Cash Flow Statements Theory | Accounting

How does a CFS show that a firm may be overtrading? (2019 Examcraft):

- If a firm has operating profits but net cash <u>out</u>flow from operating activities, this would be a strong indicator of overtrading.

What is Financial Reporting Standard (FRS)?

- A standard is prepared by the regular authorities. It is best practice in accounting which allows accounts to be compared from year to year and from company to company.

Outline the requirement of FRS 1 for companies in the preparation of cash flow statements. (2017 Examcraft mock):

- FRS 1 requires large companies to prepare CFS for each period under the following headings: (the headings from a regular CFS…)

Implications of reduced gearing (2017):

- Low interest payments increase profits available for investment elsewhere in the business.
- Shareholders more likely to get a dividend.
- Greater financial stability as less affected by rise in interest rates.
- Easier to raise additional loan finance.

Outline the purpose of a CFS. (2015):

- Show profits don't always equal cash.
- Show cash inflows and outflows during the year and predict future ones.
- Help financial planning.
- Provide information to access liquidity/solvency.
- Legal requirements.
- Help with loan applications.

Explain why, having earned a profit during 2014, the companies cash balance declined. (2015):

- Purchase of fixed assets, purchase of government securities, payment of dividends, increase in stock, increase in debtors and decrease in creditors all reduced cash but not profits.

Why might net cash inflow from operating activities be greater than operating profit? (2014):

- Depreciation and loss on sale of fixed assets reduce profits but not cash inflow.
- Increase in creditors increases cash inflow but not profit.
- Increase in debtors and stock reduce cash inflow but not profit.

Accounting obligations of a large public company under the Companies Act. (2014):

- Provide a full set of a/c's, balance sheet and CFS to shareholders at AGM.
- Register a full set of a/c's and balance sheet with the registrar of companies.
- Provide explanatory notes to these accounts.
- Must have its a/c's audited.
- Must present an annual report (including directors and auditors reports and published a/c's) to shareholders at AGM.

What is a non-cash item?

- It is an expense or a gain that affects profit but not cash e.g. Depreciation (as it doesn't involve money being spent).

a cash item affects both profit and cash

- Non-cash gain: Profit on sale of fixed asset // reduction in bad debt provision.
- Non-cash expense: Depreciation.
- Cash gain: Cash sales.
- Cash expense: Wages.

Why does an increase in profit not always necessarily mean a corresponding increase in cash?

- Some items affect profits but not cash (see above).