



*Module : English for Specific Purposes*

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## **Cash Flow Statement**

### **Related Terminology**

**Cash** comprises cash on hand and demand deposits with banks.

**Cash balance:** Cash on hand and demand deposits (cash balance on the balance sheet).

**Cash equivalents** are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

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

**Operating activities** are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

**Investing activities** are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

**Financing activities** are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

Cash plays a very important role in the economic life of a business. A firm needs cash to make payment to its suppliers, to incur day-to-day expenses and to pay salaries, wages, interest and dividends etc. In fact, what blood is to a human body, cash is to a business enterprise. Thus, it is very essential for a business to maintain an adequate balance of cash. For example, a concern operates profitably but it does not have sufficient cash balance to pay dividends, what message does it convey to the shareholders and public in general. Thus, management of cash is very essential. There should be focus on movement of cash and its equivalents. Cash means, cash in hand and demand

deposits with the bank. Cash equivalent consists of bank overdraft, cash credit, short term deposits and marketable securities.

Cash flow statements are one of the three fundamental financial statements financial leaders use. Along with income statements and balance sheets, cash flow statements provide crucial financial data that informs organizational decision-making. While all three are important to assessing a company's finances, some business leaders might argue that cash flow statements are the most important.

Business owners, managers, and company stakeholders use cash flow statements to better understand their companies' value and overall health and guide financial decision-making. Regardless of your position, learning how to create and interpret financial statements can empower you to understand your company's inner workings and contribute to its future success.

Cash Flow Statement deals with flow of cash which includes cash equivalents as well as cash. This statement is an additional information to the users of Financial Statements. The statement shows the incoming and outgoing of cash. The statement assesses the capability of the enterprise to generate cash and utilize it. *Thus a Cash-Flow statement may be defined as a summary of receipts and disbursements of cash for a particular period of time. It also explains reasons for the changes in cash position of the firm.* Cash flows are cash inflows and outflows. Transactions which increase the cash position of the entity are called as inflows of cash and those which decrease the cash position as outflows of cash. Cash flow Statement traces the various sources which bring in cash such as cash from operating activities, sale of current and fixed assets, issue of share capital and debentures etc. and applications which cause outflow of cash such as loss from operations, purchase of current and fixed assets, redemption of debentures, preference shares and other long-term debt for cash. In short, a cash flow statement shows the cash receipts and disbursements during a certain period. The statement of cash flow serves a number of objectives which are as follows :

- Cash flow statement aims at highlighting the cash generated from operating activities.
- Cash flow statement **helps in planning the schedule for repayment of loan** schedule and replacement of fixed assets, etc.

- Cash is the centre of all financial decisions. It is used as the basis for the projection of future investing and financing plans of the enterprise.
- Cash flow statement helps to ascertain the liquid position of the firm in a better manner. Banks and financial institutions mostly prefer cash flow statement to analyse liquidity of the borrowing firm.
- Cash flow Statement helps in efficient and effective management of cash.
- The management generally looks into cash flow statements to understand the internally generated cash which is best utilised for payment of dividends.
- Cash Flow Statement based on AS-3 (revised) presents separately cash generated and used in operating, investing and financing activities.
- It is very **useful in the evaluation of cash position** of a firm

### **Importance Of Cash Flow Statements**

So long as you use accrual accounting, cash flow statements are an essential part of financial analysis for three reasons:

1. **Show company's liquidity.** That means you know exactly how much operating cash flow you have in case you need to use it. So you know what you can afford, and what you can't.
2. **Show company's changes in assets, liabilities, and equity** in the forms of cash outflows, cash inflows, and cash being held. Those three categories are the core of your business accounting. Together, they form the accounting equation that lets you measure your performance.
3. **Predict future cash flows.** You can use cash flow statements to create cash flow projections, so you can plan for how much liquidity your business will have in the future. That's important for making long-term business plans.

### **Cash Flow Statement Vs. Income Statement**

Using only an income statement to track your cash flow can lead to serious problems\_and here's why.

If you use accrual basis accounting, income and expenses are recorded when they are earned or incurred—not when the money actually leaves or enters your bank accounts. (The cash accounting method only records money once you have it on hand. Learn more about the cash vs. accrual basis systems of accounting.)

For example, depreciation is recorded as a monthly expense. However, you've already paid cash for the asset you're depreciating; you record it on a monthly basis in order to see how much it costs you to have the asset each month over the course of its useful life. But cash isn't literally leaving your bank account every month.

### Cash and Relevant Terms as per AS-3

- Cash Fund includes
- (i) Cash in hand
  - (ii) Demand deposits with banks, and
  - (iii) cash equivalents.

2. Cash Flows are inflows and outflows of cash and cash equivalents.

(a) Operating activities are the principal revenue generating activities of the enterprise.

(c) Financing activities are activities that result in change in the size and composition of the owner's capital (including Preference share capital in the case of a company) and borrowings of the enterprise.

- Only listed companies are required to prepare and present Cash flow statement.

- The Accounting period for the Cash Flow Statement is the same for which Profit and Loss Account and Balance Sheet are prepared.
- Cash flow items are as (a) Cash flow from operating activities : (b) Cash flow from investing activities (c) Cash flow from financing activities.
- Operating activities include revenue producing activities which are not investing and financing activities.
- There are two methods of calculating cash flow from operating activities namely Direct method and Indirect method. SEBI (Securities Exchange Board of India) Guidelines recommend for only direct method.
- Extra ordinary Items : The Cash flow associated with extra ordinary items should be classified as arising from operating, investing and financing activities. For example, the amount received from Insurance Company on account of Loss of Stock or loss from earthquake should be reported as cash flow from operating activities.

### ❖ TextBased Activities

#### **Exercise 01: Comprehension Questions:**

1. What is the primary purpose of a cash flow statement, and how does it differ from other financial statements?
2. How does the cash flow statement assist businesses in making financial decisions?
3. Based on the text, why might some business leaders consider the cash flow statement more important than the income statement?

#### **Exercise 02: Indicate whether the following statements are true or false. Provide explanations for false statements.**

1. The cash flow statement only includes cash inflows from operating activities.
2. Depreciation affects cash flow because it is an actual cash expense.

3. Only listed companies are required to prepare a cash flow statement.
4. The cash flow statement is only required for publicly traded companies.
5. The cash flow statement helps businesses assess their liquidity and ability to meet financial obligations.
6. Cash equivalents include long-term investments that will be held for more than a year.

### **Exercise 03: Fill in the Blanks**

1. Cash flow statement deals with flow of cash which includes cash and .....
2. Cash flow statement is a ..... statement.
3. Cash flow statement shows ..... and ..... during a particular period.
4. As per AS 3, cash fund includes cash, demand deposit with bank and .....
5. Only ..... companies prepare cash flow statement.
6. Cash flows are classified in to three parts i.e. operating activities, financing activities and ..... activities.
7. Cash flow statements are crucial for assessing a company's \_\_\_\_\_ and financial health.
8. b) The three main components of a cash flow statement are \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ activities.
9. c) Businesses use cash flow statements to predict future \_\_\_\_\_ and ensure they can meet financial obligations.

### **Exercise 04: Match the following terms with their correct definitions:**

- a) Cash equivalents
- b) Operating activities
- c) Investing activities
- d) Financing activities

### **Definitions:**

- i) Transactions related to acquiring and disposing of long-term assets.
- ii) Short-term, highly liquid investments that are readily convertible to cash.
- iii) Business activities that generate revenue and expenses.
- iv) Transactions related to raising or repaying capital.