

Accounting Units 3 & 4

Chapter 11 Reporting for cash

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Chapter 11 Reporting for cash — 11A The Cash Flow Statement

Theory

Every business needs to know two different things about a period's trading: **how much profit it earned** and **how much cash it generated**. These are not the same figure, because the business does not receive and pay cash at the same moment it earns revenue and incurs expenses. The **Cash Flow Statement** is the report that answers the second question — it lists the **cash inflows and outflows** for the period and explains the change in the business's **Bank balance** from the start of the period to the end.

Cash versus accrual. Under the **accrual basis** of accounting, revenue is recognised when it is **earned** and an expense when it is **incurred**, regardless of when the cash moves. A credit sale, for example, is revenue on the day the goods are delivered, even though the cash arrives weeks later; and **depreciation** is an expense every period even though no cash is ever paid for it. The **Income Statement** is prepared on this accrual basis. The **Cash Flow Statement**, by contrast, is prepared on a **cash basis** — it records a flow **only when cash actually enters or leaves the Bank account**. This is why the two reports rarely agree: a profitable business can still run short of cash, and a business can have plenty of cash while making a loss.

Two consequences follow directly and are worth fixing in your mind now:

- **GST is a cash flow.** When the business receives or pays GST in cash — GST collected on a cash sale, GST paid on a cash purchase, or the net GST settled with the ATO — real cash moves, so it belongs in the Cash Flow Statement. Each of those three is reported on its **own line** in the operating section.
- **Depreciation is *not* a cash flow.** Depreciation is an accounting **allocation** of the cost of a non-current asset over its life; no cash is paid when it is recorded. It appears in the Income Statement as an expense but **never** in the Cash Flow Statement. (The cash outflow for the asset happened once, when the asset was **bought** — an investing flow — not each period as it is depreciated.)

The classified Cash Flow Statement. So that users can see *why* cash changed, the statement **classifies** every cash flow into one of **three activities**:

- **Operating activities** — the cash effects of the business's **day-to-day trading**: the everyday buying and selling and running of the business. Inflows include **cash sales** (reported at the GST-exclusive selling price), the **GST received** on those cash sales, **receipts from Accounts Receivable** and any **GST refund** received from the ATO. Outflows include **payments to Accounts Payable**, **payments for expenses** (wages, rent, advertising and the like), **GST paid** on the period's cash payments, the **GST settlement to the ATO** and **interest expense** on borrowings.
- **Investing activities** — the cash used to **buy** non-current assets and the cash **received** from **selling** them. A **purchase** of equipment, a vehicle, machinery or fittings is an outflow; the **proceeds** from disposing of a non-current asset are an inflow.
- **Financing activities** — the cash flows between the business and its **owner** and its **lenders**: **capital contributions** by the owner (inflow), **loans received** (inflow), **repayments of loan principal** (outflow) and **drawings** by the owner (outflow).

How GST appears in the statement. Because GST is collected and paid in cash, it needs lines of its own, and there are **three** of them. **Cash sales** are reported at the **GST-exclusive** selling price, and the GST collected on them is reported **separately** as **GST received**; since GST is 10%, the GST received line is 10% of the cash sales line.

Receipts from Accounts Receivable and **payments to Accounts Payable**, by contrast, are reported at the **full amount** of cash received or paid, with no GST line beside them: the GST on a credit sale or a credit purchase was recorded when the **credit transaction** happened, so it is not reported a second time when the cash moves. On the outflow side there are **two different items**, and confusing them is a common way to lose marks:

- **GST paid** — the GST included in the cash the business itself **paid out** during the period: GST on expenses paid in cash, on cash purchases of inventory and on non-current assets bought for cash.
- **GST settlement to ATO** — the **net GST remitted** to the Australian Taxation Office for the period.

Both are operating outflows, but they are separate lines reporting separate cash movements.

Operating versus financing — a common trap. The two flows on a loan are classified **differently**. The **interest** paid to service a loan is a **cost of running the business** for the period, so it is an **operating** outflow. **Repaying the principal** of the loan (and **receiving** the loan in the first place) changes the business's **funding**, so it is a **financing** flow. Likewise, cash the owner puts **in** (capital) and takes **out** (drawings) are **financing** flows, because they are dealings with the owner as a supplier of finance, not day-to-day trading.

The net change and the reconciliation. Each activity is sub-totalled to give **Net Cash Flows from Operating / Investing / Financing Activities**. The three sub-totals are then added to give the **net increase or decrease in cash** for the period. Finally the statement **reconciles** this net change to the Bank account:

Opening Bank balance + net change in cash = closing Bank balance.

If the closing figure is **positive** it is the Bank balance at the end (a current asset); if it is **negative** the business has ended the period with a **Bank Overdraft** (a current liability). This reconciliation is the whole point of the report: it proves that the classified inflows and outflows fully explain the movement in the business's cash.

Report title. Like the Income Statement, the Cash Flow Statement covers a **period**, so it is titled *Cash Flow Statement for the [period] ended [date]* — never “as at” (that phrasing is reserved for the Balance Sheet, which reports a position at a point in time).

Worked model. Rosewood Interiors began May with a Bank balance of \$8 400. Its cash records for the month ended 31 May 2026 show the flows below. Outflows are shown in brackets; each activity is sub-totalled, and the three sub-totals reconcile the opening Bank balance to the closing balance.

Cash Flow Statement for
the month ended 31 May
2026

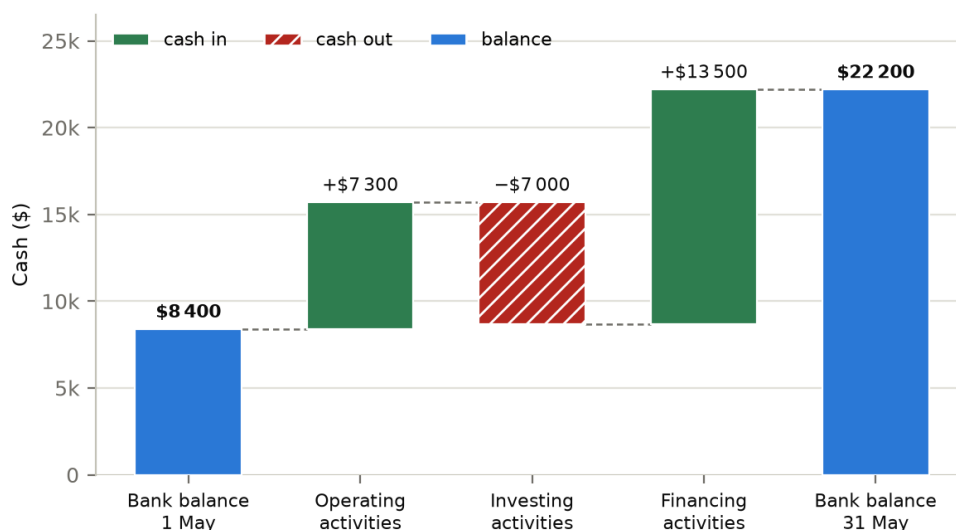
	\$	\$
Operating Activities		
Cash sales	24 000	
GST received	2 400	
Receipts from Accounts Receivable	18 700	
Payments to Accounts Payable	(21 300)	
Wages	(9 200)	
Rent expense	(3 000)	
GST paid	(1 500)	
GST settlement to ATO	(2 100)	
Interest expense	(700)	
Net Cash Flows from Operating Activities		7 300
Investing Activities		
Purchase of office equipment	(12 000)	
Proceeds from sale of delivery van	5 000	
Net Cash Flows from Investing Activities		(7 000)
Financing Activities		
Capital contribution	6 000	
Loan – Meridian Finance	10 000	
Drawings	(2 500)	

Cash Flow Statement for
the month ended 31 May
2026

	\$	\$
Net Cash Flows from Financing Activities		13 500
Net Increase in Cash		13 800
add Bank balance at start (1 May 2026)		8 400
Bank balance at end (31 May 2026)		22 200

The three sub-totals — \$7 300, (\$7 000) and \$13 500 — add to a **net increase of \$13 800**, which added to the opening \$8 400 gives a **closing Bank balance of \$22 200**. Notice the three GST lines: the \$2 400 **GST received** (10% of the \$24 000 cash sales) is an inflow, while the \$1 500 **GST paid** (the GST on the cash rent and on the office equipment) and the \$2 100 **GST settlement to ATO** are two **different** outflows. Notice too that the \$21 300 paid to suppliers is reported at the full amount paid — no GST line beside it — and that any depreciation Rosewood recorded on its equipment is **not** here at all, because it has no cash effect.

The Cash Flow Statement
Rosewood Interiors — month ended 31 May 2026



The three sub-totals — \$7 300, (\$7 000) and \$13 500 — add to a net increase of \$13 800, which explains the whole movement from \$8 400 to \$22 200.

Rosewood Interiors' three activity sub-totals bridging the opening Bank balance to the closing one

Drawn as a bridge, each activity is a step up or down from the running balance, so the reconciliation *is* the picture rather than a line at the foot of it. The \$7 300 in from operating, \$7 000 out on investing and \$13 500 in from financing lift the \$8 400 opening balance to the \$22 200 closing balance, and no other cash movement is needed to explain it.

Worked examples (scaffolded)

Example 1 — operating and financing flows, then the reconciliation

Harborline Sports (a sports store) began June with a Bank balance of \$5 200. Its cash records for the month ended 30 June 2026 were: cash sales \$32 000; GST received \$3 200; payments to Accounts Payable \$14 000; wages paid \$8 400; rent paid \$4 000; GST paid \$400; a GST settlement to the ATO \$1 500; interest paid \$400; a capital contribution by the owner \$8 000; and drawings \$1 800. There were no investing flows. Prepare the Cash Flow Statement.

