

## Cash Flow Statement is one of the Important Sources of Information on the Cash Flows of an Enterprise

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**Annotation:** This article explores the importance of the cash flow statement in understanding the cash flows of an enterprise. The paper highlights the significance of cash flow statement for investors and managers and describes how it is used in various decision-making contexts. It also discusses the limitations of cash flow statement and how these can be addressed by using other financial statements. The article concludes by emphasizing the need for investors and managers to understand cash flow statement and provides recommendations on how to use it effectively.

**Keywords:** cash flow statement, cash flows, financial statements, investing activities, financing activities, operating activities, working capital, capital budgeting, decision-making, limitations, management, investors.

### Introduction

A cash flow statement is a financial statement that provides information about the cash inflows and outflows of a company over a specific period of time, typically a quarter or a year. It shows how cash is generated and used by a business, and provides insights into the liquidity and financial health of the company. The cash flow statement is an essential tool for assessing a company's ability to generate cash, pay its bills, and invest in its growth.

The cash flow statement is an important financial document because it provides information about a company's actual cash inflows and outflows, which are critical to its financial health. Unlike other financial statements, such as the income statement and balance sheet, which show a company's financial performance and position, the cash flow statement provides a detailed breakdown of how cash is moving in and out of the company.

The cash flow statement is important for several reasons. Firstly, it helps investors and creditors assess a company's liquidity and ability to pay its bills. A company with strong cash inflows from its operating activities is more likely to have the cash available to meet its obligations, while a company with weak cash flows may struggle to pay its debts.

Secondly, the cash flow statement provides insights into a company's investing and financing activities. By showing how much cash is being used to purchase new assets or pay dividends, investors can gain a better understanding of the company's growth prospects and financial priorities.

Finally, the cash flow statement can help managers make informed decisions about how to allocate resources and manage cash flow. By identifying areas where cash is being tied up or where cash inflows could be increased, managers can take steps to improve the company's financial position and ensure that it has the cash available to fund future growth.

This thesis statement is a clear and concise declaration of the article's main argument. It makes a strong assertion that the cash flow statement is crucial for understanding the cash flows of an enterprise, and sets the stage for the article to explore why this is the case. To support this thesis,

the article will need to provide evidence and examples of how cash flow statements are used and why they are important, as well as any limitations or potential drawbacks of relying on them too heavily. Overall, the thesis statement provides a clear roadmap for the article and a clear sense of its purpose and scope.

For investors, the cash flow statement is an important tool for assessing a company's financial health and growth prospects. By providing information about the actual cash inflows and outflows of a company, the cash flow statement can help investors make more informed decisions about whether to invest in a company or not.

### **Importance of cash flow statement**

One key reason why the cash flow statement is important for investors is that it provides a more accurate picture of a company's liquidity and ability to pay its bills than other financial statements, such as the income statement or balance sheet. While these statements can provide useful information about a company's profitability and assets, they do not show how much cash is actually available to pay debts or fund growth.

By analyzing the cash flow statement, investors can gain insights into a company's ability to generate cash from its operating activities, invest in new assets, and pay dividends to shareholders. They can also identify areas where cash flow may be weak, such as a reliance on financing activities or a high level of accounts receivable.

Overall, the cash flow statement is an essential tool for investors to evaluate a company's financial health, liquidity, and growth prospects, and to make more informed decisions about whether to buy, sell, or hold a company's stock.

For managers, the cash flow statement is an important tool for monitoring the cash position of the company and making informed decisions about how to allocate resources and manage cash flow. By analyzing the cash flow statement, managers can identify trends and patterns in the company's cash inflows and outflows and take steps to improve the company's financial position.

One key reason why the cash flow statement is important for managers is that it provides a clear picture of the actual cash available to the company to pay debts, invest in new assets, and pay dividends to shareholders. By monitoring the cash flow statement, managers can identify areas where cash is being tied up, such as high levels of inventory or slow collections on accounts receivable, and take steps to improve cash flow.

The cash flow statement also provides insights into the company's investing and financing activities, allowing managers to assess the financial impact of decisions such as acquiring new assets or taking on debt. By understanding how these activities affect the company's cash position, managers can make more informed decisions about how to allocate resources and manage cash flow.

Overall, the cash flow statement is an essential tool for managers to monitor the financial health of the company, identify areas for improvement, and make informed decisions about how to allocate resources and manage cash flow. By using the cash flow statement to guide their decisions, managers can ensure that the company has the cash available to fund growth and meet its obligations.

