CASH FLOW STATEMENT – TOOL FOR EFFICIENT MANAGEMENT OF THE FINANCIAL SITUATION OF THE ENTERPRISE

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Abstract

Dynamism of economic activity and changes in the regulations which it governs, cause sometimes substantial deviations between actual and expected financial situation of enterprises. One comes to a situation where enterprises provide a result in the profit and loss statement, drawn and conform to the current regulations, while experience shortages of cash. It is to clarify such facts and circumstances of annual financial statements of enterprises targeted nature of the cash flow statement. Significant differences occur between the time when cash flows are reported in the accounts, on the one hand, and the time in which they occur, on the other. Structural changes and inflation processes in economy cause the natural need to be monitored over time, since the impact of these external factors is reflected more quickly in the information presented in the cash flow statement rather than in the content of the profit and loss statement.

Keywords:
Cash flow statement
Analysis
Control
Market economy
Management of the enterprise

Introduction

The ability of an enterprise to meet its obligations on time and its ability to expand and grow depend on adequate levels of cash. The valid measurement of an enterprise's cash inflows and outflows is an important indicator of a firm's short-term liquidity, long-term solvency, and operating performance.

When a firm issues financial statements for external use, three statements are presented: (1) an income statement, (2) a balance sheet, and (3) a statement of cash flows. The last statement is important because cash is universally acknowledged as the most liquid of assets. Also, cash is used to repay loans to lenders and pay dividends to stockholders. Cash is ultimately needed for a business to remain viable operationally. For example, it is needed to replace inventories that are sold and to replace plant and equipment a firm uses in its operations.

Cash is the beginning as well as the end of an operating cycle. Thus, cash is converted into inventories, which are then sold and converted into accounts receivable. When these accounts are ultimately collected from the firm's customers, the collected cash enters the operating cycle again and the process is repeated. The firm's objective, then, is that more cash will be returned to the firm at the end of an operating cycle than is used at the beginning of the cycle.

A balance sheet is a "snapshot" view of the status of a firm's funds at one instant of time. The liabilities and owners' equity side of the balance sheet shows the sources from which the funds that the firm is currently using were obtained: so much from accounts payable from long-term creditors, from shareholders, from retained earnings, and so on. The assets side shows the uses that the firm currently is making of these funds: so much is tied up in cash, in inventories, in plant and equipment, and so on. A flow statement explains the changes that took place in a balance sheet account or group of accounts during the period between the dates of two balance sheet "snapshots."

The income statement is a flow statement: it explains changes that occurred in the Retained Earnings account by summarizing the increases (revenues) and decreases (expenses and dividends) in retained earnings during the accounting period. The income statement focuses on the economic results of the entity's operating activities during a period. Key concepts in the measurement of the period's income are revenue recognition and the matching of expenses. Revenue is recognized in the period in which the entity performs its revenue generating tasks (e.g. delivering goods or providing services), irrespective of whether the customer pays cash at that time or agrees to pay later. Expenses measure the resources consumed in generating the period's revenue and in administering the entity during the period irrespective of when cash was used to pay for those resources. Thus, the period's income bears no direct relationship to the cash flows associated with the period's operations. Also, because of its focus on the results of operations, the income statement does not provide information about the entity's investing or financing activities during the period.

Materials and Methods

For the purposes of the investigation is used the method for recording, processing and presentation of accounting economic information.

As a whole, the "question of the formulation of the requirements to which the statement of cash flow must be subordinated and for the objectives to be achieved with its help, has been active discussed in the accounting world in economically advanced countries, and in particular in the U.S.A in the early 70s. In the 80s appear the first standardized reporting forms, which afterwards undergo some changes, following the dynamics of conceptual understanding of the goals, tasks and methods of formation of this specific report on the most important liquidity, and hence for liquidity of the company. The relative slow resolution pas this problem is connected to some purely accounting traditions arising from the need to report the obtained financial result (profit or loss) from operations. The formation of financial has its expression currently but not always and not only in the movement of funds. Its value changes during the reporting period as the principle of accumulates is applied, that, though not being in line with the "current" movement of cash, at the beginning of the discussion completely unjustified opposes the principles of accountability of cash flows" Velkov M. (1999).

In Bulgaria the Cash flow statement is included in the annual financial statement of enterprises al from 1998, when the then current Accounting Act (State Gazette no.

21/1998) included it as Annex no.3 (art.40, par. 1, p. Z of that Act). In 2002 is reelaborated and in 2005 – basically modified.

The purpose of the cash flow statement is to provide information about the *cash* flows associated with the period's operations and also about the entity's investing and financing activities during the period. This information is important to shareholders, part of whose investment return (dividends) is dependent on cash flows, and to lenders, whose interests payments and principal repayment require the use of cash. The welfare of other constituencies of a company - including its employees, its suppliers, and the local communities that may levy taxes on it - depends to varying degrees on the company's ability to generate adequate cash flows to fulfill its financial obligations.

A statement of cash flows explains the change in cash and cash equivalents for the period of the statement. Cash and cash equivalents include cash, demand deposits, and short-term, highly liquid investments. These investments are both readily convertible to known amounts of cash and so near to maturity that no significant risk is present for a change in market values from their face values.

