

CASH FLOW STATEMENT:

Very often, a business can report considerable profits in their accounts and at the same time show a significant deterioration in its bank and cash balances. This is principally due to the following:

1. Payments can be made through the bank which are not reflected in the P&L a/c. Included here are repayments on loans and payments made for new fixed assets.
2. Poor stock control which can cause an unnecessary build up of stocks which have been paid for, but not sold. So this ties up funds.
3. A large increase in debtors can arise from poor credit control. Debtors represent amounts owed by customers which, if collected, would have been lodged to the bank.

A requirement for all companies (with the exception of private companies) is to include in its annual accounts a Cash Flow Statement. This statement endeavours to reconcile the profit for the year to the movement on the bank and cash balances.

Consider the following:

You have been asked to review the accounts for a company. The company made an operating profit of €140,000 for the year ended 31st July 2018. Despite this, the bank balance moved into an overdraft position during the same period. The Balance Sheet figures for the last 2 years are set out below:

BALANCE SHEET					
	2018	2017		2018	2017
	Euro	Euro		Euro	Euro
SHARE CAPITAL	10,000	10,000	FIXED ASSETS	500,000	180,000
BAL ON P&L A/C	438,600	298,600			
TERM LOAN	120,000	0			
CURRENT LIABILITIES:			CURRENT ASSETS:		
Creditors	130,000	108,000	Stocks	100,000	70,000
Bank Overdraft	117,400	-	Debtors	216,000	150,600
			Bank	-	16,000
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	816,000	416,600		816,000	416,600
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Difference is the profit for the year of 140,000

In order to explain the adverse cash position at the end of the financial year, you are requested to prepare a Cash Flow Statement.

SOLUTION:

The first stage is to determine the net cash flow arising from normal trading operations. The profit reflects sales, purchases and costs for the year. The movement in current assets is also part of trading – stock levels, extent to which customers still owe for sales and balances outstanding to creditors in respect of purchases. The following table should assist:

Movement	Source of funds	use of funds
Increase in Stocks		√
Decrease in Stocks	√	
Increase in Debtors		√
Decrease in Debtors	√	
Increase in Creditors	√	
Decrease in Creditors		√

The next stage is to look outside of trading items and at movements in Fixed Assets and Loan Balances. Very often, a significant increase in fixed assets is not matched by a similar increase in loan balances and therefore the company has used its short term banking facilities to finance these investments. This is inappropriate as, in the main, any significant investment in fixed assets should be funded by long term borrowings and/or retained profits. The movements in these items affect cash flow as follows:

Movement	Source of funds	use of funds
Increase in Fixed Assets		√
Increase in Loans	√	
Decrease in Loans		√

SOLUTION:

CASH FLOW STATEMENT FOR YEAR ENDED 31ST JULY 2018:

Profit for Year	140,000
Change in Working Capital Items:	
- Increase in Stocks	-30,000
- Increase in Debtors	-65,400
- Increase in Creditors	22,000
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Net Source from operations	66,600
Other Sources	
- Term Loans	120,000
Other Uses	
- Purchase Fixed Assets	-320,000
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Net Source/<Use> of Funds in Year	-133,400
Represented by	
Opening Balance on Bank	16,000
Closing Balance on Bank	-117,400
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Net Adverse Movement on Bank	-133,400