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Learn More about the HBS Online Learning Model You must have heard that, albeit profitable, the businesses could not go on as they just run out of cash. This may sound ridiculous at first sight, but managing cash flow effectively is important for the business’s survival.It is important for all levels of the organization, either small or large. And believe it or not, failure of business due to cash crunch would be the stupidest idea to let yourself and your business down.Managing cash flow means managing working capital funds in and out of your business. This includes the aspects related to accounts receivable, accounts payable, office expenses, and so on. 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Cash flow is calculated by changes in cash balances from one accounting period to the next. Net income is gross income minus expenses in an accounting period. Why is cash flow necessary for business? Cash flow is important for businesses as it provides the money necessary to pay your bills, buy supplies, pay your employees, and keep your business operating. How to maximize your cash flow? To increase your cash flow, you need to start with speeding up the pace that your receivables come in. This may require reducing the time you bonus customers for paying on time or more customer service efforts. How to analyze cash flow? To analyze cash flow you need to prepare a cash flow statement which will track how much money is coming in and out of your business. Then you can analyse your investments, operating expenses, financing costs etc. What happens when cash flow is negative? Businesses cannot pay their bills when cash flow is negative. They’re forced to borrow money, pay interest, and hurt the bottom line. What is free cash flow? Free Cash Flow (FCF) is the measure of money a business creates subsequent to considering capital consumptions. How to analyse if cash flow statements are correct? In order to ensure that your cash flow statements are accurate, you’ll need to do a line by line analysis and verify that the information you input is accurate. Can cash flow be negative? Yes, cash flow can be negative. It occurs when you have more expenses than income. It is the result of poorly managed receivables and the misunderstanding of how to use credit. For a limited time, negative cash flow is allowable, but repeated negative cash flow can cause a business to fail. How to calculate Free Cash Flow (FCF) from a cash flow statement? You can calculate FCF by taking your previous-tax and interest earnings, adding depreciation and amortization, and then subtracting changes in capital expenditures and working capital. What is levered free cash flow? Levered free cash flow is basically money that is on deck after all debts are paid. It is money that is not owed to anyone. And, if you have stockholders or investors, it is available to them. Share — copy and redistribute the material in any medium or format for any purpose, even commercially. Adapt — remix, transform, and build upon the material for any purpose, even commercially. The licensor cannot revoke these freedoms as long as you follow the license terms. Attribution — You must give appropriate credit , provide a link to the license, and indicate if changes were made . You may do so in any reasonable manner, but not in any way that suggests the licensor endorses you or your use. ShareAlike — If you remix, transform, or build upon the material, you must distribute your contributions under the same license as the original. No additional restrictions — You may not apply legal terms or technological measures that legally restrict others from doing anything the license permits. You do not have to comply with the license for elements of the material in the public domain or where your use is permitted by an applicable exception or limitation . No warranties are given. The license may not give you all of the permissions necessary for your intended use. For example, other rights such as publicity, privacy, or moral rights may limit how you use the material. The movement of cash & cash equivalents or inflow and outflow of cash is known as Cash Flow. Cash inflows are the transactions that result in an increase in cash & cash equivalents; whereas, cash outflows are the transactions that result in a reduction in cash & cash equivalents. Hence, a statement showing flows of cash & cash equivalent during a specified time period is known as a Cash Flow Statement. Simply put, a cash flow statement is a summary of different sources and applications of cash during a specific time period and analyses the reasons behind changes in cash balance between the two balance sheet dates. (Here, 'cash' means cash & cash equivalent) Hence, one can prepare a cash flow statement if the two comparative balance sheets of a company are given. A cash flow statement includes only those items which affect cash. This is the reason why a cash flow statement is also known as Statement of Changes in Financial Position - Cash Basis, or a Funds Flow Statement - Cash Basis. A cash flow statement can be prepared for the past or can project the future. The transactions of a cash flow statement are categorised into three activities; namely, Cash flow from Operating Activities, Cash flow from Investing Activities, and Cash flow from Financing Activities. The Institute of Chartered Accountants in India has issued Accounting Standard AS - 3 revised for the preparation of cash flow statements. Besides, with the introduction of the Companies Act 2013, the preparation of a Cash Flow Statement is now mandatory for every type of company except OPC (One Person Company) [Section 2(40)].Objectives of Cash Flow StatementThe main objectives of preparing a cash flow statement are as follows:1. Useful for Short-term Financial Planning: A cash flow statement helps an organisation by providing it with information for planning its short-term financial needs. As this statement provides information regarding the different sources and applications of cash during a specific time period, it makes the assessment of a firm's financial position easier and the organisation can know whether or not it will have sufficient cash to meet its day-to-day expenses and pay the trade payables in time, whether or not it has enough cash for payment for the purchase of fixed assets, and whether or not it will have enough cash with it to pay the long-term loans and interests thereon. 2. Useful in Preparing the Cash Budget: An organisation can also use a cash flow statement prepared for the future, for the preparation of its cash budget. The management with the help of a cash flow statement can know about the surplus or deficit period of cash; i.e., in which months the cash receipts will be more than cash payments and in which months the cash payments will be more than cash receipts. Thus, it helps in planning the investment of surplus cash in different short-term investments and also helps in planning short-term credit in advance for deficit periods. 3. Comparison with the Cash Budget:A cash budget is prepared at the beginning of the year; however, a cash flow statement is prepared at the end of the year. By making a comparison between the cash budget and cash flow statement, an organisation can ascertain the extent to which its financial resources have been generated and used according to the plan made in cash budget. With comparison. an organisation can analyze the causes of variation between the figures of these two statements and can take proper corrective measures. 4. Study of the Trend of Cash Receipts and Payments:A cash flow statement reveals the speed at which the current liabilities are being paid and cash is being generated from inventory, trade receivables, and other current assets by the company. By doing so, the management of the company can easily assess its true position of cash in future. 