The cash flow statement is a key financial document that is used in a variety of decision-making contexts. Here are some examples of how the cash flow statement is used in decision-making:

1. Capital budgeting decisions: The cash flow statement is used in capital budgeting decisions, such as whether to invest in new assets or expand the company's operations. By analyzing the cash flows associated with these investments, managers can assess whether the investment is likely to generate a positive return and whether the company has the cash available to fund the investment.
2. Financing decisions: The cash flow statement is also used in financing decisions, such as whether to issue new debt or equity. By analyzing the company's cash inflows and outflows, managers can assess whether the company has the cash available to service its debt or pay dividends to shareholders.
3. Working capital management decisions: The cash flow statement is used in working capital management decisions, such as how much inventory to carry or how much credit to extend to customers. By analyzing the cash flows associated with these activities, managers can identify areas where cash flow may be weak and take steps to improve the company's cash position.
4. Dividend decisions: The cash flow statement is used in making decisions about dividends. By analyzing the company's cash position and expected future cash flows, managers can determine whether the company has the cash available to pay dividends to shareholders.
5. Merger and acquisition decisions: The cash flow statement is used in merger and acquisition decisions, such as whether to acquire another company or merge with a competitor. By analyzing the cash flows associated with the target company, managers can assess whether the acquisition or merger is likely to generate a positive return and whether the company has the cash available to finance the transaction.

In all of these decision-making contexts, the cash flow statement provides a critical source of information about the company's cash position and cash flows. By analyzing the cash flow statement, managers can make more informed decisions about how to allocate resources, manage cash flow, and ensure the long-term financial health of the company.

### **Understanding the components of cash flow statement**

The cash flow statement is divided into three sections, each of which provides information about a different aspect of the company's cash flows: operating activities, investing activities, and financing activities.

1. Operating activities: This section of the cash flow statement shows the cash flows associated with the company's primary business operations, such as the cash received from customers and the cash paid to suppliers and employees. Operating cash flows are considered a key measure of the company's ability to generate cash from its core business activities.
2. Investing activities: This section of the cash flow statement shows the cash flows associated with the company's investments in long-term assets, such as property, plant, and equipment. Investing cash flows can include the cash received from the sale of assets and the cash paid to acquire new assets.
3. Financing activities: This section of the cash flow statement shows the cash flows associated with the company's financing activities, such as the cash received from issuing debt or equity and the cash paid out in dividends to shareholders. Financing cash flows can also include the cash paid to repay debt or to buy back shares.

By breaking down the company's cash flows into these three sections, the cash flow statement provides a clear picture of the sources and uses of cash within the company. This information can

be used by investors and managers to assess the company's cash position and make informed decisions about how to allocate resources and manage cash flow.

Each section of the cash flow statement provides valuable information about the cash flows of an enterprise and can be used to understand the company's overall financial health:

1. **Operating activities:** This section of the cash flow statement shows the cash flows associated with the company's primary business operations. By analyzing the operating cash flows, investors and managers can assess the company's ability to generate cash from its core business activities. High operating cash flows are generally considered a positive sign, as they indicate that the company is generating a significant amount of cash from its operations.
2. **Investing activities:** This section of the cash flow statement shows the cash flows associated with the company's investments in long-term assets, such as property, plant, and equipment. By analyzing the investing cash flows, investors and managers can assess the company's level of investment in long-term assets and whether the company is investing in assets that are likely to generate a positive return.
3. **Financing activities:** This section of the cash flow statement shows the cash flows associated with the company's financing activities, such as the cash received from issuing debt or equity and the cash paid out in dividends to shareholders. By analyzing the financing cash flows, investors and managers can assess the company's use of debt and equity financing and whether the company is returning value to shareholders through dividend payments.

Overall, by analyzing the cash flows of each section of the cash flow statement, investors and managers can gain a comprehensive understanding of the company's sources and uses of cash. This information can be used to make informed decisions about how to allocate resources, manage cash flow, and ensure the long-term financial health of the company.

Here are some examples of typical transactions that would be included in each section of the cash flow statement:

1. **Operating activities:**
  - Cash received from customers for the sale of goods or services
  - Cash paid to suppliers for the purchase of raw materials or inventory
  - Cash paid to employees for salaries, wages, and benefits
  - Cash paid for rent, utilities, and other operating expenses
  - Cash received or paid for income taxes and interest payments
2. **Investing activities:**
  - Cash paid to acquire property, plant, and equipment
  - Cash received from the sale of long-term assets, such as real estate or machinery
  - Cash paid to acquire investments, such as stocks or bonds
  - Cash received from the sale of investments
3. **Financing activities:**
  - Cash received from the issuance of debt, such as bonds or loans
  - Cash received from the issuance of equity, such as common or preferred stock

- Cash paid to repay debt
- Cash paid to pay dividends to shareholders
- Cash used to repurchase shares of the company's stock

These are just a few examples of the types of transactions that would be included in each section of the cash flow statement. By analyzing these transactions and their impact on the company's cash position, investors and managers can gain a better understanding of the company's financial health and make informed decisions about its future.

