

Analyzing the Activities of Cash Flows Statement

Measurement of cash flow can be used:

- (1) To determine a project's rate of return or value.
- (2) To determine problems with a business's liquidity
- (3) As an alternate measure of a business's profits when it is believed that accrual accounting concepts do not represent economic realities
- (4) Cash flow can be used to evaluate the "quality" of Income generated by accrual accounting.
- (5) To evaluate the risks within a financial institution

The total net cash flow is the sum of cash flows that are classified in three areas:

1. Operational cash flows (التدفق النقدي التشغيلي) :

Cash received or expended as a result of the company's internal business activities. It includes cash earnings plus changes to working capital.

2. Financing cash flows (التدفق النقدي التمويلي) :

Cash received from the from the loans received and issuance of shares, or paid out as dividends, shares repurchases or debt repayments.

3. Investment cash flows (التدفق النقدي الاستثماري):

Cash received from the sale of long-life assets, or spent on capital expenditures (investments, acquisitions and long-life assets).

There are ratios and indicators derived from cash flow disclosure and help to assess liquidity; The strength or weakness of unit liquidity is linked to the availability of net cash flow from operating activities. If cash flow is positive, it means a surplus that unit management can use to expand investment activities. or cash repayment of long-term debt, and if net cash flow is negative it means a deficit, Of those ratios and indicators

1. Defensive Internal **Ratio or cash coverage ratio** = $\frac{\text{Net operating cash flow}}{\text{external cash flows for investment and financing activities}}$ X100

Examples of external cash flows for investment and financing activities include debt, loans payable, mortgage lease payments, amounts paid in the purchase of fixed assets, and dividend distribution

2. Cash flow-to-current liabilities ratio = $\frac{\text{Net operating cash flow}}{\text{Current Liabilities}}$ X100

3. Solvency ratio = $\frac{\text{Net cash flow}}{\text{Long – term debt}}$ X100

4. operating cash flow to investment payments ratio = $\frac{\text{operating cash flow}}{\text{investment payments}}$ X100

5. flows from operating activity per ordinary share ratio = $\frac{\text{operating cash flow - Preferred Shares distributions}}{\text{common stock}}$ X100

6. operating cash flow to net profit ratio = $\frac{\text{operating cash flow}}{\text{net profit}}$ X100

7. Retained operating cash = $\frac{\text{operating cash flow - cash dividends}}{\text{Current Liabilities}}$ X100

Example: No. 1 The following are the income statement and Comparative Balance sheet for Tiger Company:

Income statement for the year ended December, 31, 2018

Particular	IQD	IQD
Sales		200000

Cost of goods sold	80000	
Operating expenses	30000	(110000)
Income before income tax		90000
Income tax		(15000)
Net income		75000

Tiger Company Comparative Balance sheet (Thousands IQD) Dec., 31/12/2018

ASSETS	2017	2018	Changes	Increase /Decrease
Cash	100000	80000	-20000	Decrease
Accounts receivable	50000	90000	+40000	Increase
Furniture	20000	50000	+30000	Increase
Total	170000	220000	+50000	
Liabilities and stockholders' equity				
Accounts payable	40000	25000	-15000	Decrease
Income tax payable	5000	15000	+10000	Increase
Common stock	90000	100000	+10000	Increase
Retained Earnings	35000	80000	+45000	Increase
Total	170000	220000	+ 50000	

Additional information:

- 1) The company was declared and paid IQD 30000 as dividend in 2018.
- 2) Common stock of IQD 10000 was issued.

Required: Prepare the statement of cash flow by using Direct Method and make analysis to the cash flow statement

Tiger Company Statement of cash flows (Direct method) for the year ended Dec., 31, 2018

Particulars	IQD	IQD
1- Cash flows from operating activities:		
(1) Cash receipts from customers		160000
(2) Cash payments:		
To suppliers	95000	
For operating expenses	30000	
For income taxes	5000	(130000)
Net cash provided by operating activities		30000

2-Cash flows from investing activities: Purchase of furniture	(30000)	
Net cash used by investing activities		(30000)
3-Cash flows from financing activities: Issuance of common stock	10000	
Payment of cash dividends	(30000)	
Net cash used by financing activities		(20000)
Net increase in cash		(20000)
Cash at the beginning of the period		100000
Cash at the end of the period		80000

Net operating cash flow

1. Defensive Internal **Ratio or cash coverage ratio** =----- X100
external cash flows for investment and financing activities
30000
= ----- X100 = 50%
(60000)

2. Cash flow-to-current liabilities ratio =-----X100
Net operating cash flow
Current Liabilities
30000
= -----X100 =75%
40000

3. operating cash flow to investment payments ratio =----- X100
operating cash flow
investment payments
30000
= ----- X100 = 100%
30000

4. flows from operating activity per ordinary share ratio =----- X100
operating cash flow - Preferred Shares distributions
common stock

$$= \frac{(30000 - 0)}{10000} \times 100 = 300\%$$

5. operating cash flow to net profit ratio = $\frac{\text{operating cash flow}}{\text{net profit}} \times 100$

$$= \frac{30000}{75000} \times 100 = 40\%$$

6. Retained operating cash = $\frac{\text{operating cash flow} - \text{cash dividends}}{\text{Current Liabilities}} \times 100$

$$= \frac{(30000 - 30000)}{45000} \times 100 = 0\%$$

Example: Following are the summarized Balance Sheets of XYZ Co. Ltd. as on 31-3-2018 and 31-3-2019.