Working

Operating inflows = cash sales \$32 000 + GST received \$3 200 = **\$35 200**.

Comment

Cash sales are reported at the **GST-exclusive** price, and the \$3 200 of GST collected on them (10% of \$32 000) is a **separate** inflow line.

Working	Comment
Operating outflows = \$14 000 + \$8 400 + \$4 000 + \$400 + \$1 500 + \$400 = \$28 700 , so Operating = \$35 200 – \$28 700 = \$6 500 .	Payments to Accounts Payable are the full amount paid. GST paid \$400 is the GST on the cash rent; the GST settlement to ATO \$1 500 is the separate net remittance. Interest is operating, not financing.
Financing = capital – drawings = \$8 000 – \$1 800 = \$6 200 .	Cash from the owner is an inflow; drawings are an outflow. Both are dealings with the owner, so both are financing.
Net change = \$6 500 + \$6 200 = \$12 700 increase .	With no investing flows, the net change is operating + financing.
Closing Bank = \$5 200 + \$12 700 = \$17 900 .	Opening Bank + net change reconciles to the closing balance.

Cash Flow Statement for
the month ended 30 June
2026

	\$	\$
Operating Activities		
Cash sales	32 000	
GST received	3 200	
Payments to Accounts Payable	(14 000)	
Wages	(8 400)	
Rent expense	(4 000)	
GST paid	(400)	
GST settlement to ATO	(1 500)	
Interest expense	(400)	
Net Cash Flows from Operating Activities		6 500
Financing Activities		
Capital contribution	8 000	
Drawings	(1 800)	
Net Cash Flows from Financing Activities		6 200
Net Increase in Cash		12 700
add Bank balance at start (1 June 2026)		5 200
Bank balance at end (30 June 2026)		17 900

Example 2 — a full three-activity statement

Kingsley Timber began July with a Bank balance of \$11 500. Its cash records for the month ended 31 July 2026 were: cash sales \$30 000; GST received \$3 000; receipts from Accounts Receivable \$21 600; payments to Accounts Payable \$24 800; wages \$7 300; GST paid \$1 800; a GST settlement to the ATO \$3 100; interest paid \$900; purchase of equipment \$18 000; proceeds from the sale of a vehicle \$6 500; a loan received from Brookfield Finance \$15 000; and drawings \$3 000. Prepare the Cash Flow Statement.

Working	Comment
Operating inflows = \$30 000 + \$3 000 + \$21 600 = \$54 600 .	Cash sales at the GST-exclusive price, the GST received on them (10% of \$30 000) as its own line, and the full

Working	Comment
	cash received from credit customers — the GST on those credit sales was recorded when the sale was made, so it is not shown again.
Operating outflows = \$24 800 + \$7 300 + \$1 800 + \$3 100 + \$900 = \$37 900 , so Operating = \$16 700 .	The \$1 800 GST paid is the GST on the equipment bought for cash; the \$3 100 GST settlement to ATO is the separate net remittance. Both are operating, even though the equipment itself is investing.
Investing = proceeds \$6 500 – purchase \$18 000 = (\$11 500) .	Buying the equipment is an outflow at its GST-exclusive cost; selling the vehicle is an inflow. A net outflow is shown in brackets.
Financing = loan \$15 000 – drawings \$3 000 = \$12 000 .	The loan received is a financing inflow; drawings are a financing outflow.
Net change = \$16 700 – \$11 500 + \$12 000 = \$17 200 increase ; closing Bank = \$11 500 + \$17 200 = \$28 700 .	The three sub-totals add to the net change, which reconciles the opening balance to \$28 700.

Cash Flow Statement for
the month ended 31 July
2026

	\$	\$
Operating Activities		
Cash sales	30 000	
GST received	3 000	
Receipts from Accounts Receivable	21 600	
Payments to Accounts Payable	(24 800)	
Wages	(7 300)	
GST paid	(1 800)	
GST settlement to ATO	(3 100)	
Interest expense	(900)	
Net Cash Flows from Operating Activities		16 700
Investing Activities		
Purchase of equipment	(18 000)	
Proceeds from sale of vehicle	6 500	
Net Cash Flows from Investing Activities		(11 500)
Financing Activities		
Loan – Brookfield Finance	15 000	
Drawings	(3 000)	
Net Cash Flows from Financing Activities		12 000
Net Increase in Cash		17 200
add Bank balance at start (1 July 2026)		11 500
Bank balance at end (31 July 2026)		28 700

Worked examples (unscaffolded)

Example 3 — classifying flows; why GST is a cash flow but depreciation is not

Brightside Cellars is preparing its Cash Flow Statement. For each item below, state the activity (Operating, Investing or Financing) and whether it is an inflow or an outflow — or, if it is not a cash flow at all, say so: (i) cash sales \$9 000 plus \$900 GST; (ii) purchase of shelving \$14 000; (iii) a capital contribution \$20 000; (iv) a GST settlement to the ATO \$3 200; (v) depreciation of equipment \$4 500; (vi) interest paid \$1 100; (vii) repayment of loan principal \$6 000; (viii) drawings \$2 400.

- (i) **Operating inflows — reported on two lines.** The \$9 000 selling price is reported as **Cash sales** and the \$900 collected on it is reported separately as **GST received**; both are operating inflows, and together they are the \$9 900 actually banked.
- (ii) **Investing outflow** — buying a non-current asset.
- (iii) **Financing inflow** — cash from the owner.
- (iv) **Operating outflow** — remitting the net GST to the ATO is a cash movement from trading.
- (v) **Not a cash flow** — depreciation is an allocation of the asset's cost, so it appears in the Income Statement only, never in the Cash Flow Statement.
- (vi) **Operating outflow** — interest is the cost of running the business for the period.
- (vii) **Financing outflow** — repaying principal changes how the business is funded.
- (viii) **Financing outflow** — a dealing with the owner.

The contrast between (i)/(iv) and (v) is the key idea: the **\$900 GST received** on the sale and the **\$3 200** settlement paid to the ATO both move cash, so both are reported; the **\$4 500 depreciation** moves **no cash**, so it is excluded. Note also that the \$1 400 of GST Brightside paid on the shelving in (ii) would be reported as **GST paid** — a third, separate operating line, and not the same item as the \$3 200 settlement in (iv). The only cash Brightside ever pays for that shelving itself is the \$14 000 purchase price — an investing outflow recorded **once**, not each period.

∴ every item is placed by its **nature** — trading, investing or financing — and a non-cash item like depreciation is left out of the Cash Flow Statement entirely.

Example 4 — preparing a Cash Flow Statement from a full year's cash records

Meadowbrook Cycles began the year with a Bank balance of \$9 300. Its cash records for the year ended 30 June 2026 were: cash sales \$128 000; GST received \$12 800; receipts from Accounts Receivable \$74 000; payments to Accounts Payable \$96 000; wages \$38 000; advertising \$6 000; GST paid \$4 600; a GST settlement to the ATO \$9 900; interest paid \$2 800; purchase of a shop fit-out \$40 000; proceeds from the sale of an old van \$12 000; a capital contribution \$20 000; a loan from Coastline Bank \$25 000; and drawings \$18 000. Prepare the Cash Flow Statement.

Operating cash in was $\$128\,000 + \$12\,800 + \$74\,000 = \$214\,800$, less $\$96\,000 + \$38\,000 + \$6\,000 + \$4\,600 + \$9\,900 + \$2\,800 = \$157\,300$ out, a net operating inflow of \$57 500. (The \$4 600 GST paid is the GST on the cash advertising and the shop fit-out; the \$9 900 settlement to the ATO is a separate outflow.) Investing was \$12 000 in less \$40 000 out = (\$28 000). Financing was \$20 000 + \$25 000 in less \$18 000 out = \$27 000. The net change is $\$57\,500 - \$28\,000 + \$27\,000 = \$56\,500$, which added to the opening \$9 300 gives a closing Bank balance of \$65 800.

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Operating Activities		
Cash sales	128 000	
GST received	12 800	
Receipts from Accounts Receivable	74 000	
Payments to Accounts Payable	(96 000)	
Wages	(38 000)	
Advertising	(6 000)	
GST paid	(4 600)	
GST settlement to ATO	(9 900)	
Interest expense	(2 800)	
Net Cash Flows from Operating Activities		57 500
Investing Activities		
Purchase of shop fit-out	(40 000)	
Proceeds from sale of old van	12 000	
Net Cash Flows from Investing Activities		(28 000)
Financing Activities		
Capital contribution	20 000	
Loan – Coastline Bank	25 000	
Drawings	(18 000)	
Net Cash Flows from Financing Activities		27 000
Net Increase in Cash		56 500
add Bank balance at start (1 July 2025)		9 300
Bank balance at end (30 June 2026)		65 800

∴ Meadowbrook's cash grew by \$56 500 over the year — strong operating cash funded the whole fit-out, with the loan and the owner's contribution adding to the balance and leaving \$65 800 in the Bank.

Practice questions — scaffolded

Question 1

Ferndale Supplies is classifying its cash flows for the month.

- State, for each item, the activity (Operating, Investing or Financing) and whether it is an inflow or an outflow:
 - cash sales of inventory and the GST received on them;
 - cash paid to buy a delivery van;
 - cash contributed by the owner;
 - cash paid to Accounts Payable;
 - cash drawings by the owner;
 - cash received from selling old office equipment;
 - cash received from a bank loan;
 - interest paid on the loan.