5. Explains the Deviations of Cash from Earnings:It is quite possible that a firm is earning huge profits, yet it lacks cash. Similarly, it is also possible that a firm is suffering losses, yet it has plenty of cash with it. A cash flow statement helps the user in understanding the reason behind it by describing the deviation of its cash from earnings. 6. Helpful in Ascertaining Cash Flow from Various Activities Separately:A cash flow statement separately highlights the Cash flow from operating, investing, and financing activities. It does so by indicating how much cash has been generated or used in these activities. A cash flow statement not only helps the organisation(insiders), but also the outsiders such as bankers, shareholders, lenders, creditors, etc. The outsiders can easily analyze the financial position of the organisation and can take proper decisions on the basis of the analysis.8. Helpful in Making Dividend Decisions:An organisation has to deposit the amount of the dividend in a separate Dividend Bank A/c within 5 days of its declaration. The management can thus, take the help of the cash flow statement in ascertaining the position of the cash generated from its operating activities which can ultimately be used for paying dividends.9. Test for the Managerial Decisions:There is a general rule for the purchase of fixed assets, which is, they should be purchased from the funds raised by the company from its long-term sources, like issue of debentures, issue of shares, long-term loans, etc., and these sources should be repaid out of the cash generated from the firm's operating activities. The cash flow statement of an organisation shows whether or not this policy/rule has been followed by the management. Importance of Cash Flow StatementA cash flow statement is of great importance to Financial Management as it is an essential tool of financial analysis for short-term planning. The basic advantages of a cash flow statement are as follows:1. As a cash flow statement is based on cash basis of accounting, it helps in the evaluation of the cash position of an organisation.2. It provides information about all the activities of an organisation classified as operating, investing, and financing activities. 3. A cash flow statement prepared according to AS-3 (Revised) is more useful and suitable for an organisation than a fund flow statement. It is because there is no standard format for a fund flow statement that can represent a better picture of the firm's position. 4. A cash flow statement also helps in planning the repayment of loans, replacement of fixed assets, and other related long-term planning of cash. Besides, it is also significant for capital budgeting decisions. 5. Sometimes a firm is in a poor cash position in spite of having substantial profits. A cash flow statement helps in determining the reason behind the same by throwing light on different uses of cash generated by the firm.6. If a firm wants to analyse its short-term financial position, cash flow analysis is more useful instead of a fund flow analysis. It is because, in a short period, cash is more relevant for the firm than the working capital to forecast its ability to meet its immediate obligations. 7. A firm can also prepare a projected cash flow statement and can know how much cash will be generated into the firm and how much cash will it need to make payments. In the end, the firm can plan well for the arrangement for its future cash requirements.8. An organisation can also make a comparison between historical and projected cash flow statements and can hence find the variations and deficiencies in its performance. It ultimately helps the firm in taking immediate and effective actions.9. With the help of inter-firm and intra-firm cash flow statements, a firm can also get to know about its liquidity position; i.e., whether its liquidity position is improving or deteriorating over a period of time. It can also compare its liquidity with other organisations over a period of time.Limitations of Cash Flow Statement1. Not Suitable for Judging the Liquidity:The liquidity of an organisation does not only depend on the cash alone; hence, a cash flow statement does not represent a true picture of an organisation's liquidity. A firm's liquidity also depends upon the assets which can be converted into cash easily which are excluded in a cash flow statement, obstructing the true picture of a firm's ability to meet its liabilities when they become due for payment.2. Possibility of Window Dressing:Window Dressing means showing a false and better picture of an organisation by manipulating its statements. The possibility of window dressing of cash in cash flow statement is much higher as an organisation can easily manipulate its statements by postponing purchases and payments, and by quickly collecting cash from its trade receivables before the balance sheet date. Therefore, a fund flow statement presents a more realistic picture of a firm than a cash flow statement. 3. Ignores Non-cash Transactions:All the non-cash transactions like issue of bonus shares, purchase of fixed assets by issue of debentures or shares, etc., are ignored under a cash flow statement. Therefore, a firm's true position cannot be judged by a cash flow statement. 4. Ignores the Accrual Concept of Accounting:As a cash flow statement is prepared on a cash basis, it ignores one of the basic concepts of accounting; i.e., the accrual concept. Accrual Basis of Accounting is a system where the transactions are recorded whenever they occur, no matter if actual cash is received or not in the case of income or actual cash is paid or not in the case of payment. Just like Income Statement, a cash flow statement does not take both cash and non-cash transactions into account, it is not a substitute for an income statement. It also means that net cash flow does not mean the net income of the business.6. Historical in Nature:The information revealed by a cash flow statement is historical in nature, as, it is prepared with the help of two comparative balance sheets of the past years. Hence, a cash flow statement can provide useful information if it is accompanied by a projected cash flow statement. You must have heard that, albeit profitable, the businesses could not go on as they just run out of cash. This may sound ridiculous at first sight, but managing cash flow effectively is important for the business’s survival.It is important for all levels of the organization, either small or large. And believe it or not, failure of business due to cash crunch would be the stupidest idea to let yourself and your business down.Managing cash flow means managing working capital funds in and out of your business. This includes the aspects related to accounts receivable, accounts payable, office expenses, and so on. 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Uses of Cash Flow Statement: A Cash Flow Statement is of primary importance to the financial management. It is an essential tool of short-term financial analysis. Its main uses are as follows: 1. Cash Flow Statement facilitates to prepare sound financial policies. It also helps to evaluate the current cash position. 2. A projected Cash Flow Statement can be prepared in order to know the future cash position of a concern so as to enable a firm to plan and coordinate its financial operations properly. 3. It helps in taking loan from Banks and other financial institutions. The repayment capacity of the firm can be understood by going through the Cash Flow Statement. 4. It helps the management in taking short-term financial decisions. 