stock exchanges, supervisory authorities or standard setting bodies, have not issued rules on cash flow statements in Belgium, France, Germany, Greece, Italy and Spain. In Finland, the accounting act has no provisions to preparation of funds statements. Only major company requires presents their fund flow statement in financial statements. But there is no any format to present CFS in the law. In Germany, to listing of securities, company has present (1) sources of funds and application of funds and (2) funds flow statements. In Italy, the presentation of a statement, as recommended in the Accounting Principles issued by Dottori Commercialisti and Ragionieri, which should contain; the financial flows of the company during the period, and the amount of cash generated by the company, compared with the cash collected from external sources, the investments made by the company during the period, the increase/decrease in the assets and in the indebtedness,

the sources and the uses of the funds. In Norway, the companies act of 1976 addresses cash flow statements for large companies. The companies act requires a statement of changes in financial positions (financial analysis). Normally, the large companies present a cash flow statement to fulfill the legal requirements. Also large enterprises other than limited liability companies have to present a statement of changes in financial position according to the accounting act 1977. In Sweden, the law requires that companies of a certain size prepare a statement of changes in financial position. As explain in IAS-7, there are different views on cash flow statement. The different definitions terms are explained as requirement of companies or countries. (committee-UK, 1992,) (FEE, 1996)

Uses of CFS:

Cash flow statement helps to evaluate the current cash position of the enterprise and also helpful to understand the practice of the cash cycle. A pre-planned CFS can be generated for knowledge of cash positions for the future investment; may be for short-term or/and long-term. It helps to take loan from financial institution or bank. It helps to know repayment capacity of the firm/company. Cash is in center of all business activities, which helps to a comparison of CFS with the cash budget for the same period for comparing and controlling cash expenditure.

Conclusion:

Cash flow statement is used by many researchers as analytical tools for proper results. IAS-7 and AS-3 have not suggested any special format but suggested three headings for cash flow statement presentation. Cash flow statement is distributed in three parts; Operating Activities, Investing Activities and Financing Activities. Under the headings, particulars are presented as per countries law of company. Otherwise, users can prepare as per accounting standard.

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