- b. From these operating flows, calculate the Net Cash Flows from Operating Activities: cash sales \$42 000; GST received \$4 200; receipts from Accounts Receivable \$27 000; payments to Accounts Payable \$31 000; wages \$12 000; a GST settlement to the ATO \$3 500; interest paid \$1 200.
- c. Explain, in one sentence, why the purchase of the delivery van is classified as an investing flow rather than an operating flow.

Question 2

Brightwater Traders began the month with a Bank balance of \$6 800. Its cash records were: cash sales \$58 000; GST received \$5 800; payments to Accounts Payable \$33 000; wages \$14 000; a GST settlement to the ATO \$4 600; interest paid \$1 400. There were no investing or financing flows.

- a. Prepare the Operating Activities section of the Cash Flow Statement and state the Net Cash Flows from Operating Activities.
- b. State the closing Bank balance.
- c. Explain, in one sentence, why the interest paid is an operating flow while **repaying the loan principal** would be a financing flow.

Question 3

Oakhaven Traders began the month with a Bank balance of \$7 200. Its cash records for the month ended 31 August 2026 were: cash sales \$36 000; GST received \$3 600; receipts from Accounts Receivable \$15 000; payments to Accounts Payable \$22 000; wages \$8 000; GST paid \$1 400; a GST settlement to the ATO \$2 600; interest paid \$800; purchase of equipment \$14 000; proceeds from the sale of a vehicle \$4 500; a loan from Highvale Finance \$12 000; drawings \$2 200.

- a. Prepare the classified Cash Flow Statement for the month.
- b. State the net change in cash for the month.
- c. State the Bank balance at the end of the month.

Question 4

Pinevale Motors is preparing the investing section of its Cash Flow Statement.

- a. State the activity (Operating, Investing or Financing) of each item: (i) purchase of machinery; (ii) cash sales; (iii) repayment of loan principal; (iv) proceeds from the sale of a vehicle; (v) GST paid.
- b. Prepare the Investing Activities section and state the Net Cash Flows from Investing Activities: purchase of machinery \$26 000; proceeds from the sale of a vehicle \$9 000; purchase of fittings \$5 000.
- c. Explain, in one sentence, why buying a non-current asset is an investing flow.

Question 5

Stonegate Homewares began the month with a Bank balance of \$4 300. Its Net Cash Flows from Operating Activities for the month were \$9 500, and there were no investing flows. Its financing cash records were: a capital contribution \$16 000; a loan from Ironbark Finance \$30 000; a repayment of loan principal to Ironbark Finance \$12 000; and drawings \$3 400.

- a. Prepare the Financing Activities section and state the Net Cash Flows from Financing Activities.
- b. Calculate the net change in cash and the closing Bank balance.
- c. Distinguish, in one sentence, between the capital contribution and the drawings.

Question 6

Larkspur Bakery is preparing the operating section of its Cash Flow Statement. Its records for the month show: cash sales \$40 000; GST received \$4 000; payments to Accounts Payable \$22 000; wages \$9 000; a GST settlement to the ATO \$3 000; and depreciation of ovens \$5 000.

- a. Explain, in one sentence, the difference between the **cash basis** used in the Cash Flow Statement and the **accrual basis** used in the Income Statement.
- b. Calculate the Net Cash Flows from Operating Activities.
- c. Explain why the GST settlement to the ATO is included in your answer to (b) but the depreciation of the ovens is not.

Practice questions — unscaffolded

Question 7

Havenport Trading is classifying its cash flows. State, for each item, the activity (Operating, Investing or Financing) and whether it is an inflow or an outflow: (i) cash received from cash sales and the GST received on them; (ii) cash paid for wages; (iii) cash paid to buy a new photocopier; (iv) cash received from the owner as additional capital; (v) cash received from selling a used truck; (vi) cash drawings by the owner; (vii) the GST settlement paid to the ATO; (viii) cash received from a loan.

Question 8

Cedar Ridge Hardware began the month with a Bank balance of \$8 100. Its cash records for the month ended 30 September 2026 were: cash sales \$44 000; GST received \$4 400; receipts from Accounts Receivable \$26 000; payments to Accounts Payable \$33 000; wages \$11 000; GST paid \$2 000; a GST settlement to the ATO \$3 400; interest paid \$900; purchase of a forklift \$20 000; proceeds from the sale of an old vehicle \$7 000; a capital contribution \$10 000; and drawings \$2 600. Prepare the classified Cash Flow Statement and state the Bank balance at the end of the month.

Question 9

Tidewater Marine began the month with a Bank balance of \$3 000. Its cash records for the month ended 31 October 2026 were: cash sales \$21 000; GST received \$2 100; payments to Accounts Payable \$18 000; wages \$9 000; GST paid \$1 500; a GST settlement to the ATO \$2 200; interest paid \$600; purchase of workshop equipment \$15 000; a loan from Seaboard Finance \$5 000; and drawings \$2 500. Prepare the classified Cash Flow Statement, state the net change in cash, and state how the closing Bank balance is reported.

Question 10

Willowmere Florist's operating cash records for the year were: cash sales \$64 000; GST received \$6 400; receipts from Accounts Receivable \$38 000; payments to Accounts Payable \$47 000; wages \$19 000; a GST settlement to the ATO \$5 200; and interest paid \$1 600. Prepare the Operating Activities section of the Cash Flow Statement and state the Net Cash Flows from Operating Activities.

Question 11

Granite Peak Quarry's investing cash records for the year were: purchase of an excavator \$85 000; proceeds from the sale of a truck \$22 000; and purchase of a screening plant \$13 000. Prepare the Investing Activities section and state the Net Cash Flows from Investing Activities. Explain, in one sentence, why a large net investing **outflow** is not necessarily a sign of poor performance.

Question 12

Aspenwood Furniture's financing cash records for the year were: a capital contribution \$40 000; a loan from Parkline Bank \$50 000; a repayment of loan principal to Parkline Bank \$20 000; and drawings \$9 000. Prepare the Financing Activities section and state the Net Cash Flows from Financing Activities.

Question 13

Silverbrook Cellars began the year with a Bank balance of \$15 400. Its cash records for the year ended 30 June 2026 were: cash sales \$246 000; GST received \$24 600; receipts from Accounts Receivable \$118 000; payments to Accounts Payable \$180 000; wages \$72 000; GST paid \$6 000; a GST settlement to the ATO \$21 000; interest paid \$9 500; purchase of a bottling plant \$60 000; proceeds from the sale of a vehicle \$18 000; a capital contribution \$30

000; a loan from Vinegrove Finance \$40 000; and drawings \$28 000. Prepare the classified Cash Flow Statement and state the Bank balance at the end of the year.

Question 14

Explain, with reference to the cash basis of the Cash Flow Statement, why **GST paid on a cash purchase** is reported in the Cash Flow Statement but **depreciation** is not. In your answer, refer to the \$600 GST paid on a \$6 000 (plus GST) cash purchase, distinguish that **GST paid** line from the **GST settlement to the ATO**, and explain in one further sentence why a business can report a profit yet see its cash fall.

Question 15

Coppertown Cafe's Cash Flow Statement for the month showed a **net decrease in cash of \$3 200**, and the Bank balance at the end of the month was \$4 600. Calculate the Bank balance at the **start** of the month, and explain in one sentence how the reconciliation at the foot of the statement works.

Question 16

Redcliff Auto Parts has the following loan-related cash flows for the year: a loan received from Ashford Finance \$35 000; a repayment of loan principal to Ashford Finance \$7 000; and interest paid on the loan \$1 900.

State the activity of each of the three items, prepare the Financing Activities section (loan flows only), state the Net Cash Flows from Financing Activities, and explain in one sentence why the interest is **not** included in that figure.

Question 17

Northgate Electrical began the month with a Bank balance of \$20 000. Its cash records for the month ended 30 November 2026 were: cash sales \$52 000; GST received \$5 200; receipts from Accounts Receivable \$19 000; payments to Accounts Payable \$38 000; wages \$12 500; GST paid \$1 600; a GST settlement to the ATO \$4 100; interest paid \$1 300; purchase of a van \$16 000; a repayment of loan principal to Westhaven Finance \$8 000; and drawings \$3 000. Prepare the classified Cash Flow Statement and state the Bank balance at the end of the month. Comment in one sentence on how the business's cash fell even though its operating activities generated cash.

Question 18

Emberfield Nursery began the year with a Bank balance of \$12 800. Its cash records for the year ended 30 June 2026 were: cash sales \$188 000; GST received \$18 800; receipts from Accounts Receivable \$96 000; payments to Accounts Payable \$142 000; wages \$54 000; GST paid \$5 700; a GST settlement to the ATO \$17 500; interest paid \$7 200; purchase of land improvements \$48 000; proceeds from the sale of a vehicle \$15 000; purchase of fittings \$9 000; a capital contribution \$25 000; a loan from Greenline Bank \$35 000; and drawings \$22 000. Prepare the classified Cash Flow Statement and state the Bank balance at the end of the year.