5. Cash is the soul and heart of the business. Cash is pivot of all business activities. Everyone is cash minded. The aim of business is to gather cash. Business is a source while cash is the end. Therefore, it is very useful. 6. The statement explains the causes for poor cash position in spite of substantial profits in a firm by throwing light on various applications of cash made by the firm. Limitations of Cash Flow Statement: Cash Flow Statement is a useful tool of financial analysis. However, it suffers from some limitations, which are as follows: (1) A Cash Flow Statement only reveals the inflow and outflow of cash. The cash balance disclosed by this statement may not depict the true liquid position. There are controversies over a number of items like cheques, stamps, postal orders etc. to be included in cash. (2) A Cash Flow Statement cannot be equated with the income statement. An income statement takes into account both cash and non-cash items. Hence Cash Fund does not mean net income of the business. (3) Working Capital being a wider concept of funds, a funds flow statement presents a more complete picture than cash flow statement. A cash flow statement is a statement of the inflow or outflow of cash or cash equivalent of the company in the specified period. In other words, the cash flow statement presents the reason for changes in cash passion in two Balance Sheet dates.What is Cash Flow Statement?Cash flow includes the inflow or outflow of cash or cash equivalent. ‘Cash Flows’ implies the movement of cash in and out due to some non-cash items. Receipt of cash from a non-cash item is termed as cash inflow while cash payment in respect of such items as cash outflow.For example, the purchase of machinery by paying cash is cash outflow while sale proceeds received from the sale of machinery are cash inflow. Other examples of cash flows include the collection of cash from trade receivables, payment to trade payables, payment to employees, receipt of dividends, interest payments, etc.As per AS-3, these activities are to be classified into three categories:(1) operating, (2) investing, and (3) financing activities so as to show separately the cash flows generated (or used) by (in) these activities. This helps the users of cash flow statements to assess the impact of these activities on the financial position of an enterprise and also on its cash and cash equivalents.A Cash flow statement shows the inflow and outflow of cash and cash equivalents from various activities of a company during a specific period. The primary objective of a cash flow statement is to provide useful information about the cash flows (inflows and outflows) of an enterprise during a particular period under various heads, i.e., operating activities, investing activities, and financing activities.This information is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilize those cash flows.The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation. The main objectives of cash flow statement are:To provide information on a firm’s liquidity and solvency to change cash flow in future circumstances.To provide additional information for evaluating changes in assets, liabilities, and equity.To improve the comparability of different firms’ operating performance by eliminating the effects of different accounting methods.To indicate the amount, timing, and probability of future cash flows.The cash flow statement provides information regarding inflows and outflows of cash of an organization for a particular period. Therefore, we say that the following are the importance of cash flow statement:The cash flow statement helps to identify the sources from where cash inflows have arisen and where in the cash was utilized within a particular period.The cash flow statement is significant to management for proper cash planning and maintaining a proper matching between cash inflows and outflows.The cash flow statement shows the efficiency of a firm in generating cash inflows from its regular operations.The cash flow statement reports the amount of cash used during the period in various long-term investing activities, such as the purchase of fixed assets.The cash flow statement reports the amount of cash received during the period through various financing activities, such as the issue of shares, debentures, and raising long-term loans.Cash flow statement helps for appraisal of various capital investment programs to determine their profitability and viability.A cash flow statement helps investors to judge whether the company is financially sound or not.These are The limitation of cash flow statement explained below:Limitation of Cash Flow StatementAs CFS is based on the cash basis of accounting; it ignores the basic accounting concept of accrual basis.CFS ignores non-cash transactions. In other words, it does not consider those transactions which do not affect the cash e.g., issue of shares against the purchase of fixed assets, conversion of debentures into equity shares, etc.CFS is not suitable for judging the profitability of a firm as non-cash charges are ignored while calculating cash flows from operating activities.CFS is based on secondary data. It merely rearranges the primary data already appearing in other statements i.e., Balance Sheet and Income Statement 5. Short-term analysis: CFS is a technique of short-term financial analysis. It does not help much in knowing the long-term financial position.CFS does not present a true picture of the liquidity of a firm. Liquidity does not depend upon ‘cash’ alone. Liquidity is also affected by the assets which can be easily converted into cash. The exclusion of these assets obstructs the true reporting of the ability of the firm to meet its liabilities.By itself, it cannot provide a complete analysis of the financial position of the firm.It can be interpreted only when it is in confirmation with other financial statements and other analytical tools like ratio analysis.Funds flow and cash flow statements both are used in the analysis of business transactions in a particular period. These are the following points of difference between funds flow statement and cash flow statement:Funds flow statements are based on the accrual accounting system but in the case of cash flow statements, only those transactions are taken into consideration which affect the cash or cash equivalents only.Funds flow statement analysis of the sources and application of funds of long-term nature and the net increase or decrease in long-term funds will be reflected on the working capital of the firm. The cash flow statement will only consider the increase or decrease in current assets and current liabilities in calculating the cash flow of funds from operations.Funds Flow analysis is more useful for long-range financial planning while cash flow analysis is more useful for identifying and correcting die current liquidity problems of the firm.Funds flow statement analysis is a broader concept, it takes into account both long-term and short-term funds into account in analysis. But the cash flow statement deals with one of the current assets on the balance sheet assets side only.The fund’s flow statement tallies the funds generated from various sources with various uses to which they are put. Cash flow statements start with the opening balance of cash and reach the closing balance of cash by proceeding through sources and uses.This helps the users of cash flow statements to assess the impact of these activities on the financial position of an enterprise and also on its cash and cash equivalents. Cash flow includes the inflow or outflow of cash or cash equivalent.It means the movement of cash into the company and out of the company. Types of cash flow:Cash Flow from Operating ActivitiesCash Flow from Investing ActivitiesOperating activities are the activities that constitute the primary or main activities of an enterprise. For example, for a