

Activities

- 1. Operations** -- cash flows related to selling goods and services; that is, the principle business of the firm.
- 2. Investing** -- cash flows related to the acquisition or sale of non-current assets.
- 3. Financing** -- long term and short term cash flows related to liabilities and owners' equity; dividends are a financing cash outflow.

Chapter 13

Mugan-Akman 2007

4-36

External Uses of CFS

- To assess the ability of a firm to manage cash flows
- To assess the ability of a firm to generate cash through its operations
- To assess the company's ability to meet its obligations and its dividend policy
- To provide information about the effectiveness of the firm to convert its revenues to cash
- To provide information to estimate or anticipate the company's need for additional financing

Chapter 13

Mugan-Akman 2007

5-36

Internal Uses of CFS

- Along side with cash budget CFS is used:
 - To assess liquidity
 - Determine if short-term financing is necessary
 - To determine dividend policy
 - Decide to distribute; or increase or decrease
 - To evaluate the investment and financing decisions

Chapter 13

Mugan-Akman 2007

6-36

Cash flow from operating activities

- Examples (IAS No.7):
- cash received from customers through sale of goods or services performed;
- cash received from non-operating activities such as dividends from investments, interest revenue, commissions, and fees;
- cash payments to suppliers or employees;
- cash payments for taxes and other expenses;

In effect, the income statement is changed from accrual basis to cash basis

Chapter 13

Mugan-Akman 2007

7-36

Investing Activities

Examples of investing activities include (IAS No.7):

- cash payments to acquire property, plant, and equipment (PPE), other tangible or intangible assets, and other long-term assets;
- cash received from sales of assets that are not held for the regular trading purposes such as sale of building; marketable securities such as trading and available for sale securities, and investments;
- loans extended to other companies; and collection of such loans;
- cash received from sale of, and paid for purchases of derivative instruments;

Chapter 13

Mugan-Akman 2007

8-36

Financing Activities

Examples of financing activities are (IAS No.7):

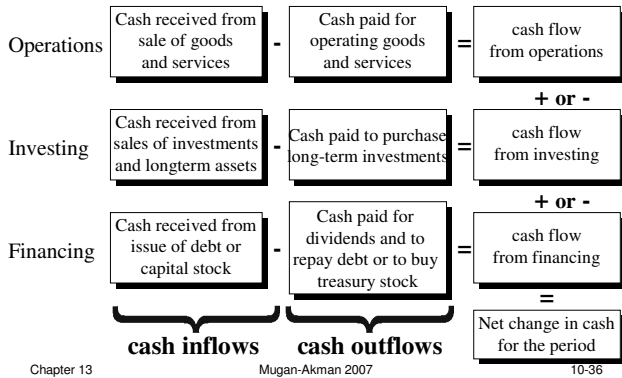
- cash received from issuing share capital;
- cash payments to shareholders to redeem existing shares- treasury stock;
- cash proceeds from issuing bonds, loans, notes, mortgages and other short or long-term borrowings;
- cash repayment of loans and other borrowings; and
- cash payments to shareholders as dividends.

Chapter 13

Mugan-Akman 2007

9-36

Components of the Cash Flow Statement

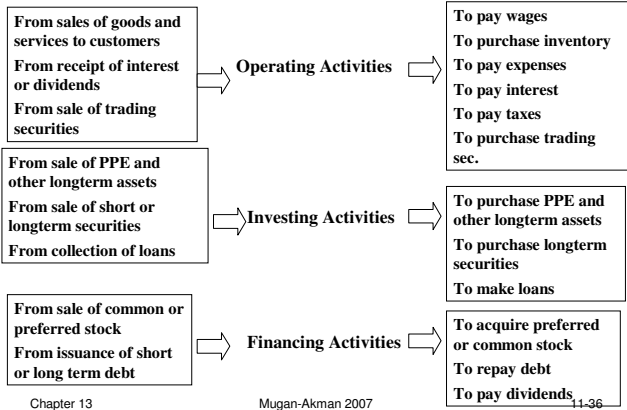


Chapter 13

Mugan-Akman 2007

10-36

Classification of Cash in-flows and outflows



Chapter 13

Mugan-Akman 2007

11-36

Format of the Cash Flow Statement

Name of the Company	
Cash Flow Statement	
For the period ...	
Cash from operating activities	A
Cash from investing activities	B
Cash from financing activities	C
Net Change in Cash	D = (A+B+C) increase or (decrease)
+ Beginning Cash balance	CB, from the beginning balance sheet
Ending Cash balance	=CB + D should equal to ending cash balance in the ending balance sheet
Non-cash Investing and Financing Activities	

Chapter 13

Mugan-Akman 2007

12-36

Determination of Cash Flows From Operating Activities

Direct Method

Income Statement items are converted to cash flows individually

Indirect Method

Net income or loss is adjusted for accruals such as accounts receivable and payable, and for non-cash expenses such as depreciation

reconciliation of the accrual based and cash based accounting

Chapter 13

Mugan-Akman 2007

13-36

Comparison of Methods

- Direct method of presentation calculates cash flow from operations by subtracting cash disbursements to supplies, employees, and others from cash receipts from customers.
- The indirect method calculates cash flow from operations by adjusting net income for non-cash revenues and expenses.
- Most firms present their cash flows using the indirect method.