Answers

1.
 - a.
 - (i) Operating inflow (ii) Investing outflow (iii) Financing inflow (iv) Operating outflow (v) Financing outflow (vi) Investing inflow (vii) Financing inflow (viii) Operating outflow.
 - b. Net Cash Flows from Operating \$25 500. c. See solutions
2.
 - a. Net Cash Flows from Operating \$10 800. b. Closing Bank \$17 600. c. See solutions
3.
 - b. Net increase \$20 100. c. Bank at end \$27 300
4.
 - a.
 - (i) Investing (ii) Operating (iii) Financing (iv) Investing (v) Operating.
 - b. Net Cash Flows from Investing (\$22 000). c. See solutions
5.
 - a. Net Cash Flows from Financing \$30 600. b. Net change \$40 100; closing Bank \$44 400
6.
 - b. Net Cash Flows from Operating \$10 000
7.
 - (i) Operating inflow (ii) Operating outflow (iii) Investing outflow (iv) Financing inflow (ii) Investing inflow (vi) Financing outflow (vii) Operating outflow (viii) Financing inflow
8. Net increase \$18 500; Bank at end \$26 600
9. Net decrease \$20 700; Bank Overdraft at end \$17 700 (a current liability)
10. Net Cash Flows from Operating \$35 600
11. Net Cash Flows from Investing (\$76 000)
12. Net Cash Flows from Financing \$61 000
13. Net increase \$100 100; Bank at end \$115 500
14. See solutions
15. Opening Bank \$7 800
16. Net Cash Flows from Financing \$28 000 (interest \$1 900 is an operating flow)
17. Net decrease \$8 300; Bank at end \$11 700
18. Net increase \$72 400; Bank at end \$85 200

Fully-worked solutions

Question 1

- a.
 - (i) **Operating inflow** (both the cash sales and the GST received on them); (ii) **Investing outflow**; (iii) **Financing inflow**; (iv) **Operating outflow**; (v) **Financing outflow**; (vi) **Investing inflow**; (vii) **Financing inflow**; (viii) **Operating outflow**.
- b. Net Cash Flows from Operating = $(\$42\,000 + \$4\,200 + \$27\,000) - (\$31\,000 + \$12\,000 + \$3\,500 + \$1\,200) = \$73\,200 - \$47\,700 = \mathbf{\$25\,500}$.
- c. Buying the delivery van acquires a **non-current asset** the business will use over several years, so it is an **investing** flow, not part of the day-to-day trading reported under operating activities.

Question 2

Cash Flow Statement (extract) for
the month ended 30 June 2026

\$

\$

Operating Activities

Cash Flow Statement (extract) for
the month ended 30 June 2026

	\$	\$
Cash sales	58 000	
GST received	5 800	
Payments to Accounts Payable	(33 000)	
Wages	(14 000)	
GST settlement to ATO	(4 600)	
Interest expense	(1 400)	
Net Cash Flows from Operating Activities		10 800

Net Cash Flows from Operating = (\$58 000 + \$5 800) – (\$33 000 + \$14 000 + \$4 600 + \$1 400) = \$63 800 – \$53 000 = **\$10 800**.

- b. Closing Bank = opening \$6 800 + net change \$10 800 = **\$17 600** (there were no investing or financing flows, so the net change equals the operating figure).
- c. The **interest** is the cost of using the borrowed money during the period — a day-to-day cost of running the business, hence **operating** — whereas **repaying the principal** returns the borrowed funds and changes how the business is **financed**, hence **financing**.

Question 3

Cash Flow Statement for
the month ended 31

August 2026	\$	\$
Operating Activities		
Cash sales	36 000	
GST received	3 600	
Receipts from Accounts Receivable	15 000	
Payments to Accounts Payable	(22 000)	
Wages	(8 000)	
GST paid	(1 400)	
GST settlement to ATO	(2 600)	
Interest expense	(800)	
Net Cash Flows from Operating Activities		19 800
Investing Activities		
Purchase of equipment	(14 000)	
Proceeds from sale of vehicle	4 500	
Net Cash Flows from Investing Activities		(9 500)
Financing Activities		
Loan – Highvale Finance	12 000	
Drawings	(2 200)	
Net Cash Flows from Financing Activities		9 800

Cash Flow Statement for
the month ended 31

August 2026	\$	\$
Net Increase in Cash		20 100
add Bank balance at start (1 August 2026)		7 200
Bank balance at end (31 August 2026)		27 300

b. Net change = \$19 800 – \$9 500 + \$9 800 = **\$20 100 increase**.

c. Bank at end = \$7 200 + \$20 100 = **\$27 300**.

Question 4

a.

(i) **Investing**; (ii) **Operating**; (iii) **Financing**; (iv) **Investing**; (v) **Operating**.

Cash Flow Statement (extract) for
the year ended 30 June 2026

	\$	\$
Investing Activities		
Purchase of machinery	(26 000)	
Proceeds from sale of vehicle	9 000	
Purchase of fittings	(5 000)	
Net Cash Flows from Investing Activities		(22 000)

Net Cash Flows from Investing = \$9 000 – \$26 000 – \$5 000 = **(\$22 000)**. Note that the GST paid on the machinery and the fittings is an **operating** outflow, not an investing one, so it does not enter this sub-total.

c. Buying a **non-current asset** is an **investing** flow because the asset will be used to generate revenue over **more than one period**, rather than being part of the current period's trading.

Question 5

Cash Flow Statement
(extract) for the month

	\$	\$
Financing Activities		
Capital contribution	16 000	
Loan – Ironbark Finance	30 000	
Repayment of loan – Ironbark Finance	(12 000)	
Drawings	(3 400)	
Net Cash Flows from Financing Activities		30 600

Net Cash Flows from Financing = \$16 000 + \$30 000 – \$12 000 – \$3 400 = **\$30 600**.

b. Net change = operating \$9 500 + financing \$30 600 = **\$40 100 increase**; closing Bank = \$4 300 + \$40 100 = **\$44 400**.

c. A **capital contribution** is cash the owner puts **into** the business (a financing inflow that increases owner's equity), whereas **drawings** are cash the owner takes **out** for private use (a financing outflow that decreases owner's equity).

Question 6

- a. Under the **cash basis** a flow is recorded only when cash actually enters or leaves the Bank, whereas under the **accrual basis** revenue is recorded when **earned** and an expense when **incurred**, regardless of when the cash moves.
- b. Net Cash Flows from Operating = $(\$40\,000 + \$4\,000) - (\$22\,000 + \$9\,000 + \$3\,000) = \$44\,000 - \$34\,000 = \mathbf{\$10\,000}$. (The \$5 000 depreciation is **not** included.)
- c. The **GST settlement to the ATO** is an actual movement of cash out of the Bank, so on the cash basis it belongs in the Cash Flow Statement; **depreciation** is an accounting **allocation** of the ovens' cost with **no cash effect**, so it is reported only in the Income Statement and is left out of the Cash Flow Statement.

Question 7

- (i) **Operating inflow** (the cash sales and the GST received are both operating inflows, reported on separate lines); (ii) **Operating outflow**; (iii) **Investing outflow**; (iv) **Financing inflow**;
- (ii) **Investing inflow**; (vi) **Financing outflow**; (vii) **Operating outflow**; (viii) **Financing inflow**.

Question 8

Cash Flow Statement for
the month ended 30
September 2026

	\$	\$
Operating Activities		
Cash sales	44 000	
GST received	4 400	
Receipts from Accounts Receivable	26 000	
Payments to Accounts Payable	(33 000)	
Wages	(11 000)	
GST paid	(2 000)	
GST settlement to ATO	(3 400)	
Interest expense	(900)	
Net Cash Flows from Operating Activities		24 100
Investing Activities		
Purchase of forklift	(20 000)	
Proceeds from sale of old vehicle	7 000	
Net Cash Flows from Investing Activities		(13 000)
Financing Activities		
Capital contribution	10 000	
Drawings	(2 600)	
Net Cash Flows from Financing Activities		7 400
Net Increase in Cash		18 500
add Bank balance at start (1 September 2026)		8 100
Bank balance at end (30 September 2026)		26 600

Net change = $\$24\,100 - \$13\,000 + \$7\,400 = \mathbf{\$18\,500}$; Bank at end = $\$8\,100 + \$18\,500 = \mathbf{\$26\,600}$.

Question 9

Cash Flow Statement for
the month ended 31
October 2026

	\$	\$
Operating Activities		
Cash sales	21 000	
GST received	2 100	
Payments to Accounts Payable	(18 000)	
Wages	(9 000)	
GST paid	(1 500)	
GST settlement to ATO	(2 200)	
Interest expense	(600)	
Net Cash Flows from Operating Activities		(8 200)
Investing Activities		
Purchase of workshop equipment	(15 000)	
Net Cash Flows from Investing Activities		(15 000)
Financing Activities		
Loan – Seaboard Finance	5 000	
Drawings	(2 500)	
Net Cash Flows from Financing Activities		2 500
Net Decrease in Cash		(20 700)
add Bank balance at start (1 October 2026)		3 000
Bank Overdraft at end (31 October 2026)		(17 700)

Net change = $(\$8\,200) - \$15\,000 + \$2\,500 = \textbf{(\$20\,700) decrease}$. Adding the opening \$3 000 gives (\$17 700): the business has **overdrawn its Bank account**, so the closing balance is reported as a **Bank Overdraft of \$17 700**, a current liability. Operating activities used cash (a net outflow), and the equipment purchase could not be covered by the small loan, so cash fell sharply.

Question 10

Cash Flow Statement (extract) for
the year ended 30 June 2026

	\$	\$
Operating Activities		
Cash sales	64 000	
GST received	6 400	
Receipts from Accounts Receivable	38 000	
Payments to Accounts Payable	(47 000)	
Wages	(19 000)	
GST settlement to ATO	(5 200)	
Interest expense	(1 600)	

Cash Flow Statement (extract) for
the year ended 30 June 2026

\$

\$

**Net Cash Flows from Operating
Activities**

35 600

Net Cash Flows from Operating = (\$64 000 + \$6 400 + \$38 000) – (\$47 000 + \$19 000 + \$5 200 + \$1 600) = \$108 400 – \$72 800 = **\$35 600**.

