

CASH FLOW STATEMENTS: Operating Activity part 2

GRADE 12
ACCOUNTING
MODULE 4 (2)
LESSON 3

2. WORKING CAPITAL

- Working capital affects CASH FLOW = Part of Balance Sheet

- (**current Asset – current Liabilities**)

CA – CL

- Working Capital concerns:
 - buying stock,
 - paying creditors &
 - receiving money from debtors

DEBTORS

EXTRACTS

Income Statement June 2007	
Sales	R500 000
Cost of Sales	(300 000)
Gross Profit	200 000
Operating expenses	(160 000)
Operating profit	40 000
Interest expense	(10 000)
Profit before	30 000

Balance Sheet	2007	2006
Debtors	12 000	15 000

Debtors at year end:	2006	R15 000
	2007	12 000
Net inflow of cash from debtors		R3 000

It is not correct to say the **INFLOW** of cash from sales is R500 000

R12 000 of this has not been paid by the debtors yet

R15 000 was paid by debtors for sales from the previous year!

Therefore: Cash we collected this year from sales =
 $R500\ 000 - R12\ 000 + R15\ 000 = R503\ 000$

Once you understand this, you can do a simpler calculation:

DEBTORS

Therefore: Cash we collected this year from sales =
 $R500\ 000 - R12\ 000 + R15\ 000$
 $= R503\ 000$

Once you understand this, you can do a simpler calculation:

Debtors at year end:	2006	R15 000
	2007	12 000
Net inflow of cash from debtors		R3 000

- The R3 000 will have a positive effect on the cash flow of O.A.
- Operating Profit NOT = R40 000, but R43 000
- If debtors:
 - DECREASE = INFLOW of cash (more debtors have paid us)
 - INCREASE = OUTFLOW of cash (fewer debtors are paying us)

INVENTORIES

EXTRACTS

Income Statement June 2007	
Sales	R500 000
Cost of Sales	(300 000)
Gross Profit	200 000
Operating expenses	(160 000)
Operating profit	40 000
Interest expense	(10 000)
Profit before	30 000

Balance Sheet	2007	2006
Inventories(Trading Stock)	50 000	30 000

Trading stock at year end:	2006	R30 000
	2007	50 000
Net outflow of cash as result of TS		(R20 000)

Lets assume ALL stock was purchased for CASH

It is not correct to say that the outflow of cash from stock purchased (COS) is R300 000

R50 000 was still not sold at the end of the current year

R30 000 was already in the stores as stock at the beginning of the year

Therefore: Cash we PAID this year for stock =
 $R300\ 000 - R30\ 000 + R50\ 000 = R320\ 000$

Once you understand this, you can do a simpler calculation:

INVENTORIES

Therefore: Cash we PAID this year for stock =
 $R300\ 000 - R30\ 000 + R50\ 000$
 $= R320\ 000$

Once you understand this, you can do a simpler calculation:

Trading stock at year end:	2006	R30 000
	2007	50 000
Net OUTFLOW of cash as result of TS		(R20 000)

- The R20 000 will have a negative effect on the cash flow of Operating Activities
- If stock:
 - DECREASES = INFLOW of cash (bought less stock) **SOLD** 😊
 - INCREASE = OUTFLOW of cash (**bought** more stock)

CREDITORS

EXTRACTS

Income Statement June 2007

Sales	R500 000
Cost of Sales	(300 000)
Gross Profit	200 000
Operating expenses	(160 000)
Operating profit	40 000
Interest expense	(10 000)
Profit before	30 000

Balance Sheet

	2007	2006
Creditors	10 000	14 000

Creditors at year end:	2007	R10 000
	2006	14 000
Net outflow of cash to Creditors		(R4 000)

Lets assume ALL stock was SOLD at end of year & ALL stock was bought on CREDIT

It is not correct to say that the outflow of cash from buying stock is R300 000

R10 000 has not yet been paid & is still owing to creditors

R14 000 was paid to creditors for stock purchased from them last year.

Therefore: Cash we PAID this year for stock =
 $R300\ 000 - R10\ 000 + R14\ 000 = R304\ 000$

Once you understand this, you can do a simpler calculation:

CREDITORS

Therefore: Cash we PAID this year for stock =
 $R300\ 000 - R10\ 000 + R14\ 000$
 $= R304\ 000$

Once you understand this, you can do a simpler calculation:

Creditors at year end:	2007	R10 000
	2006	14 000
Net OUTFLOW of cash to Creditors		(R4 000)

- The R4 000 will have a negative effect on the cash flow of O.A.
- If stock:
 - DECREASES = OUTFLOW of cash (**paid** Creditors more)
 - INCREASE = INFLOW of cash (paid Creditors less)
 - **BORROWED**

DEBTORS, STOCK & CREDITORS

Extracts from Balance Sheet

	2007	2006
Inventories (Trading Stock)	100 000	80 000
Debtors	40 000	45 000
Cash	12 000	9 000
Creditors	50 000	56 000

INCREASE R20 000 = outflow

DECREASE R5 000 = inflow

INCREASE R3 000 = inflow

DECREASE R6 000 = outflow

REQUIRED:

Calculate the effect on cash generated (utilised) as a result of changes in **working capital**

Increase in Inventories	(R20 000)
Decrease in debtors	5 000
Decrease in creditors	(6 000)
EFFECT ON CASH GENERATED BY OPERATIONS	(R21 000)

NOTE: **Cash** does **not** form part of this calculation

REMEMBER: the objective of the CFS is to prove WHY & HOW the cash balance changed.