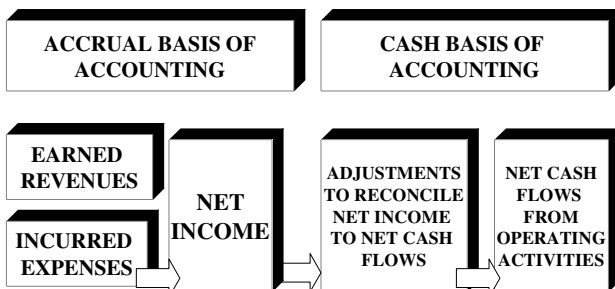
Only operating activities section is different between the methods, investing and financing sections are the same.

Chapter 13

Mugan-Akman 2007

14-36

Relationship of Accrual and Cash Basis of Accounting



Chapter 13

Mugan-Akman 2007

15-36

Steps in Direct Method-CFS operating activities

- compute collections
 - from customers
 - from other revenues
- compute payments for operating expenses
- compute payments for non-operating expenses

Chapter 13

Mugan-Akman 2007

19-36

Accounts Receivable		Cash Collections from Customers	
31.12.2006	3.500	Collections from customers	
Sales	8.750		
31.12.2005	4.800		
		7.450	
Cash Collection from Customers = Revenue		}	+Decrease in Accounts Receivable -Increase in Accounts Receivable
		}	+Increase in customer advances -Decrease in customer advances
Sales		TL	8.750
Deduct: increase in accounts receivable		TL	(1.300)
Add: increase in advances from customers			<u>200</u>
Cash collections from customers		TL	7.650

Chapter 13

Mugan-Akman 2007

20-36

Inventories		Cash Payments to Suppliers	
31.12.2006	1.500	Cost of Goods Sold	
Purchases	5.100		
31.12.2007	2.400		
		4.200	
Cash Payments to Suppliers = COGS		}	- Decrease in Inventories + Increase in Inventories
		}	+Decrease in Accounts Payable -Increase in Accounts Payable
Purchases of the period		TL	5.100
Deduct: increase in inventories		TL	4.200
Add: increase in inventories			<u>900</u>
Cash payments to suppliers		TL	4.600

Chapter 13

Mugan-Akman 2007

21-36

Cash Payments for Operating Expenses

Salaries and Wages Payable	
31.12.2006	400
Payments to Employees 1.700	Salaries & Wages Expense 2.000
	31.12.2007 700

Salaries and Wages Expense	TL 2.000
Deduct: Increase in Salaries and Wages Payable	300
Salaries and Wages Paid	TL 1.700

Prepaid Insurance	
31.12.2006	800
Insurance Payments 600	Insurance Expense 900
31.12.2007	500

Insurance Expense	TL 900
Deduct: Decrease in Prepaid Insurance	300
Cash paid for Insurance	TL 600

Cash Payments for Operating Expenses = Operating Expenses	}	+Increase in prepaid expenses	+Decrease in Accrued Expenses
		-Decrease in prepaid expenses	-Increase in Accrued Expenses

Chapter 13 Mugan-Akman 2007 22-36

Cash Flows From Operating Activities

Cash flows from operating activities:

Cash Receipts:		
Collections from customers		TL 7.650
Dividend and interest revenue		150
		<u>7.800</u>
Cash payments:		
To suppliers	TL 4.600	
For operating expenses		
Salaries and wages paid	TL 1.700	
Insurance payments	600	2.300
For non-operating expenses		800
Interest expense	350	
For income tax	450	(7.700)
Net Cash Provided by Operating Activities		TL 100

Chapter 13 Mugan-Akman 2007 23-36

Cash Flows from Investing Activities

	2006	2007	Change
<i>Trading Securities</i>	1.800	900	(900)
<i>Property, Plant and Equipment</i>			
Land	2.200	2.200	0
Buildings	8.600	8.900	300
Equipment	12.940	13.960	1.020
Less Accumulated Depreciation	(6.240)	(6.490)	(250)

Equipment		Trading Securities	
31.12.2006	12.940	31.12.2006	1.800
Leased Equipment 1.000	Equipment sold-at cost 1.500	Purchased	300
Purchased 1.520		Securities sold-at cost	1.200
31.12.2007	13.960	31.12.2007	900

Chapter 13 Mugan-Akman 2007 24-36

Cash Flow from Investing Activities

Cash flow from investing activities:	
Purchase of building	TL (300)
Sale of equipment	1.320
Purchase of equipment	(1.520)
Sale of trading securities	1.500
Purchase of trading securities	(300)
Net Cash flow from investing activities	TL 700