Although fragmentary information on sources and uses of cash is obtained from comparative balance sheets and income statements, a comprehensive picture of this area of activity is found only on a statement of cash flows. A statement of cash flows, classified into operating activities, investing activities, and financing activities, provides information about the sources and uses of cash over a period of time. Operating activities include all the earning-related activities of producing goods and services for customers. Thus they include all the cash inflows and outflows entering into the determination of net income. Investing activities include the making and collecting of loans to other enterprises, the purchase and sale of equity instruments (stocks) of other enterprises, and the purchase and sale of the firm's property, plant, and equipment. Financing activities include the sale and purchase of a firm's own capital stock, the borrowing of cash, the repayment of debt, and the payment of dividends to a firm's stockholders.

Cash flow is a term that is widely used but poorly understood. Standing alone and unqualified, the term cash flow is meaningless. A company can experience cash *inflows* (i.e., cash receipts) and cash *outflows* (i.e., cash disbursements). Moreover, these cash inflows and outflows can relate to a variety of activities (e.g., the profit-directed activities that are called "operations," or financing activities, or investing activities). We can also identify the difference between the inflows and outflows of cash for each of these activities and for all combined activities of the enterprise. These are referred to as net inflows or net outflows of cash. Thus, a net inflow of cash reconciles to an *increase* in the cash balance for the period, and a net outflow corresponds to a *decrease* of the cash balance for the period. To avoid confusion, the type of cash flow referred to should be specifically described. When using the term *cash flow,* users of financial reports mean cash generated by operations. However, cash flow is also used to describe other concepts of generated cash, such as the net change in the cash balance. These uses of the term depend on the needs and objectives of the users.

Results

Managers, stockholders, potential investors, creditors, financial analysts, employees, and their representatives are concerned with the future course a company will probably take. Managers are concerned with the firm's future operating results and its ability to attract capital. Satisfactory profits are needed to keep stockholders satisfied and to preserve their tenure as managers. Sufficient cash must be generated for the firm to continue operating and pay dividends. Stockholders are concerned with a firm's operating performance and its profits. Dividend payments and the stock market price of a firm's shares are usually a function of the firm's profit performance. Potential stockholders have similar concerns. Creditors are concerned that interest and principal payments will be paid when due. Normally, a sufficient cash flow must be generated to provide for these payments. Financial analysts provide advisory services to other users, and their recommendations depend on their ability to make satisfactory predictions regarding a firm's future operations and financial condition. Employees and their collective bargaining representatives are concerned with negotiating increases in wages and benefits without forcing the firm into bankruptcy. Essentially, a firm's employees are interested in securing a "fair share of the pie," so they need analysts to project what the size of the pie will be in the future. Thus, they must also project what the firm's future results of operations will probably be.

Although financial statement analysis by itself cannot provide all the answers to the concerns of the decision makers noted above, it can assist them in their deliberations. All user groups are the major users of a firm's financial statements. Because financial statements are prepared using a historical cost framework, the statements represent a summary of past transactions. Although external users may be interested in historical results to evaluate the company's past performance, their main focus is future oriented (i.e., how well the company will perform in the future). Management's concerns are also future oriented. Thus, statement users must use various analytical tools to make inferences from historical financial statements regarding a firm's future expected performance. The inferences assist users in their decision making.

In the enterprise must be given considerable attention to cash flow because they "present the most fundamental events to which accounting measurers are based, on the one hand, and the assumptions on which conclusions of investors and creditors are based, on the other" Hendriksen E. (1982).

Objectivity of the data presented in the cash flow statement is complemented by their possibility to allow appraisal of liquidity and solvency of the enterprise.

The short-term liquidity of an enterprise is measured by the degree to which it can meet its short-term obligations. Liquidity implies the ready ability to convert assets into cash or to obtain cash. The short term is conventionally viewed as a time span up to a year, although it is sometimes also identified with the normal operating cycle of a business (that is, the time span that is the buying-producing-selling and collecting cycle of an enterprise).

The importance of short-term liquidity can best be measured by examining the repercussions that stem from a lack of ability to meet short-term obligations.

A lack of liquidity may mean the enterprise cannot take advantage of favorable discounts and profitable business opportunities as they arise. At this stage, a lack of liquidity implies a lack of freedom of choice as well as constraints on management's freedom of movement.

Solvency is a broad concept concerning the possibility of obtaining funds for a short time in order to meet unforeseen or extraordinary payments or to be used for favorable investment opportunities, as well as make them available for any purpose required by business interests. The importance of the category solvency is that it is necessary when considering the prospects for the future existence of the company. The inability to overcome systemic insolvency leads to bankruptcy, compulsory liquidation, loss of the right to claim toward the company by the share and stock holders, by its creditors, i.e. leads to restructure debts and value of stocks and shares, resulting in losses for both sides.

One of the most widely used measures of liquidity is working capital. In addition to its importance as a pool of liquid assets that provides a safety cushion to creditors, net working capital is also important because it provides a liquid reserve with which to meet contingencies and the ever-present uncertainty regarding an enterprise's ability to balance the outflow of funds with an adequate inflow of funds.

Conclusion

The amount of cash held by a well-managed enterprise is a precautionary reserve, intended to take care of short-term imbalances in cash flows. In cases of a business downturn, sales may fall more rapidly than outlays for purchases and other costs. Because cash is a nonearning asset and cash equivalents are usually low-yielding securities, the investment in such assets is kept at a safe minimum. To consider this minimum balance as available for payment of current debts would require the dropping of the going-concern assumption underlying accounting statements. Even though the balance of cash has some relation to the existing level of activity, such a relationship is not strong, nor does it contain predictive implications regarding the future. In fact, some enterprises may use cash substitutes, such as open lines of credit, that do not enter into the computation of the current ratio. The important link between cash and solvency is illustrated by the well-known fact that a shortage of cash, more than any other factor, is the element that can clinch the insolvency of an enterprise.

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