company manufacturing garments, operating activities are procurement of raw materials, the incurrence of manufacturing expenses, sale of garments, etc.These are the principal revenue-generating activities (or the main activities) of the enterprise and these activities are not investing or financing activities.The amount of cash from operations’ indicates the internal solvency level of the company, and is regarded as the key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows to maintain the operating capability of the enterprise, paying dividends, making of new investments and repaying of loans without recourse to an external source of financing.Cash flows from operating activities are primarily derived from the main activities of the enterprise. They generally result from the transactions and other events that enter into the determination of net profit or loss.Examples of cash flows from operating activities are:Cash Inflows from operating activities: (1) Cash receipts from the sale of goods and the rendering of services. (2) Cash receipts from royalties, fees, commissions, and other revenues.Cash Outflows from operating activities: (1) Cash payments to suppliers for goods and services. (2) Cash payments to and on behalf of the employees. (3) Cash payments to an insurance enterprise for premiums and claims, annuities, and other policy benefits. (4) Cash payments of income taxes unless they can be specifically identified with financing and investing activities.The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows.Cash Outflows from investing activities:Cash payments to acquire fixed assets including intangibles and capitalized research and development.Cash payments to acquire shares, warrants, or debt instruments of other enterprises other than the instruments held for trading purposes.Cash advances and loans made to third parties (other than advances and loans made by a financial enterprise wherein it is operating activities).Cash Inflows from Investing Activities:Cash receipt from the disposal of fixed assets including intangibles.Cash receipt from the repayment of advances or loans made to third parties (except in the case of financial enterprise).Cash receipt from the disposal of shares, warrants, or debt instruments of other enterprises except those held for trading purposes.Interest is received in cash from loans and advances.Dividends received from investments in other enterprises.Cash Flow from Financial Activities: The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds(both capital and borrowings) to the enterprise.Cash Inflows From Financing Activities:Cash proceeds from issuing shares (equity or/and preference).Cash proceeds from issuing debentures, loans, bonds, and other short/long-term borrowings.Cash Outflows From Financing Activities:Cash repayments of amounts borrowed.Interest paid on debentures and long-term loans and advances.Dividends are paid on equity and preference capital.The financial statements of the business are prepared on the accrual basis of accounting, therefore in order to calculate the cash flow, some adjustments are made for non-cash expenses and incomes. There are two methods of preparing cash flow statement:Direct Method Cash Flow StatementsIndirect Method Cash Flow StatementsThe direct method for creating a cash flow statement reports major classes of gross cash receipts and payments. Under Accounting Standards dividends received may be reported under operating activities or under investing activities.If taxes paid are directly linked to operating activities, they are reported under operating activities; if the taxes are directly linked to investing activities or financing activities, they are reported under investing or financing activities.The indirect method uses net income as a starting point, makes adjustments for all transactions for non-cash items, then adjusts for all cash-based transactions. An increase in an asset account is subtracted from net income, and an increase in a liability account is added back to net income.This method converts accrual basis net income (loss) into cash flow by using a series of additions and deductions. The following rules are used to make adjustments for changes in current assets and liabilities, operating items not providing or using cash, and non-operating items:Decreases in non-cash current assets are added to net income.Increases in non-cash current assets are subtracted from net income.Increases in current liabilities are added to net income.Decrease in current liabilities are subtracted from net income.Expenses with no cash outflows are added back to net income.Revenues with no cash inflows are subtracted from net income (depreciation expense is the only operating item that has no effect on cash flows in the period).Non-operating losses are added back to net income 8. Non-operating gains are subtracted from net income.Limitations of cash flow statement are:1. Ignore Accounting Concept of Accrual Basis2. Ignores Non-cash Transactions3. Not Suitable for Judging Profitability4. Based on Secondary Data5. Not Based on Full Information6. Incomplete Analysis. Whether you’re a working professional, business owner, entrepreneur, or investor, knowing how to read and understand a cash flow statement can enable you to extract important data about the financial health of a company. If you’re an investor, this information can help you better understand whether you should invest in a company. If you’re a business owner or entrepreneur, it can help you understand business performance and adjust key initiatives or strategies. If you’re a manager, it can help you more effectively manage budgets, oversee your team, and develop closer relationships with leadership—ultimately allowing you to play a larger role within your organization. Not everyone has finance or accounting expertise. For non-finance professionals, understanding the concepts behind a cash flow statement and other financial documents can be challenging. To facilitate this understanding, here’s everything you need to know about how to read and understand a cash flow statement. Free Resource: Financial Statement Templates Access your interactive balance sheet, income statement, and cash flow statement templates today. DOWNLOAD NOW What is a Cash Flow Statement? The purpose of a cash flow statement is to provide a detailed picture of what happened to a business’s cash during a specified period, known as the accounting period. It demonstrates an organization’s ability to operate in the short and long term, based on how much cash is flowing into and out of the business. The cash flow statement is typically broken into three sections: Operating activities Investing activities Financing activities Operating activities detail cash flow that’s generated once the company delivers its regular goods or services, and includes both revenue and expenses. Investing activities include cash flow from purchasing or selling assets—think physical property, such as real estate or vehicles, and non-physical property, like patents—using free cash, not debt. Financing activities detail cash flow from both debt and equity financing. Based on the cash flow statement, you can see how much cash different types of activities generate, then make business decisions based on your analysis of financial statements. Ideally, a company’s cash from operating income should routinely exceed its net income, because a positive cash flow speaks to a company’s ability to remain solvent and grow its operations. It’s important to note that cash flow is different from profit, which is why a cash flow statement is often interpreted together with other financial documents, such as a balance sheet and income statement. How Cash Flow Is Calculated Now that you understand what comprises a cash flow statement and why