Question 11

Cash Flow Statement (extract) for
the year ended 30 June 2026

\$

\$

Investing Activities

Purchase of excavator (85 000)

Proceeds from sale of truck 22 000

Purchase of screening plant (13 000)

**Net Cash Flows from Investing
Activities**

(76 000)

Net Cash Flows from Investing = \$22 000 – \$85 000 – \$13 000 = **(\$76 000)**. A large net investing **outflow** simply means the business has **invested heavily in new non-current assets** this period, which is often a sign of expansion; it is not, on its own, a sign of poor performance.

Question 12

Cash Flow Statement (extract) for
the year ended 30 June 2026

\$

\$

Financing Activities

Capital contribution 40 000

Loan – Parkline Bank 50 000

Repayment of loan – Parkline Bank (20 000)

Drawings (9 000)

**Net Cash Flows from Financing
Activities**

61 000

Net Cash Flows from Financing = \$40 000 + \$50 000 – \$20 000 – \$9 000 = **\$61 000**.

Question 13

Cash Flow Statement for
the year ended 30 June
2026

\$

\$

Operating Activities

Cash sales 246 000

GST received 24 600

Receipts from Accounts
Receivable 118 000

Payments to Accounts
Payable (180 000)

Wages (72 000)

GST paid (6 000)

GST settlement to ATO (21 000)

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Interest expense	(9 500)	
Net Cash Flows from Operating Activities		100 100
Investing Activities		
Purchase of bottling plant	(60 000)	
Proceeds from sale of vehicle	18 000	
Net Cash Flows from Investing Activities		(42 000)
Financing Activities		
Capital contribution	30 000	
Loan – Vinegrove Finance	40 000	
Drawings	(28 000)	
Net Cash Flows from Financing Activities		42 000
Net Increase in Cash		100 100
add Bank balance at start (1 July 2025)		15 400
Bank balance at end (30 June 2026)		115 500

Net change = \$100 100 – \$42 000 + \$42 000 = **\$100 100**; Bank at end = \$15 400 + \$100 100 = **\$115 500**.

Question 14

The Cash Flow Statement is prepared on the **cash basis**, so it reports a flow only when cash actually moves. The **\$600 GST** paid on the \$6 000 (plus GST) cash purchase is part of the \$6 600 that actually **leaves the Bank**, so it is reported as an operating outflow on the **GST paid** line. That line is **not** the same report item as the **GST settlement to the ATO**: GST paid is the GST the business hands to its own suppliers as part of its cash payments, whereas the settlement is the single net amount it remits to the Australian Taxation Office for the period; both are operating outflows, but each is reported on its own line. **Depreciation**, by contrast, is an **allocation** of a non-current asset's cost across its useful life; recording it moves **no cash**, so it is an Income Statement expense only and never appears in the Cash Flow Statement. A business can therefore report a **profit yet see its cash fall** — for example, if much of its revenue is still owed by credit customers (Accounts Receivable), or if it has used cash to buy assets or repay loans, transactions that reduce cash without reducing profit.

Question 15

Opening Bank = closing Bank – net change = \$4 600 – (–\$3 200) = \$4 600 + \$3 200 = **\$7 800**. The reconciliation at the foot of the statement works because **opening Bank + net change in cash = closing Bank**: the net change (here a \$3 200 **decrease**) added to the opening balance of \$7 800 gives the \$4 600 closing balance, proving that the classified inflows and outflows fully explain the movement in cash.

Question 16

The **loan received \$35 000** is a **financing inflow**; the **repayment of loan principal \$7 000** is a **financing outflow**; the **interest paid \$1 900** is an **operating outflow**.

Cash Flow Statement
(extract) for the year

	\$	\$
Financing Activities		

Cash Flow Statement
(extract) for the year

	\$	\$
Loan – Ashford Finance	35 000	
Repayment of loan – Ashford Finance	(7 000)	
Net Cash Flows from Financing Activities		28 000

Net Cash Flows from Financing = \$35 000 – \$7 000 = **\$28 000**. The **interest of \$1 900** is **not** included because it is the **cost of servicing** the loan during the period — a day-to-day expense — so it is reported as an **operating** outflow, not a financing one.

Question 17

Cash Flow Statement for
the month ended 30
November 2026

	\$	\$
Operating Activities		
Cash sales	52 000	
GST received	5 200	
Receipts from Accounts Receivable	19 000	
Payments to Accounts Payable	(38 000)	
Wages	(12 500)	
GST paid	(1 600)	
GST settlement to ATO	(4 100)	
Interest expense	(1 300)	
Net Cash Flows from Operating Activities		18 700
Investing Activities		
Purchase of van	(16 000)	
Net Cash Flows from Investing Activities		(16 000)
Financing Activities		
Repayment of loan – Westhaven Finance	(8 000)	
Drawings	(3 000)	
Net Cash Flows from Financing Activities		(11 000)
Net Decrease in Cash		(8 300)
add Bank balance at start (1 November 2026)		20 000
Bank balance at end (30 November 2026)		11 700

Net change = \$18 700 – \$16 000 – \$11 000 = **(\$8 300) decrease**; Bank at end = \$20 000 – \$8 300 = **\$11 700**.

Although **operating activities generated \$18 700** of cash, the business spent \$16 000 on a van and paid out \$11 000 in loan repayment and drawings, so overall its cash **fell by \$8 300** — a healthy operating result can still be outweighed by investing and financing outflows.

Question 18

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Operating Activities		
Cash sales	188 000	
GST received	18 800	
Receipts from Accounts Receivable	96 000	
Payments to Accounts Payable	(142 000)	
Wages	(54 000)	
GST paid	(5 700)	
GST settlement to ATO	(17 500)	
Interest expense	(7 200)	
Net Cash Flows from Operating Activities		76 400
Investing Activities		
Purchase of land improvements	(48 000)	
Proceeds from sale of vehicle	15 000	
Purchase of fittings	(9 000)	
Net Cash Flows from Investing Activities		(42 000)
Financing Activities		
Capital contribution	25 000	
Loan – Greenline Bank	35 000	
Drawings	(22 000)	
Net Cash Flows from Financing Activities		38 000
Net Increase in Cash		72 400
add Bank balance at start (1 July 2025)		12 800
Bank balance at end (30 June 2026)		85 200

Operating cash was $(\$188\,000 + \$18\,800 + \$96\,000) - (\$142\,000 + \$54\,000 + \$5\,700 + \$17\,500 + \$7\,200) = \$302\,800 - \$226\,400 = \$76\,400$; investing was $\$15\,000 - \$48\,000 - \$9\,000 = (\$42\,000)$; financing was $\$25\,000 + \$35\,000 - \$22\,000 = \$38\,000$. Net change = $\$76\,400 - \$42\,000 + \$38\,000 = \textbf{\$72\,400}$; Bank at end = $\$12\,800 + \$72\,400 = \textbf{\$85\,200}$.

Chapter 11 Reporting for cash — 11B Uses of the Cash Flow Statement; financial indicators

Theory

The **Cash Flow Statement** reports every cash inflow and outflow of a business over a period, classified into three activities — **Operating**, **Investing** and **Financing** — and explains the change in the business's **bank balance** from the start of the period to the end. Preparing the statement (11A) is only half the story; its real value lies in what it tells the owner and other users about the business's **cash position** and how well cash is being **managed**. This section is about **using** the Cash Flow Statement to make those judgements, and about one indicator built from it — the **Cash Flow Cover**.

Why a business needs the Cash Flow Statement. A business can report a healthy **profit** and still run out of **cash** — profit is measured on the **accrual basis** (revenues earned and expenses incurred, including non-cash items such as depreciation and credit sales not yet collected), whereas survival depends on having cash to pay wages, suppliers, loans and the owner. The Cash Flow Statement is the only report that shows, in one place, **where the business's cash came from and where it went**. It lets a user:

- assess the **cash position** — did the bank balance rise or fall over the period, and by how much?
- assess **cash management** — was cash generated by the core business, or by borrowing and selling assets? Were the business's investing and financing needs funded from a sustainable source?
- **explain why cash changed**, by reading the three activity categories together, and
- support decisions about **liquidity** — the business's ability to meet its short-term debts as they fall due.

What each activity category reveals. The three classifications each answer a different question about the business's cash:

- **Operating activities** are the cash flows from the firm's **day-to-day trading** — receipts from customers, less payments to suppliers, employees and for other expenses, interest paid and the net **GST paid** to the ATO. This is the **engine** of the business. A healthy business generates most of its cash here.
- **Investing activities** are the cash flows from **buying and selling non-current assets** — cash paid to purchase equipment, vehicles or fittings (outflows), and cash received from selling them (inflows). A **growing** business typically shows a **net outflow** here, because it is acquiring assets to expand or replace worn-out ones.
- **Financing activities** are the cash flows between the business and its **owner and lenders** — capital contributed and loans received (inflows), and drawings and loan repayments (outflows).

What a healthy operating cash flow looks like. The **Net cash flows from Operating activities** figure is the single most important line in the statement. A healthy operating cash flow is:

- **Positive** — the core trading of the business brings in more cash than it consumes. A business whose operations *drain* cash cannot survive for long, however large its reported profit.
- **Large enough to fund the rest of the business** — ideally, operating cash covers the firm's **investing** needs (buying replacement and growth assets) and its **financing** outflows (drawings and loan repayments) *without* the business having to borrow more or sell off assets to stay afloat.
- **Sustainable and, where possible, growing** — a business that consistently produces strong operating cash can pay its debts, reward its owner, and invest in its future from its own resources.

