Cash flow statement: meaning and practical use (3) (3/46/19)

This article completes what we wrote in the last two weeks.

Cash flows from financing include cash paid and cash received from external financing sources as far as substantial amounts are concerned. To calculate those amounts, the final figure for non-current liabilities or shareholders' equity and any share premium appearing on the company's balance sheet are compared with the opening position of the same items. It is also important to consider the impact of any share capital changes unrelated to cash flows (e.g. any debt conversion should be excluded from share capital increase cash flows).

Cash flows from financing – example

	2019 EUR	2018 EUR
Cash flows from financing		
Income from issuing shares and bonds or from share investments	100	-
Borrowings	-	190
Subsidies, grants, gifts or donations received	-	100
Expenses to repay borrowings	(190)	(120)
Expenses to purchase a leased asset	-	(80)
Dividends paid	-	(100)
Net cash flow from financing	(90)	(10)

Aspects to consider when interpreting cash flow indicators

In analysing cash flow indicators, financial theory suggests answering the following questions:

- What is the total increase/decrease in cash?
- What are the key elements of cash flows? Are they positive or negative?
- How do the present cash flows compare with the expected cash flows?
- Do operations represent the main inflow of cash? Can this cover the cash needed for investing and financing?
- Does investing activity represent the main outflow of cash?
- Is financing activity used to finance acquisitions?

These questions provide information about the company's financial position and liquidity. In addition to this kind of analysis, professionals recommend using ratios such as –

- cash return on invested capital,
- cash flow to total debt, and
- cash flow to invested capital.

Cash return on invested capital is calculated as follows:

> Operating Cash Flow / (Total Assets – Liabilities) x 100%

This ratio helps the company assess the extent to which its profit for the year covers the owners' investment, in fact showing the profitability of their investment.
The ratio of cash flow to invested capital is calculated as follows:

Operating Cash Flow / Invested Capital x 100%

This ratio shows the extent to which the company's operations cover the required capital expenditures, in fact showing whether the company is able to renew its asset base on its own and allowing the company to plan for any extra borrowing.

The ratio of cash flow to total debt is calculated as follows:

Operating Cash Flow / Total Debt x 100%

This ratio provides information about the company's ability to cover its past borrowings out of its operating income, as well as showing whether its cash flows from operations will allow it to pay for its borrowings when due.

Our experience suggests that companies that regularly monitor and use their cash flows in long-term planning are better at liquidity planning, i.e. they can identify early on how much cash they need and what they can afford, as well as being able to prevent any possible cash deficit.