it’s important for financial analysis, here’s a look at two common methods used to calculate and prepare the operating activities section of cash flow statements. Cash Flow Statement Direct Method The first method used to calculate the operation section is called the direct method, which is based on the transactional information that impacted cash during the period. To calculate the operation section using the direct method, take all cash collections from operating activities, and subtract all of the cash disbursements from the operating activities. Cash Flow Statement Indirect Method The second way to prepare the operating section of the statement of cash flows is called the indirect method. This method depends on the accrual accounting method in which the accountant records revenues and expenses at times other than when cash was paid or received—meaning that these accrual entries and adjustments cause the cash flow from operating activities to differ from net income. Instead of organizing transactional data like the direct method, the accountant starts with the net income number found from the income statement and makes adjustments to undo the impact of the accruals that were made during the period. Essentially, the accountant will convert net income to actual cash flow by de-accruing it through a process of identifying any non-cash expenses for the period from the income statement. The most common and consistent of these are depreciation, the reduction in the value of an asset over time, and amortization, the spreading of payments over multiple periods. Related: Financial Terminology: 20 Financial Terms to Know How to Interpret a Cash Flow Statement Whenever you review any financial statement, you should consider it from a business perspective. Financial documents are designed to provide insight into the financial health and status of an organization. For example, cash flow statements can reveal what phase a business is in: whether it’s a rapidly growing startup or a mature and profitable company. It can also reveal whether a company is going through transition or in a state of decline. Using this information, an investor might decide that a company with uneven cash flow is too risky to invest in; or they might decide that a company with positive cash flow is primed for growth. Similarly, a department head might look at a cash flow statement to understand how their particular department is contributing to the health and wellbeing of the company and use that insight to adjust their department’s activities. Cash flow might also impact internal decisions, such as budgeting, or the decision to hire (or fire) employees. Cash flow is typically depicted as being positive (the business is taking in more cash than it’s expending) or negative (the business is spending more cash than it’s receiving). Related: How Learning About Finance Can Jumpstart Your Career No Matter Your Industry Positive Cash Flow Positive cash flow indicates that a company has more money flowing into the business than out of it over a specified period. This is an ideal situation to be in because having an excess of cash allows the company to reinvest in itself and its shareholders, settle debt payments, and find new ways to grow the business. Positive cash flow does not necessarily translate to profit, however. Your business can be profitable without being cash flow-positive, and you can have positive cash flow without actually making a profit. Negative Cash Flow Having negative cash flow means your cash outflow is higher than your cash inflow during a period, but it doesn’t necessarily mean profit is lost. Instead, negative cash flow may be caused by expenditure and income mismatch, which should be addressed as soon as possible. Negative cash flow may also be caused by a company’s decision to expand the business and invest in future growth, so it’s important to analyze changes in cash flow from one period to another, which can indicate how a company is performing overall. Cash Flow Statement Example Here's an example of a cash flow statement generated by a fictional company, which shows the kind of information typically included and how it's organized. Go to the alternative version. This cash flow statement shows Company A started the year with approximately $10.75 billion in cash and equivalents. Cash flow is broken out into cash flow from operating activities, investing activities, and financing activities. The business brought in $53.66 billion through its regular operating activities. Meanwhile, it spent approximately $33.77 billion in investment activities, and a further $16.3 billion in financing activities, for a total cash outflow of $50.1 billion. The result is the business ended the year with a positive cash flow of $3.5 billion, and total cash of $14.26 billion. The Importance of Cash Flow Cash flow statements are one of the most critical financial documents that an organization prepares, offering valuable insight into the health of the business. By learning how to read a cash flow statement and other financial documents, you can acquire the financial accounting skills needed to make smarter business and investment decisions, regardless of your position. Are you interested in gaining a toolkit for making smart financial decisions and the confidence to clearly communicate those decisions to key internal and external stakeholders? Explore our online finance and accounting courses and download our course flowchart to determine which best aligns with your goals. If you want to dive into creating a cash flow statement, download our free financial statement templates to start practicing. Data Tables Company A - Statement of Cash Flows (Alternative Version) Year Ended September 28, 2019 (In millions) Cash and cash equivalents, beginning of the year: $10,746 OPERATING ACTIVITIES Activity Amount Net Income 37,037 Adjustments to Reconcile Net Income to Cash Generated by Operating Activities: Depreciation and Amortization 6,757 Deferred Income Tax Expense 1,141 Other 2,253 Changes in Operating Assets and Liabilities: Accounts Receivable, Net (2,172) Inventories (973) Vendor Non-Trade Receivables 223 Other Current and Non-Current Assets 1,080 Accounts Payable 2,340 Deferred Revenue 1,459 Other Current and Non-Current Liabilities 4,521 Cash Generated by Operating Activities 53,666 INVESTING ACTIVITIES Activity Amount Purchases of Marketable Securities (148,489) Proceeds from Maturities of Marketable Securities 20,317 Proceeds from Sales of Marketable Securities 104,130 Payments Made in Connection with Business Acquisitions, Net of Cash Acquired (496) Payments for Acquisition of Intangible Assets (911) Other (160) Cash Used in Investing Activities (33,774) FINANCING ACTIVITIES Activity Amount Dividends and Dividend Equivalent Rights Paid (10,564) Repurchase of Common Stock (22,860) Proceeds from Issuance of Long-Term Debt, Net 16,896 Other 149 Cash Used in Financing Activities (16,379) Increase / Decrease in Cash and Cash Equivalents: 3,513 Cash and Cash Equivalents, End of Year: $14,259 Go back to the article. A cash flow statement is a financial report which provides information about the inflow of money into the business during a specific period, usually month or quarter and year. It is one of the three key financial statements, along with the balance sheet and income statement that provide investors a clear idea as to how healthy the company is. The cash flow statement is divided into three main sections: 1. Operating Activities: Contains the cash generated or used in a company's main business activities. What it does include are areas such as cash received from customers for the sales of goods and services or its payments in terms of expenses like salaries, rents plus utilities. Fundamental analysisThis section tells us about the company's