Using the three categories to explain WHY cash changed. The **net change in cash** is simply the sum of the three category subtotals:

$$\text{Net change in cash} = \text{Net Operating} + \text{Net Investing} + \text{Net Financing}$$

Reading the categories *together* explains the change — and the direction of the change on its own can be misleading:

- A **fall** in the bank balance is **not automatically bad**. If cash fell because the business bought new equipment (an investing outflow) and repaid a loan (a financing outflow), and those outflows were funded by a **strong positive operating cash flow**, the fall reflects sound management — the business is investing in its future and reducing its debt from cash its own trading generated.

- A **rise** in the bank balance is **not automatically good**. If cash rose because the business **sold off assets** or **took on new borrowings** while its **operating cash flow was negative**, the increase is a **warning sign**: the core business is consuming cash, and the higher bank balance has only been propped up by one-off or unsustainable sources.

Reading the pattern of the three categories. The combination of positive and negative subtotals gives a “signature” that describes the business’s stage and health:

- **Positive Operating, negative Investing, mixed Financing** — the classic signature of an **established, growing** business: trading generates cash, which is used to buy assets and service the owner and lenders. Generally healthy.
- **Negative Operating** — a red flag whatever the other categories show: the day-to-day business is losing cash and must be propped up from outside.
- **Positive net change driven by Investing and Financing while Operating is negative** — cash is up, but only because assets were sold or money borrowed; this is **not sustainable**.

The Cash Flow Cover indicator. Assessing liquidity from the Cash Flow Statement can be sharpened with an indicator. The **Cash Flow Cover** measures **how many times** a business’s operating cash flow could **cover (pay off) its current liabilities** — the debts due within the next twelve months. It relates the cash the business generates from trading to the short-term debts that cash must service:

$$\text{Cash Flow Cover} = \frac{\text{Net cash flows from Operating activities}}{\text{Average current liabilities}}$$

where

$$\text{Average current liabilities} = \frac{\text{Opening current liabilities} + \text{Closing current liabilities}}{2}$$

Three points about the formula matter:

- **Net cash flows from Operating activities** — not profit, and not the total change in cash — is the numerator, because it is the **cash the core business actually generated** and therefore the cash genuinely available to meet current debts. Investing and financing flows are excluded: a business should not have to sell assets or borrow to meet its everyday obligations.
- **Average current liabilities** is used because the numerator is a **flow** (operating cash measured across the whole period) while current liabilities are a **balance** (measured at a point in time). Averaging the **opening** and **closing** current-liability balances gives a figure representative of the level of short-term debt carried *throughout* the period, so the comparison is like-with-like.
- The result is expressed as a number of **times (times per period)**, conventionally rounded to **one decimal place**. A Cash Flow Cover of **3.0 times** means the operating cash generated in the period was **three times** the average level of current liabilities.

Interpreting the Cash Flow Cover. The indicator is a measure of **short-term liquidity from a cash perspective**:

- A **higher** Cash Flow Cover means the business generates operating cash **well in excess** of its current liabilities — a **strong** position, because it could meet its short-term debts several times over from one period’s trading.
- A **lower** Cash Flow Cover means operating cash covers the current liabilities by a smaller margin. A cover of **less than 1.0** is a serious concern: one period’s operating cash would not even cover the average current liabilities once, so the business may have to rely on its cash reserves, new borrowing or asset sales to meet its obligations.

As with every indicator, a single figure means little on its own. Cash Flow Cover is most useful when **compared** — against the **same business in earlier periods** (is its cash coverage strengthening or weakening?) and against **similar businesses** or an industry benchmark. A **falling** Cash Flow Cover warns that either operating cash is shrinking, current liabilities are climbing, or both — a trend management should investigate. Comparing only *like* businesses respects the qualitative characteristic of **comparability**.

Worked model. Kirraway Traders reports the following Cash Flow Statement for the year ended 30 June 2026. Its current liabilities were \$30 000 at the start of the year and \$26 000 at the end.

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Operating activities		
Receipts from customers	344 000	
Payments to suppliers	(176 000)	
Payments to employees	(58 000)	
Payments for other expenses	(34 000)	
GST paid	(14 000)	
Interest paid	(6 000)	
Net cash flows from Operating activities		56 000
Investing activities		
Purchase of equipment	(40 000)	
Net cash flows from Investing activities		(40 000)
Financing activities		
Capital contribution	20 000	
Repayment of Loan – Horizon Bank	(16 000)	
Drawings	(24 000)	
Net cash flows from Financing activities		(20 000)
Net decrease in cash held		(4 000)
Bank balance at start (1 July 2025)		18 000
Bank balance at end (30 June 2026)		14 000

The bank balance **fell by \$4 000** over the year, but the statement shows this is **not** a sign of trouble. Operating activities generated a strong **\$56 000** of cash. The business used **\$40 000** of it to buy equipment and a net **\$20 000** on financing (repaying \$16 000 of its loan and paying the owner \$24 000 of drawings, partly offset by a \$20 000 capital contribution). In other words, the whole of the investing and most of the financing outflows were funded from **operating cash**, and the small fall in the bank balance reflects the business **investing in assets and reducing its debt** — sound cash management.

The **Cash Flow Cover** confirms the strong operating position:

Cash Flow Cover

Working	\$
Average current liabilities (30 000 + 26 000) ÷ 2	28 000
Net cash flows from Operating activities	56 000
Cash Flow Cover = 56 000 ÷ 28 000	2.0 times

Kirraway's operating cash flow was **2.0 times** its average current liabilities — the cash generated by one year's trading could cover its short-term debts twice over, a comfortable margin.

Worked examples (scaffolded)

Example 1 — interpreting the three activity categories to explain why cash changed

Marrandah Traders reports the Cash Flow Statement below for the year ended 30 June 2026.

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Operating activities		
Receipts from customers	300 000	
Payments to suppliers	(150 000)	
Payments to employees	(52 000)	
Payments for other expenses	(22 000)	
GST paid	(12 000)	
Interest paid	(8 000)	
Net cash flows from Operating activities		56 000
Investing activities		
Purchase of shop fittings	(44 000)	
Net cash flows from Investing activities		(44 000)
Financing activities		
Capital contribution	30 000	
Repayment of Loan – Meridian Bank	(14 000)	
Drawings	(26 000)	
Net cash flows from Financing activities		(10 000)
Net increase in cash held		2 000
Bank balance at start (1 July 2025)		26 000
Bank balance at end (30 June 2026)		28 000

Working

Comment

Operating: net inflow of **\$56 000**.

Trading brought in far more cash than it consumed — the healthy, positive engine of the business.

Investing: net outflow of **\$44 000** (purchase of shop fittings).

A net outflow here is normal — the business is acquiring a non-current asset to expand or renew its capacity.

Financing: net outflow of **\$10 000** (capital \$30 000 in, less \$14 000 loan repayment and \$26 000 drawings).

The owner put in \$30 000 but took \$26 000 in drawings and \$14 000 went to reduce the loan, giving a small net outflow.

Net change: $56\,000 - 44\,000 - 10\,000 = \$2\,000$ increase; bank 26 000 → **28 000**.

The three subtotals add to the change in cash and reconcile the opening and closing bank balances.

The bank balance rose only **\$2 000**, but the statement shows a **well-managed** business: the \$56 000 generated by operations **fully funded** the \$44 000 spent on fittings and the \$10 000 net financing outflow, and still left the bank balance slightly higher. Cash grew because the core business generated it — not because the firm borrowed or sold assets.

Example 2 — calculating and interpreting Cash Flow Cover

Cedar & Fern Homewares generated **\$90 000** in net cash flows from operating activities for the year ended 30 June 2026. Its current liabilities were **\$28 000** at the start of the year and **\$32 000** at the end. Calculate the Cash Flow Cover and interpret it.

Working	Comment
Average current liabilities = $(\$28\,000 + \$32\,000) \div 2 =$ \$30 000.	Average the opening and closing balances — a balance is being compared with a period-long flow.
Cash Flow Cover = $\$90\,000 \div \$30\,000 =$ 3.0 times.	Divide operating cash by average current liabilities; express the result in times, to one decimal place.
A cover of 3.0 means operating cash was three times the average current liabilities.	The business could pay off its short-term debts three times over from one year's operating cash.

Cash Flow Cover

Working	\$
Average current liabilities $(28\,000 + 32\,000) \div 2$	30 000
Net cash flows from Operating activities	90 000
Cash Flow Cover = $90\,000 \div 30\,000$	3.0 times

At **3.0 times**, Cedar & Fern generates operating cash comfortably in excess of its current liabilities — a strong short-term cash position. Whether this is satisfactory over time depends on how it compares with the business's own earlier years and with similar homewares retailers.

Worked examples (unscaffolded)

Example 3 — comparing Cash Flow Cover across two periods

Brightwater Cafe reports net cash flows from operating activities of **\$66 000** in 2025 and **\$60 000** in 2026. Its current liabilities were \$20 000 at 1 July 2024, \$24 000 at 30 June 2025, and \$36 000 at 30 June 2026. Calculate the Cash Flow Cover for each year and interpret the change.

2025: average current liabilities = $(\$20\,000 + \$24\,000) \div 2 = \$22\,000$; Cash Flow Cover = $\$66\,000 \div \$22\,000 =$ **3.0 times**. 2026: average current liabilities = $(\$24\,000 + \$36\,000) \div 2 = \$30\,000$; Cash Flow Cover = $\$60\,000 \div \$30\,000 =$ **2.0 times**.