Chapter 13

Mugan-Akman 2007

25-36

Cash Flow from Financing Activities

	31-Dec		
	2006	2007	change
Current Liabilities			
Bank Notes Payable	TL 2.000	TL 2.600	TL 600
Dividends Payable	800	400	(400)
Long-term Liabilities			
Bonds Payable	2.800	1.500	(1300)
Lease Obligation	2.500	3.200	700
Shareholders' Equity			
Share Capital	3.000	3.600	600
Additional Paid in Capital	2.000	2.100	100
Legal Reserves	100	150	50
Retained Earnings	12.600	12.920	320

Chapter 13

Mugan-Akman 2007

26-36

Financing Activities

Lease Obligations		
	31.12.2006	2.500
Lease Payments	300	
	31.12.2007	3.200
	Leased Equipment	1.000

Retained Earnings		
Legal Reserves	50	31.12.2006
		12.600
Dividends Declared	400	Net Income
		770
	31.12.2007	12.920

Dividends Payable		
	31.12.2006	800
Dividends Paid	800	Dividends Declared
		400
	31.12.2007	400

Chapter 13

Mugan-Akman 2007

27-36

EICC A.Ş.Cash Flow Statement, For the year 2007- Direct Method

Cash flow from operating activities		
Cash Receipts:		
Collections from Customers		TL 7.650
Dividend and Interest Revenue		150
		<u>7.800</u>
Cash Payments:		
To suppliers	TL 4.600	
For operating expenses	2.300	
For non-operating expenses	350	
For income tax	450	(7.700)
Net cash Provided by Operating Activities		100
Cash Flow from Investing Activities		
Purchase of Buildings	(300)	
Sale of Equipment	1.320	
Purchase of Equipment	(1.520)	
Sale of Trading Securities	1.500	
Purchase of Trading Securities	(300)	
Net Cash Flow from Investing Activities		700
Cash Flow from Financing Activities		
Bank Loans Received	600	
Issuance of Common Stock	600	
Additional Paid in Capital	100	
Cash Dividends Paid	(800)	
Bond Repayment	(1.300)	
Lease Obligation Payments	(300)	
Net Cash Flow from Financing Activities		(1.100)
Net increase (decrease) in Cash		(300)
Cash at the beginning of the period		1.300
Cash at the end of the period		1.000
Non-Cash Investing and Financing Activities:		
Leasing of equipment		TL 1.000

Indirect Method

Investigation of Changes in Specific Accounts

increase decrease

Assets:

If assets increased, then cash was spent, so it is an outflow.	If assets decreased, then they provided cash so it is an inflow.
--	--

Liabilities and Shareholders' equity

If liabilities or S.H.E. increased, then cash was received, so it is an inflow.	If liabilities or S.H.E. decreased, then cash was spent, so it is an outflow.
---	---

Non-cash Expenses

- Non-cash expenses, such as depreciation expense, are added back
- These are not truly sources of cash even though they are associated with cash inflows; rather, this is a reversal of the accrual process that required the expenses to be recognized without regard for the cash flow

Indirect Method- operating activities

Net income

- + noncash expenses: depreciation, amortization, uncollectible account expense, etc
- + loss on sale of asset
- + increases in current liabilities
- + decreases in current assets
- gain on sale of asset
- decrease in current liabilities
- increase in current assets

Chapter 13

Mugan-Akman 2007

31-36

Indirect Method-Operating

	31-Dec		
	2006	2007	Change
Accounts Receivable (net)	3.500	4.800	1.300
Inventories	1.500	2.400	900
Prepaid Insurance	800	500	(300)
Accounts Payable	1.900	2.400	500
Salaries and Wages Payable	400	700	300
Advances from Customers	200	400	200

Depreciation Expense	380
Amortization Expense	100

Gain on sale of Trading Securities	300
Loss on sale of equipment	(50)

Chapter 13

Mugan-Akman 2007

32-36

Cash Flow from Operating Activities –Indirect Method

EICC A.Ş
For the year 2007

Net Income		TL 770
Depreciation and Amortization		480
Add: increase in Accounts Payable		500
Add: increase in salaries and wages payable		300
Add: Advances from customers		200
Add: Decrease in Prepaid Insurance		300
Add: Loss on Sale of Equipment		50
		2.600
Deduct: increase in Accounts Receivable	(1.300)	
Deduct: increase in Inventories	(900)	
Deduct: Gain on Sale of Marketable Securities	(300)	(2.500)
Net Cash from Operating Activities		TL 100

Chapter 13

Mugan-Akman 2007

33-36

Uses of Cash Flow Statement Information

- pattern of cash flow statements would provide valuable information about the growth stage, and possible strategies of companies
- predicting financial distress
- ratios

Cash Flow Statement Patterns

Pattern	1	2	3	4	5	6	7	8
Cash Flows from Operating	+	+	+	+	0	-	-	-
Cash Flows from Investing	-	-	0	-	-	0	-	-
Cash Flows from Financing	+	-	-	0	+	+	+	-
Cement Industry Patterns	27	31	1	1	1	0	1	0
Textile Industry Patterns	17	7	4	1	2	6	24	1