operating capabilities indicative of whether a company can generate enough cash flow to support and develop its operations.2. Investing Activities: This section of the statement shows cash spent on purchases or sales of investments in assets, such as property, plant and equipment, or securities. The investment strategy will be a look at whether the company is growing or divesting.3. Financing activities: The cash generated or spent through transaction in equity of debt by the company. It consists of the cash received from issuing or borrowing shares, and the cash paid back for debt etc., dividends to be paid out or buybacks.The cash flow statement provides a very important tool for managing the company’s funds, determining a company’s solvency and its ability to meet its obligations and it gives overall information about the financial performance of the business. This way, it assists investors, creditors and the management in the evaluation of a firm’s ability to successfully control their cash flows and to fund their activities, investments and financing.Types of Cash Flow StatementCash flow statements are generally categorised into two types based on the method of presentation:1. Direct Cash Flow Statement: Overview: The direct method records all the cash receipts and payments directly in the cash flow statement for the period concerned. The statement of cash flows lists out the following cash transactions relating to the operating activities.Components:Cash Receipts from Customers: Amount of money received from the customers for the goods sold or services given.Cash Payments to Suppliers and Employees: Payments actually made during the process using cash for such items as raw material, employees’ salaries, utility bills etc.Cash Paid for Interest and Taxes: The real expenditure incurred for interest payments whether to banks or suppliers and income tax.Advantages: Gives a real and real linear picture of its cash flow, that makes it possible to track the actual cash flow during the period.Disadvantages: It is relatively more time-consuming and requires detailed information of all cash transactions involved.2. Indirect Cash Flow Statement: Overview: The indirect method derives from the net income stated in the income statement and then filtered through adjusting for non-operating cash activities, variation in working capital accounts, and other related factors to determine the net cash provided by operating activities.Components:Net Income: Based on the net income reported on the income statement.Adjustments for Non-Cash Transactions: Subtracts back other expenses which are not recovered by cash, for instance depreciation charges and amortisation expenses.Changes in Working Capital: Adjusts for changes in current assets and liabilities, like accounts receivable, inventory, and accounts payable.Advantages: Less time consuming to prepare as most of the information is extracted from income statements and balance sheets. It is the most popular method widely practised in the preparation of financial statements.Disadvantages: They are less natural for the identification of the real cash flows as they work with the changes in the balances instead of the direct Cash Flow statement. Comparison:Direct Method: Is more specific, revolve round cash transactions and so is more clear than other types of budgets but then, it takes more time to prepare.Indirect Method: Depends on changes in net income and is less complex to calculate than cash flow whereas it gives less information about actual cash operations. Most companies utilise mostly the indirect method due to its relative ease of computation and because it is much closer to the flows depicted in the income statements and balance sheets. But the direct method is widely regarded as being more enlightening in relation to a company’s cash flows.Uses of Cash Flow Statement1. Assessing Liquidity and Solvency:The cash flow statement is useful in analysing the company’s strength in satisfying its near term liabilities. With reference to the operating cash flow, the shareholders will be able to identify whether the company is able to generate enough cash to cater for its current obligations and expenses.2. Evaluating Financial Performance:The cash flow statement gives information on the more efficiency of using its cash resources. Positive operations cash flows depict good core business operations while steady negative flows depict poor or deteriorating operations.3. Investment Analysis:Shareholders and other users of the cash flow statement rely on this statement to analyse the company’s performance thus future outlook. It assists in evaluation with regard to the extent to which a firm can generate sufficient cash flows to fund reinvesting operations, manufacture dividends to shareholders, or seize new venture chances.4. Understanding Cash Flow from Operations:The operating section from the cash flow statement indicates the number of cash which is earned from the normal operations of the business. The ups and downs of gross profit are important to show whether the cement-maker can produce steady cash flows from its principal working activities.5. Monitoring Cash Management:The cash flow statement thus assists management in monitoring and making better the management’s cash practices. The fixed asset turn over and inventory turnover are some of the areas where the cash is tied up in working capital and where improvement can be made.6. Planning and Budgeting:From the past cash flows are developed, companies can be in a position to predict future cash requirements and hence manage them effectively. It assists in control over expenditure since it provides an accurate outlook of what is expected in terms of revenues received as well as expenses making ensuring adequate cash flow for operations and for making investments.7. Debt Management:The statement of cash flows is absolutely necessary for any creditor or lender in determining the ability of the company to repay loans. It basically provides a clear picture of how much cash is available to service debt and is, therefore, invaluable during an assessment of creditworthiness.8. Assessing Risk:It helps in the assessment of possible risks arising from fluctuating cash flows. Companies with volatile cash flows may have limited ability to continue operations, meet debt obligations, or make necessary investments.9. Comparative Analysis:Through the cash flow statement, stakeholders can have a base for comparison against competitors' or industrial performance benchmarks. Any investor or potential investor can relate the relative performances with valuable decisions from the comparative cash flow data accordingly.10. Supporting Investment Decisions:The statement of cash flows provides the investor with essential information about the company's ability to generate cash, which is widely regarded as a key indicator when assessing the potential return on investment. This will help to make an investment decision, such as buying, holding, or selling stock in the company based on the cash flow trend.Importance of Cash Flow Statement1. Insight into Liquidity:The cash flow statement is apparent from time to time; hence, the stakeholders would be able to judge the company's capabilities regarding its short-term obligations like bill payments, salary, and other operational expenses. Therefore, its immediate explanation is concerning the company's liquidity position.2. Evaluation of Financial Health:Unlike other financial statements, such as the profit and loss account, that could have non-cash items, such as depreciation, the cash flow statement will effectively show the real cash undertakings of the company. This provides a clear and accurate picture of the company's financial health, reflecting its ability to generate cash from its core business