The Cash Flow Cover has fallen from **3.0 to 2.0 times** — a weakening of one full “time” of cover. Two forces pushed it down at once: operating cash **fell** (from \$66 000 to \$60 000) while average current liabilities **rose** (from \$22 000 to \$30 000). The business still covers its current liabilities twice over from operating cash, so it is not in difficulty, but the trend is unfavourable and management should find out why short-term debt has climbed and operating cash has slipped.

∴ Brightwater's cash coverage of its short-term debts has weakened over the year, from 3.0 to 2.0 times.

Example 4 — explaining what strong operating cash flow signals and how the other flows were funded

Tembrook Manufacturing reports the Cash Flow Statement below for the year ended 30 June 2026. Explain what its operating cash flow signals about the business, and how its investing and financing outflows were funded.

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Operating activities		
Receipts from customers	376 000	
Payments to suppliers	(168 000)	
Payments to employees	(58 000)	
Payments for other expenses	(24 000)	
GST paid	(16 000)	
Interest paid	(10 000)	
Net cash flows from Operating activities		100 000
Investing activities		
Purchase of equipment	(60 000)	
Net cash flows from Investing activities		(60 000)
Financing activities		
Repayment of Loan – Coastline Finance	(8 000)	
Drawings	(20 000)	
Net cash flows from Financing activities		(28 000)
Net increase in cash held		12 000
Bank balance at start (1 July 2025)		34 000
Bank balance at end (30 June 2026)		46 000

Tembrook's operating activities generated **\$100 000** of cash — a strong, positive operating cash flow. This signals a business whose **core trading is genuinely self-sustaining**: it brings in far more cash than day-to-day operations consume, so the firm does not depend on borrowing or asset sales to keep running. That \$100 000 was more than enough to fund **both** the \$60 000 spent on new equipment (investing) **and** the \$28 000 net financing outflow (an \$8 000 loan repayment and \$20 000 of drawings). In total the business spent \$88 000 on investing and financing, all of it funded from operating cash, and still finished the year with **\$12 000 more** in the bank.

∴ a strong operating cash flow allowed Tembrook to invest in assets, repay debt and reward its owner **entirely from its own trading**, while still building its cash reserves — the hallmark of sound cash management.

Practice questions — scaffolded

Question 1

Brookdale Supplies reports the Cash Flow Statement below for the year ended 30 June 2026.

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Operating activities		
Receipts from customers	262 000	
Payments to suppliers	(140 000)	

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Payments to employees	(46 000)	
Payments for other expenses	(14 000)	
GST paid	(10 000)	
Interest paid	(4 000)	
Net cash flows from Operating activities		48 000
Investing activities		
Purchase of shop fittings	(30 000)	
Net cash flows from Investing activities		(30 000)
Financing activities		
Capital contribution	25 000	
Repayment of Loan – Parkview Bank	(10 000)	
Drawings	(18 000)	
Net cash flows from Financing activities		(3 000)
Net increase in cash held		15 000
Bank balance at start (1 July 2025)		9 000
Bank balance at end (30 June 2026)		24 000

- State the net cash flow from each of the three activity categories.
- Explain why the bank balance increased over the year.
- State whether the increase reflects healthy cash management, and justify your answer in one sentence.

Question 2

Cedar Point Bakery generated **\$78 000** in net cash flows from operating activities for the year ended 30 June 2026. Its current liabilities were **\$24 000** at the start of the year and **\$36 000** at the end.

- Calculate the average current liabilities.
- Calculate the Cash Flow Cover.
- Interpret the result in one sentence.

Question 3

Hartley Motors reports net cash flows from operating activities of **\$56 000** in 2025 and **\$84 000** in 2026. Its current liabilities were \$26 000 at 1 July 2024, \$30 000 at 30 June 2025, and \$18 000 at 30 June 2026.

- Calculate the Cash Flow Cover for each year.
- State whether the coverage has strengthened or weakened, and by how many times.
- Explain one implication of the change for the business.

Question 4

Willowmere Nursery reports the Cash Flow Statement below for the year ended 30 June 2026.

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Operating activities		
Receipts from customers	218 000	
Payments to suppliers	(118 000)	
Payments to employees	(28 000)	
Payments for other expenses	(8 000)	
GST paid	(8 000)	
Interest paid	(2 000)	
Net cash flows from Operating activities		54 000
Investing activities		
Purchase of greenhouse	(36 000)	
Net cash flows from Investing activities		(36 000)
Financing activities		
Repayment of Loan – Greenbelt Bank	(12 000)	
Drawings	(16 000)	
Net cash flows from Financing activities		(28 000)
Net decrease in cash held		(10 000)
Bank balance at start (1 July 2025)		22 000
Bank balance at end (30 June 2026)		12 000

- State whether the operating cash flow is healthy, and explain why.
- Identify how the purchase of the greenhouse was funded.
- Explain whether the \$10 000 fall in the bank balance is a cause for concern.

Question 5

Pinnacle Print generated **\$60 000** in net cash flows from operating activities for the year ended 30 June 2026. Its current liabilities were **\$20 000** at the start of the year and **\$28 000** at the end. In the previous year its Cash Flow Cover was **3.0 times**.

- Calculate the average current liabilities.
- Calculate the Cash Flow Cover for the year ended 30 June 2026.
- State whether the coverage has strengthened or weakened against the previous year, and by how many times.

Question 6

Rosco Hardware generated **\$120 000** in net cash flows from operating activities for the year ended 30 June 2026. During the year it purchased a delivery vehicle for \$48 000 and repaid \$30 000 of its loan, and the owner took \$30 000 in drawings. Its current liabilities were **\$36 000** at the start of the year and **\$44 000** at the end.

- Explain what the strong positive operating cash flow signals about the business.
- State how the vehicle purchase and loan repayment were funded.

- c. Calculate the Cash Flow Cover.

Practice questions — unscaffolded

Question 7

Marlow Foods generated **\$98 000** in net cash flows from operating activities for the year ended 30 June 2026. Its current liabilities were **\$26 000** at the start of the year and **\$30 000** at the end. Calculate the Cash Flow Cover.

Question 8

Tidewater Cafe generated **\$50 000** in net cash flows from operating activities for the year ended 30 June 2026. Its current liabilities were **\$18 000** at the start of the year and **\$22 000** at the end. Calculate the Cash Flow Cover.

Question 9

Greenlow Timber reports net cash flows from operating activities of **\$60 000** in 2025 and **\$32 000** in 2026. Its current liabilities were \$28 000 at 1 July 2024, \$32 000 at 30 June 2025, and \$48 000 at 30 June 2026. Calculate the Cash Flow Cover for each year, state whether the coverage has strengthened or weakened and by how many times, and explain what the 2026 figure means for the business.

Question 10

Ashford Electrical reports the Cash Flow Statement below for the year ended 30 June 2026.

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Operating activities		
Receipts from customers	312 000	
Payments to suppliers	(176 000)	
Payments to employees	(44 000)	
Payments for other expenses	(16 000)	
GST paid	(12 000)	
Interest paid	(4 000)	
Net cash flows from Operating activities		60 000
Investing activities		
Purchase of equipment	(90 000)	
Net cash flows from Investing activities		(90 000)
Financing activities		
Capital contribution	20 000	
Loan from Ridgeline Finance	40 000	
Drawings	(18 000)	
Net cash flows from Financing activities		42 000
Net increase in cash held		12 000
Bank balance at start (1 July 2025)		8 000
Bank balance at end (30 June 2026)		20 000

Explain why the bank balance increased over the year, and how the \$90 000 purchase of equipment was funded.

Question 11

Brentwood Joinery reports the Cash Flow Statement below for the year ended 30 June 2026.

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Operating activities		
Receipts from customers	300 000	
Payments to suppliers	(162 000)	
Payments to employees	(40 000)	
Payments for other expenses	(12 000)	
GST paid	(12 000)	
Interest paid	(2 000)	
Net cash flows from Operating activities		72 000
Investing activities		
Purchase of machinery	(100 000)	
Net cash flows from Investing activities		(100 000)
Financing activities		
Loan from Foundry Finance	40 000	
Drawings	(16 000)	
Net cash flows from Financing activities		24 000
Net decrease in cash held		(4 000)
Bank balance at start (1 July 2025)		30 000
Bank balance at end (30 June 2026)		26 000

Explain how the \$100 000 purchase of machinery was funded, and comment on whether relying on that mix of funding is a concern.

Question 12

Selby Sports generated **\$140 000** in net cash flows from operating activities for the year ended 30 June 2026. Its current liabilities were **\$30 000** at the start of the year and **\$40 000** at the end. Calculate the Cash Flow Cover and interpret what it says about the business's short-term cash position.

Question 13

Overton Bikes reports net cash flows from operating activities of **\$84 000** in 2025 and **\$54 000** in 2026. Its current liabilities were \$20 000 at 1 July 2024, \$22 000 at 30 June 2025, and \$23 000 at 30 June 2026. Calculate the Cash Flow Cover for each year, and discuss what has driven the change.

Question 14

Kingsford Trading does not disclose its operating cash flow directly, but reports a **Cash Flow Cover of 2.5 times** for the year ended 30 June 2026. Its current liabilities were **\$28 000** at the start of the year and **\$36 000** at the end. Calculate the net cash flows from operating activities the business must have generated.

Question 15

Lantern Retail generated **\$90 000** in net cash flows from operating activities for the year ended 30 June 2026 and reports a **Cash Flow Cover of 3.0 times**. Its current liabilities were **\$26 000** at the start of the year. Calculate the average current liabilities and hence the closing current liabilities.

Question 16

Kimberley Interiors has reported strong, positive operating cash flow of about \$110 000 for each of the last three years, even in a year when its net profit was lower than usual. Explain what a consistently strong operating cash flow signals about a business, and why it matters more for survival than a single year's profit figure.

