Cash Flow Statement

A company can show a profit and still run out of money. The cash flow statement shows where cash really came from and where it went during a period, such as a year. Together with the income statement and the balance sheet, it is one of the three main financial statements. Under the international accounting standard IAS 7, where it is called the statement of cash flows, cash flows are grouped into three activities: operating, investing and financing. Reading it helps managers, owners and lenders see whether a business can pay its bills.

1. Profit Is Not Cash

Profit and cash are not the same thing. Profit is recorded when a sale is made, even if the customer pays months later. In the same way, a large purchase of equipment is spread as a cost over many years, while the cash leaves at once. This is why a profitable business can still be short of cash, and why the cash flow statement is needed next to the income statement.

Example: A freelance designer finishes a big project in March and records the profit. But profit is not cash: the client pays only in June, so in April the rent must come from savings.

At work: Reham, the finance manager of a furniture maker, sees a large sale to a hotel on ninety days' credit. The sale counts as profit this month, but profit is not cash, and the bank balance does not change until the hotel pays.

2. Operating Activities

Operating activities are the cash flows of the main business. Cash comes in from customers and goes out to suppliers, employees, rent and taxes. Over time, this section should be positive, because a healthy business pays for itself from its daily work. Many companies show it with the indirect method, which starts from profit and adjusts it for items that are not cash, such as depreciation and changes in what customers owe.

Example: A small café checks its operating activities: cash from customers in, and cash out for coffee, wages and rent. The result is positive, so the daily business pays for itself.

At work: Reham looks at the operating activities and finds a negative figure, even though profits are high. Customers are paying late, so she shortens payment terms, and operating cash turns positive within two months.

3. Investing Activities

Investing activities are the cash spent on, or received from, long-term assets. They include buying or selling machines, buildings, vehicles and investments in other companies. A negative figure here is often a good sign, because the business is investing in its future. A large positive figure may mean that the company is selling assets, so it is worth asking why.

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Example: A family buys a car that will be used for many years, which is like an investing activity. Cash goes down now, but the car serves the family for a long time.

At work: Reham's company buys a new cutting machine, shown under investing activities as cash going out. The negative figure is not a worry, because the machine will raise production for years.

4. Financing Activities

Financing activities show how the business is funded by lenders and owners. Cash comes in when the company borrows money or when owners invest. Cash goes out when loans are repaid or when dividends are paid to owners. This section helps us see whether a business depends more and more on borrowing.

Example: A student takes a bank loan for a course, which is like a financing activity. Cash comes in now, and repayments go out every month later.

At work: To pay for the machine, Reham's company takes a five-year bank loan, shown under financing activities as cash coming in. Each later repayment appears in the same section as cash going out.

5. Reading the Whole Statement

The three sections together give the net change in cash for the period. Cash at the start, plus this net change, equals cash at the end. The pattern matters more than any single number. A healthy pattern is positive operating cash that pays for investment, while a warning sign is negative operating cash that is covered by new loans, year after year.

Example: A household reads its whole month: salary in, a new laptop out, and a loan payment out. Adding the three shows clearly whether its savings grew or fell.

At work: Reham reads the whole statement for the board: operating cash is positive again, investing shows the machine, and financing shows the loan. Cash at the end of the year is higher than at the start, and the board can see exactly why.

Conclusion

In summary, the cash flow statement shows the real movement of cash in a business. It separates cash flows into operating, investing and financing activities. It reminds us that profit is not cash, and that a business needs both to survive. Reading its pattern regularly helps us spot problems early, before the bank account does.

Sources

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