operations.3. Monitoring Cash Management:Effective cash management is vital for the very survival and growth of a business concern. Therefore, the cash flow statement enables management to understand how cash is generated and utilised within the business and where tied-up cash may be in working capital or inefficient processes.4. Facilitates Financial Planning and Forecasting:The cash flow statement is a critical document for financial planning and forecasting. Organisational levels require it in that; through the help of this statement, companies can predict future cash needs and plan for any potential shortfalls or surpluses. For this reason, the document is very important when it comes to the forward-looking aspect, especially for budgeting and long-term strategic planning.5. Assessment of Operational Efficiency:Cash flow statement signifies how a business effectively operates its operation and the management of the relation between cash inflow operating activities and the requirements of a business to meet day-to-day requirements of operations. It is important to determine the possible areas where improvements can be achieved.6. Understanding Solvency and Risk:The cash flow statement aids in evaluating the solvency of a company to meet its long-term obligations. It shows the risks on the volatility of cash flow and which sometimes may impair the company's ability to remain solvent in the long period.7. Transparency and Accountability:The cash flow statement brings another layer of transparency with the financial statements by focusing only on the actual cash inflows and outflows. It holds the managers responsible for the practices they manipulate on cash and decisions affecting the totality of financial stability within the firm.8. Comparative Analysis:Because of the cash flow statement, comparisons between different periods or against competition will be so easy. It assists the stakeholders in highlighting some of the trends in financial performance, such as improving or declining cash flow, which will be important to help with decision-making.9. Ensuring Dividend Payments:Importantly, the cash flow statement becomes very pertinent for those firms paying dividends to make sure adequate cash exists to distribute to shareholders. The cash flow statement aids in determining the sustainability of future dividend payments.10. Decision-Making Tool:The cash flow statement is an extremely crucial decision-making tool for any management. It gives current and real-time information on the availability of cash for decisions on expansion, cost-cutting, investment in new projects, and so on.Advantages of Cash Flow Statement1. Provides Clear Insight into Cash Position:It shows what comes in and out of a business as far as cash flow is concerned It shows cash that is really flowing into and out of the business in order to allow stakeholders an insight into how much real cash it has available with which to run its operations efficiently.2. Focuses on Cash Transactions:It focuses only on cash transactions, this is in comparison to the income executed where non-cash items making it harder for investors and lenders alike who might use these reports as a quick way of seeing how much money can be generated by selling off assets. Such a focus on cash actually gives you an updated view of the company's financial health and how the good or bad business can generate real money for it.3. Facilitates Better Financial Planning and Forecasting:Cash flow statement provides perspective for businesses to plan, predict future cash needs. Looking at experience, cash flows can help companies much more accurately predict future cash requirements—which is very important as part of both budgeting and providing adequate liquidity for operations and growth.4. Assists in Evaluating Business Performance:The cash flow statement allows investors to see how well a company is generating and spending its operating, investment activities, and financing decisions. One is that regularly positive cash flow from operations can be a sign of strong business performance, and negative cash flow might flag considerable areas for improvement.5. Enhances Decision-Making:The statement of cash flows is a key management tool and aids in making informed decisions. From policymaking in relation to capital expenditures, working capital management or making judgements on new investment choices with cash flow statements a business owner can make decisions efficiently.6. Helps in Assessing Liquidity and Solvency:The cash flow statement is fundamental for understanding whether a company can meet its short and long-term financial obligations. It gives you an idea that the cash-in-hand can pay back debts, cover other obligations and invest in your business — it assesses liquidity and solvency.7. Supports Investment and Financing Strategies:Cash flow statement helps the investors and creditors to analyse the company’s financial position and its prospects for future growth. It assists in evaluating the level of risk to be incurred for any investment to be made on the firm or the rate of return the firm is willing and able to offer to its creditors to warrant its financing.8. Allows for Better Comparison and Analysis:The cash flow statement is very useful in comparing the financial performance of a business at different periods or with the other businesses. It assists the stakeholders to realise different areas, which can be concerning, and to compare the company to its rivals within the industry.9. Enhances Transparency and Accountability:This is because a cash flow statement improves the financial reporting by dealing with actual cash flows. It ensures that management is also answerable to the business cash management, thus enabling all the stakeholders to have confidence in the numbers.10. Essential for Dividend Policy Decisions:In fact, for companies that declare dividends, the cash flow statement is essential to know if the company has sufficient cash to cater for shareholders’ dividends. It helps to check whether the payments on dividends will not harm the company’s financial position.Disadvantages of Cash Flow Statement1. Does Not Account for Non-Cash Items:The cash flow statement is the simplest statement of all the financial statements as it records only cash receipts and payments ignoring non- cash transactions like depreciation, amortisation, or gains and losses arising from revaluation of assets. This is helpful in determining cash flows in the organisation but it also tends to ignore other important aspects of financial performances that are vital to the financial health of a company.2. Limited View of Profitability:Thus, the cash flow statement is another statement of the financial position of a company which does not reflect the overall profit making potential of the company. It presents both the receipts and payments but does not record them where they have not impacted on cash. Thus, such concepts as ‘‘cash and profit’’ and ‘‘positive cash flow profit’’ can be distinguished, and a company can have one of them but not the other, have both, or have neither.3. Short-Term Focus:Commonly, the cash flow statement focuses on the short-term cash flows and often does not supply adequate information regarding the company’s future cash earnings or its solvency. This may cause the firm to have a myopic view regarding its cash status thereby having an inaccurate value of its actual financials.4. Does Not Reflect the Timing of Cash Flows:The cash flow statement indicates when cash was received or paid, and although it shows the frequency, it does not reveal the timing of cash flows. For instance, a rise in cash receipts just before the preparation of the statement of cash flows will give an impression of a healthy statement, while in fact the company was facing severe