Liabilities	31-3-2018	31-3-2019	Assets	31-3-2018	31-3-2019
Share Capital	200,000	250,000	Land & Building	200,000	190,000
General Reserve	50,000	60,000	Machinery	150,000	169,000
Profit & Loss A/c	30,500	30,600	Stock	100,000	74,000
Loan (Long-term)	70,000	-	Debtors	80,000	64,200
Sundry Creditors	150,000	135,200	Cash	500	8600
Provision For Taxation	30000	40000	Goodwill	-	39,0000
	530,000	525,800		530,000	544,800

Addition information : During the year ended 31 -3-2019.

1. Dividend of IQD 3,000 was paid
2. The following assets were purchased : Stock IQD 20,000; Goodwill IQD 39,000.
3. Depreciation written-off on machinery IQD 12,000

Requirement: Prepare a Cash Flow Statement and make analysis to the cash flow statement

Cash from Operations:	IQD	IQD
Net Income	100	
+ Depreciation	12000	
Decrease In Stock	26,000	
+ Decrease A/R	15800	
- Decrease A/P	(14800)	
Purchase of Stock	20,000	
Provision For Taxation	10,000	
Purchase of machinery	(19000)	
Total Cash from Operations		50100
Cash from Financing:		
+ General Reserve	10000	
-Dividends paid	(3000)	
-Payment of Bank Loan	(70000)	
+Share Capital	50000	
Total Cash from Financing		(13000)
Cash from Investing:		
Purchase of Goodwill	(39000)	
sales of Land	10000	
Total cash from Investing		(29000)
Net Increase in Cash Flow		8100
Cash at the beginning of the period		500
Cash at the end of the period		8600

Net operating cash flow

1. Defensive Internal Ratio or cash coverage ratio =-----X100
external cash flows for investment and financing activities

$$= \frac{50100}{112000} \times 100 = 48\%$$

Net operating cash flow

2. Cash flow-to-current liabilities ratio =-----X100
Current Liabilities

$$= \frac{50100}{(70000+150000)} \times 100 = 22,7\%$$

$$\begin{aligned}
 & \text{Net cash flow} \\
 3. \text{ Solvency ratio} &= \frac{\text{-----}}{\text{Long - term debt}} \times 100 \\
 & \frac{8100}{70000} \times 100 = 11.5\%
 \end{aligned}$$

$$\begin{aligned}
 & \text{operating cash flow} \\
 4. \text{ operating cash flow to investment payments ratio} &= \frac{\text{-----}}{\text{investment payments}} \times 100 \\
 & \frac{50100}{39000} \times 100 = 128\%
 \end{aligned}$$

$$\begin{aligned}
 & \text{operating cash flow - Preferred Shares distributions} \\
 5. \text{ flows from operating activity per ordinary share ratio} &= \frac{\text{-----}}{\text{common stock}} \times 100 \\
 & \frac{(50100 - 0)}{50000} \times 100 = 100.2\%
 \end{aligned}$$

$$\begin{aligned}
 & \text{operating cash flow - cash dividends} \\
 6. \text{ Retained operating cash} &= \frac{\text{-----}}{\text{Current Liabilities}} \times 100 \\
 & \frac{(50100 - 3000)}{220000} \times 100 = 21.4\%
 \end{aligned}$$

Example: Cash Flow Statement of Bassam Corporation For Year Ending 31/12/2018

Cash from Operations:	IQD	IQD
Net Income	120000	
+ Depreciation	20000	
- Gain on Sale	(20000)	
+ Decrease A/R	50000	
- Decrease A/P	(20000)	
-Increase Prepaid Rent	(10000)	
Total Cash from Operations		140000
Cash from Financing:		
+ Bonds Issued	50000	
-Dividends paid	(20000)	
+Stock Issued	50000	
Total Cash from Financing		80000
Cash from Investing:		
Sale of Equipment	50000	
Purchase of Land	(100000)	
Total cash from Investing		(50000)
Net Increase in Cash Flow		170000
+Beginning Cash		10000
= Ending Cash		180000

Required : calculate Cash flow-to-current liabilities ratio, Defensive Internal **Ratio** , operating cash flow to investment payments ratio, flows from operating activity per ordinary share ratio , Retained operating cash if you knew the Accounts Payable IQD 200000 and Bonds payable IQD 50000

Net operating cash flow

1. Cash flow-to-current liabilities ratio =-----X100

140000

Current Liabilities

=----- X100 = 56%

250000

Net operating cash flow

2. Defensive Internal **Ratio or cash coverage ratio** =-----X100

external cash flows for investment and financing activities

140000

=----- X100 =116%

120000

3. operating cash flow to investment payments ratio = $\frac{\text{operating cash flow}}{\text{investment payments}} \times 100$

$$= \frac{140000}{100000} \times 100 = 140\%$$

4. flows from operating activity per ordinary share ratio = $\frac{\text{operating cash flow} - \text{Preferred Shares distributions}}{\text{common stock}} \times 100$

$$= \frac{(140000 - 0)}{50000} \times 100 = 280\%$$

1. Retained operating cash = $\frac{\text{operating cash flow} - \text{cash dividends}}{\text{Current Liabilities}} \times 100$

$$= \frac{(140000 - 20000)}{250000} \times 100 = 48\%$$