39 Lecture - MGT401

Important Subjective

1. Explain the significance of the Cash Flow Statement in financial reporting.
   Answer: The Cash Flow Statement provides information about the cash inflows and outflows of a company during a particular period. It helps in assessing a company's liquidity and ability to generate cash. The statement also assists investors in determining the extent to which a company's operations are generating cash flows and whether it has the potential to meet its financial obligations.

2. What is the difference between operating, investing, and financing activities in the Cash Flow Statement?
   Answer: Operating activities involve cash inflows and outflows that arise from a company's primary business activities, such as sales and purchases of goods and services. Investing activities refer to cash inflows and outflows related to the acquisition or disposal of long-term assets. Financing activities comprise cash inflows and outflows resulting from the issuance and repayment of long-term liabilities and equity.

3. How does depreciation impact the Cash Flow Statement?
   Answer: Depreciation is a non-cash expense, meaning that it does not involve the actual outflow of cash. However, it does reduce the value of a company's assets over time, which is reflected in the Cash Flow Statement. Depreciation is added back to net income when calculating operating cash flows.

4. What are the advantages of the direct method for preparing the Cash Flow Statement?
   Answer: The direct method provides a more detailed and transparent picture of a company's cash inflows and outflows. It also allows for a better understanding of the company's operating activities and how they generate cash. Additionally, it facilitates the identification of cash flow issues and helps in developing strategies to address them.

5. What is the purpose of the reconciliation of net income to cash flows from operating activities in the Cash Flow Statement?
   Answer: The reconciliation of net income to cash flows from operating activities adjusts net income for non-cash items such as depreciation and amortization and also takes into account changes in current assets and liabilities that impact cash flows. The purpose is to arrive at the actual cash generated or used by the company's operations during a particular period.

6. Explain the importance of the Cash Flow Statement in assessing a company's solvency.
   Answer: The Cash Flow Statement provides information about a company's cash inflows and outflows, which helps in assessing its ability to meet its financial obligations. By analyzing a company's cash flows, investors and creditors can determine whether the company has sufficient cash reserves to pay its debts and meet its other financial obligations.

7. How does a change in accounts receivable impact the Cash Flow Statement?
   Answer: A decrease in accounts receivable represents a cash inflow, while an increase in accounts receivable represents a cash outflow. This is because a decrease in accounts receivable means that the company has collected cash from its customers, while an increase in

accounts receivable means that the company has extended credit to its customers and has not yet received payment.

8. What is the significance of the free cash flow metric?
   Answer: Free cash flow is a metric that indicates the cash generated by a company after taking into account all capital expenditures required to maintain and grow the business. It is a useful metric for assessing a company's ability to generate cash and reinvest in its operations. A positive free cash flow indicates that a company is generating more cash than it requires to maintain its operations, while a negative free cash flow suggests that the company may need to raise additional capital.

9. How can the Cash Flow Statement be used to identify potential financial problems in a company?
   Answer: By analyzing the Cash Flow Statement, investors and creditors can identify potential financial problems in a company, such as a negative operating cash flow, a high level of investing cash outflows, or a low level of free cash flow. These issues could indicate that the company is not generating sufficient