debtor problems at some time in the period.5. Lack of Detailed Explanations:The cash flow statement gives numerical information but does not sometimes give additional details that would give explanations to changes in the cash flows. This is especially true when for a given cash flow, preparation of a statement of cash flow does not provide adequate information regarding the nature of the cash inflow or outflow, or it may be challenging to explain why they occurred and what impact they might have in the future.6. May Be Misleading in Isolation:The cash flow statement must be read in conjunction with other financial statements namely the income statement and balance sheet. Simple reliance on this statement may entail restriction to flow of funds and misunderstanding or incomplete information of the firm’s financial conditions.7. Does Not Capture Accruals and Deferred Payments:The cash flow statement is not revised, it is only prepared by classifying income and expenses that have not necessitated cash receipts or payments for a certain period of time. This indicates that there can be differences between the cash flow statement and the income statement especially in businesses which engage in credit transactions8. Potential for Manipulation:As observed with other financial statements, the cash flow statement is subject to manipulation in an effort to give a better picture of the company’s financial health. For instance, a business may delay some of its bills or make extra efforts in collecting amounts due to be received around the period of preparing the financial statements with an aim of inflating cash flows.9. Difficulty in Comparability: There are differences in the way companies may make use of relative accounting practices or policies while preparing their cash flow statements and this may warrant the use of caution when comparing cash flow statements of different companies or even in different industries. Besides, another dimension involving differences of comparability is the decision between using direct or indirect methods of reporting cash flows.10. Does Not Address Financing Costs or Capital Structure: Despite the fact that the cash flow statement reflects the cash flows relating to the financing activities the statement doesn’t provide details of the company financing structure and cost of financing. There is further information that is required by the stakeholders in order to give a comprehensible assessment of the company’s financial stability resulting from the financing decisions.Strategies to Improve Cash Flow Statement for BusinessImproving the cash flow statement in a business involves implementing strategies that enhance cash inflows, manage cash outflows efficiently, and optimise overall cash management. Here are some effective strategies:1. Improve Accounts Receivable Management:Strategy: Optimise receivables collection through measures such as, stricter credit terms, bulk quantity discounts, and constant reminders to debtors. Other methods that can reduce the time taken to collect the outstanding amount are also the use of electronic invoices and payments.Benefit: Saves time when it comes to collection of payments hence enhances the cash flow generated from operating activities.2. Optimise Inventory Management:Strategy: Deploy just in time inventory systems, cut on unnecessary and produce inventory, check on the inventory stock on a regular basis with an aim to be in tandem with the current events. This ensures that a small amount of cash is held in raw material or work in progress or unmoved stock as compared to the traditional accounting method of first-in-first out policy which holds a large amount of cash with unmoved stock.Benefit: Allows elimination of cash that is tied to inventory thus increasing cash availability.3. Extend Accounts Payable Period:Strategy: The other way is to reach an agreement with your suppliers for the extension of credit terms in the form of delaying your payment for a number of days without attracting any penalties. This can enhance your cash flow as this makes you hold on to the cash for a long time in your business.Benefit: Promotes control since it manages to slow down outgoings, this cash may be used by the business in other areas.4. Increase Sales Revenue:Strategy: Strategy: Increased attention should be paid to sales promotion by means of marketing, addition of new products to the existing array or penetration into new segments. This is equally true with promotions and discounts, since these are good ways to facilitate sales and to improve cash inflows.Benefit: Higher sales mean increase in cash receipts which enhances the operating cash flow in the business.5. Control Operating Expenses:Strategy: Examine operating expenses and manage them by eliminating all the expenses that are not crucial. Introduce measures that would help with reducing cost for instance energy saving measures, renegotiating contracts, outsourcing activities that are considered peripheral to organisational programmes.Benefit: They also help in cutting costs in terms of cash thereby enhancing the net cash flow for the firm.6. Lease Instead of Buying:Strategy: Leasing should be preferred over purchasing especially equipment and other items of property. Leasing in most of the time involves little initial returns, thus protecting cash.Benefit: Decreases the amount of money that needs to be paid out at one time and that cost is amortised over time, leading to better cash flow in the short run.7. Improve Cash Flow Forecasting:Strategy:Strengthen cash flow forecasting and conduct it as frequently as possible in order to determine the possible deficits in cash requirements. This leads to effective management of cash flows since management is in a position to suppress or advance payment in line with the current needs.Benefit: There is improved planning that means early corrections in order to have enough cash for use and also for investment.8. Seek Alternative Financing Options:Strategy: Hire short-term business finance like, line of credit and invoice financing to bridge the financing gaps. Also equity financing should also be considered in an attempt to raise cash without which it should not lead to more debt.Benefit: Is another source of cash inflows that enables the organisation to address issues of short term cash shortages.9. Delay or Reduce Capital Expenditures:Strategy: Lease or delay nonstrategic capital outlays or carry out in more gradual stages. On the same note, what you can do is to lease or rent instead of buying new equipment.Benefit: Reduction of large cash outflows in order to retain cash for use in purposes that are core to the business.10. Enhance Cash Management Practices:Strategy: Bring all the funds in a central place to monitor the cash receipts and payments more efficiently. Maintaining cash pooling is an important factor of how the available cash should be utilised within the organisation.Benefit: This makes the overall cash management to be efficient as the chances of wrong cash flow management are avoided.The cash flow statement is one of the most useful financial statements which gives investors and managers a clear and accurate picture of cash revenue receipts and cash expenditures, which can make the business a valuable source of information on the company’s liquidity, efficiency and financial fitness. Thus, by directing its attention towards actual cash transactions, it becomes more transparent, and it provides relevant information for management and decision-making for investors and creditors. Despite having its drawbacks including its inability to factor non-cash items , its importance in planning and forecasting and evaluating risks makes it a very important tool in the maintenance of and improvement of the overall financial position of a business entity.