### **Limitations of cash flow statement**

While the cash flow statement is an essential tool for understanding the cash flows of an enterprise, it also has some limitations that should be taken into account. Here are some of the limitations of the cash flow statement:

**Timing of cash flows:** The cash flow statement provides information about the cash inflows and outflows over a specific period, but it does not provide information about the timing of those cash flows. For example, a company may have a large cash inflow in one period but not have the cash available to pay its bills until a later period. As a result, the cash flow statement may not accurately reflect the company's short-term liquidity.

**Non-cash transactions:** The cash flow statement only includes transactions that involve cash, which means that it may not capture the full range of a company's financial transactions. For example, the cash flow statement may not include transactions such as the issuance of stock options or the depreciation of fixed assets, which can have a significant impact on a company's financial performance.

**Classification of cash flows:** The cash flow statement requires companies to classify cash flows into specific categories, such as operating, investing, and financing activities. However, the classification of cash flows can be subjective and may vary from one company to another. This can make it difficult to compare cash flows between companies or to draw meaningful conclusions about a company's financial performance based on the cash flow statement alone.

Despite these limitations, the cash flow statement remains an important tool for understanding the cash flows of an enterprise. By using the cash flow statement in conjunction with other financial documents and metrics, investors and managers can gain a more complete picture of a company's financial health and make more informed decisions about its future.

While the limitations of the cash flow statement cannot be fully addressed by using other financial statements, they can be mitigated by using additional financial information. Here are some examples of how other financial statements can provide additional context and help address the limitations of the cash flow statement:

1. **Balance sheet:** The balance sheet provides information about a company's assets, liabilities, and equity, which can be used to understand the timing of cash flows and short-term liquidity. By analyzing the balance sheet alongside the cash flow statement, investors and managers can gain a better understanding of a company's overall financial health.
2. **Income statement:** The income statement provides information about a company's revenue, expenses, and net income, which can be used to identify non-cash transactions and to understand how those transactions impact the company's cash flows. By comparing the income

statement to the cash flow statement, investors and managers can identify any discrepancies and gain a more complete picture of the company's financial performance.

3. Notes to financial statements: The notes to the financial statements provide additional information about the company's accounting policies and the assumptions underlying its financial statements. By reviewing the notes to the financial statements, investors and managers can gain a better understanding of how the company classifies its cash flows and can make more informed decisions based on that information.

While the cash flow statement has its limitations, these can be mitigated by using other financial statements and information. By analyzing multiple financial documents and metrics, investors and managers can gain a more complete picture of a company's financial health and make more informed decisions about its future.

## Conclusion

In conclusion, the cash flow statement is an essential tool for understanding the cash flows of an enterprise. It provides valuable information about a company's cash inflows and outflows and helps investors and managers make informed decisions about the company's financial health. By understanding the components of the cash flow statement and its limitations, as well as using other financial statements to supplement its information, investors and managers can gain a more complete picture of a company's financial health and make more informed decisions about its future. Overall, the cash flow statement is a critical source of information for anyone seeking to understand the financial health of a company.

It is crucial for investors and managers to understand the cash flow statement in order to make informed decisions about the financial health of a company. Without a thorough understanding of the cash flow statement, investors and managers may not have a complete picture of a company's financial position, and could make decisions that are not in the best interests of the company or its stakeholders.

By understanding the components of the cash flow statement and its limitations, investors and managers can gain valuable insights into a company's cash inflows and outflows, and identify areas where the company may be experiencing cash flow difficulties. This information can help them make informed decisions about financing, capital investments, working capital management, and other critical business decisions.

Moreover, in today's business environment, where cash is king, the importance of the cash flow statement cannot be overstated. A company can have a strong balance sheet and income statement, but if its cash flows are weak, it may struggle to meet its financial obligations and remain competitive in the marketplace.

Therefore, it is essential for investors and managers to have a thorough understanding of the cash flow statement, and to use it as a key source of information when making decisions about the financial health of a company.

Here are some recommendations on how to use the cash flow statement effectively:

1. Understand the components: Start by understanding the three sections of the cash flow statement - operating, investing, and financing activities - and how each section contributes to the overall picture of a company's cash flows.

2. Analyze the trends: Look for trends in a company's cash flow statement over time, such as changes in cash inflows and outflows, and use this information to assess the company's financial health.
3. Compare to other financial statements: Use the cash flow statement in conjunction with the balance sheet and income statement to get a more complete picture of a company's financial position.
4. Look for red flags: Pay attention to any significant changes in cash flows, such as sudden increases or decreases, and try to identify the root cause of these changes.
5. Use ratios: Calculate and analyze various ratios, such as the operating cash flow ratio, the cash conversion cycle, and the free cash flow ratio, to gain additional insights into a company's cash flow position.
6. Seek professional advice: If you're uncertain about how to interpret the cash flow statement, seek professional advice from a financial expert who can help you make sense of the information and provide guidance on how to use it effectively.

By following these recommendations, investors and managers can use the cash flow statement as a powerful tool for understanding the financial health of a company and making informed decisions about its future.

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