Question 17

Dunmore Retail reports the Cash Flow Statement below for the year ended 30 June 2026.

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Operating activities		
Receipts from customers	187 000	
Payments to suppliers	(128 000)	
Payments to employees	(48 000)	
Payments for other expenses	(18 000)	
GST paid	(7 000)	
Interest paid	(6 000)	
Net cash flows from Operating activities		(20 000)
Investing activities		
Proceeds from sale of equipment	30 000	
Net cash flows from Investing activities		30 000
Financing activities		
Loan from Brightpath Finance	25 000	
Drawings	(18 000)	
Net cash flows from Financing activities		7 000
Net increase in cash held		17 000
Bank balance at start (1 July 2025)		12 000
Bank balance at end (30 June 2026)		29 000

The owner is pleased that the bank balance rose by \$17 000. Explain why this increase is nonetheless a cause for concern, with reference to the pattern of the three activity categories.

Question 18

Vandelay Freight reports the Cash Flow Statement below for the year ended 30 June 2026. Its current liabilities were **\$40 000** at the start of the year and **\$48 000** at the end, and in the previous year its Cash Flow Cover was **2.5 times**.

Cash Flow Statement for
the year ended 30 June
2026

	\$	\$
Operating activities		
Receipts from customers	438 000	
Payments to suppliers	(198 000)	
Payments to employees	(66 000)	
Payments for other expenses	(18 000)	
GST paid	(18 000)	
Interest paid	(6 000)	
Net cash flows from Operating activities		132 000
Investing activities		
Purchase of trucks	(80 000)	
Net cash flows from Investing activities		(80 000)
Financing activities		
Repayment of Loan – Meridian Bank	(30 000)	
Drawings	(40 000)	
Net cash flows from Financing activities		(70 000)
Net decrease in cash held		(18 000)
Bank balance at start (1 July 2025)		50 000
Bank balance at end (30 June 2026)		32 000

Calculate the Cash Flow Cover, compare it with the previous year, explain how the purchase of trucks and the loan repayment were funded, and evaluate the business's cash management for the year despite the fall in its bank balance.

Answers

1.
 - a. Operating \$48 000; investing (\$30 000); financing (\$3 000) b. Net increase \$15 000
2.
 - a. \$30 000 b. 2.6 times
3.
 - a. 2025 = 2.0 times; 2026 = 3.5 times b. Strengthened, by 1.5 times
4.
 - a. Healthy — net operating inflow of \$54 000 b. From operating cash
5.
 - a. \$24 000 b. 2.5 times c. Weakened, by 0.5 times
6.
 - c. 3.0 times (average current liabilities \$40 000)
7. 3.5 times (average current liabilities \$28 000)
8. 2.5 times (average current liabilities \$20 000)
9. 2025 = 2.0 times; 2026 = 0.8 times; weakened, by 1.2 times — a cover below 1.0 is a serious concern
10. Net increase \$12 000; equipment funded by \$60 000 of operating cash plus \$30 000 of the \$60 000 raised from a loan and owner's capital
11. Machinery funded by operating cash \$72 000 plus a \$40 000 loan
12. 4.0 times (average current liabilities \$35 000)
13. 2025 = 4.0 times; 2026 = 2.4 times; weakened, by 1.6 times
14. \$80 000
15. Average current liabilities \$30 000; closing current liabilities \$34 000
16. See solutions
17. See solutions
18. 3.0 times (average current liabilities \$44 000); strengthened by 0.5 times against the prior year

Fully-worked solutions

Question 1

- a. **Operating** = net inflow \$48 000; **investing** = net outflow \$30 000; **financing** = net outflow \$3 000 (capital \$25 000 in, less \$10 000 loan repayment and \$18 000 drawings).
- b. The three subtotals combine to $48\,000 - 30\,000 - 3\,000 = \mathbf{\$15\,000\ increase}$, lifting the bank balance from \$9 000 to \$24 000. The increase arose because the \$48 000 generated by operations more than covered the \$30 000 spent on shop fittings and the \$3 000 net financing outflow.
- c. Yes — the increase reflects **healthy cash management**, because the growth in cash came from a strong **operating** inflow that funded the business's investing and financing outflows in full, rather than from borrowing or selling assets.

Question 2

- a. Average current liabilities = $(\$24\,000 + \$36\,000) \div 2 = \mathbf{\$30\,000}$.
- b. Cash Flow Cover = $\$78\,000 \div \$30\,000 = \mathbf{2.6\ times}$.
- c. Cedar Point's operating cash was **2.6 times** its average current liabilities, so one year's operating cash could cover its short-term debts more than two and a half times over — a strong cash position.

Question 3

- a. 2025: average current liabilities = $(\$26\,000 + \$30\,000) \div 2 = \$28\,000$; Cash Flow Cover = $\$56\,000 \div \$28\,000 = \mathbf{2.0\ times}$. 2026: average current liabilities = $(\$30\,000 + \$18\,000) \div 2 = \$24\,000$; Cash Flow Cover = $\$84\,000 \div \$24\,000 = \mathbf{3.5\ times}$.
- b. The coverage has **strengthened, by 1.5 times** (from 2.0 to 3.5).

- c. Two forces improved the cover at once: operating cash **rose** (from \$56 000 to \$84 000) while average current liabilities **fell** (from \$28 000 to \$24 000), as Hartley paid down its short-term debt. The business can now meet its current liabilities three and a half times over from a single year's operating cash rather than twice, so its short-term liquidity is markedly stronger and it has more capacity to fund new assets, repay debt or reward its owner from its own trading rather than by borrowing.

Question 4

- a. The operating cash flow is **healthy** — a net inflow of **\$54 000**. Day-to-day trading brings in substantially more cash than it consumes, which is the sign of a sound, self-sustaining business.
- b. The \$36 000 greenhouse was funded entirely from **operating cash**: the \$54 000 operating inflow covered the \$36 000 investing outflow in full and left \$18 000 towards the \$28 000 financing outflow (loan repayment and drawings). Because total outflows of \$64 000 exceeded the \$54 000 of operating cash, the remaining \$10 000 came from the opening bank balance.
- c. The \$10 000 fall is **not a cause for concern**. Cash fell because the business **invested in a new greenhouse** and **repaid \$12 000 of its loan** — both sound uses — funded largely by strong operating cash. Reducing debt and acquiring a productive asset strengthen the business, so a modest fall in the bank balance is an acceptable and well-managed outcome rather than a warning sign.

Question 5

- a. Average current liabilities = $(\$20\,000 + \$28\,000) \div 2 = \$24\,000$.
- b. Cash Flow Cover = $\$60\,000 \div \$24\,000 = 2.5$ times.
- c. The coverage has **weakened, by 0.5 times** (from 3.0 to 2.5). Operating cash now covers current liabilities two and a half times rather than three times, so although the position is still sound, the business's cash coverage of its short-term debts has slipped a little over the year.

Question 6

- a. A strong positive operating cash flow of \$120 000 signals that the business's **core trading is genuinely self-sustaining** — it generates well more cash than its day-to-day operations consume, so the firm can meet its obligations, invest and reward its owner without depending on borrowing or asset sales.
- b. Both were funded from **operating cash**: the \$120 000 generated by operations comfortably covered the \$48 000 vehicle purchase and the \$30 000 loan repayment (and the \$30 000 of drawings) from the business's own trading.
- c. Average current liabilities = $(\$36\,000 + \$44\,000) \div 2 = \$40\,000$; Cash Flow Cover = $\$120\,000 \div \$40\,000 = 3.0$ times.

Question 7

Average current liabilities = $(\$26\,000 + \$30\,000) \div 2 = \$28\,000$. Cash Flow Cover = $\$98\,000 \div \$28\,000 = 3.5$ times. Marlow's operating cash was three and a half times its average current liabilities — a strong short-term cash position.

Question 8

Average current liabilities = $(\$18\,000 + \$22\,000) \div 2 = \$20\,000$. Cash Flow Cover = $\$50\,000 \div \$20\,000 = 2.5$ times.

Question 9

2025: average current liabilities = $(\$28\,000 + \$32\,000) \div 2 = \$30\,000$; Cash Flow Cover = $\$60\,000 \div \$30\,000 = 2.0$ times. 2026: average current liabilities = $(\$32\,000 + \$48\,000) \div 2 = \$40\,000$; Cash Flow Cover = $\$32\,000 \div \$40\,000 = 0.8$ times. The coverage has **weakened, by 1.2 times** (from 2.0 to 0.8): operating cash almost halved while average current liabilities rose from \$30 000 to \$40 000.

A cover of **0.8 times** is a **serious concern**, because it is **below 1.0**: a full year's operating cash of \$32 000 would not even cover Greenlow's average current liabilities of \$40 000 once. The business therefore cannot meet its short-term debts from its trading alone and must fall back on its cash reserves, new borrowing or the sale of assets — none of

which is sustainable. Management should act on both drivers: restore operating cash and bring the growing short-term debt back under control.

Question 10

The bank balance rose by $60\,000 - 90\,000 + 42\,000 = \textbf{\$12\,000}$, from \$8 000 to \$20 000. The \$90 000 spent on equipment was **larger than the \$60 000 generated by operations**, so it could not be funded from operating cash alone. The business made up the difference through **financing**: a \$40 000 loan from Ridgeline Finance and a \$20 000 capital contribution (net financing inflow \$42 000, after \$18 000 of drawings). In effect, the equipment was funded by the \$60 000 of operating cash plus \$30 000 of the \$60 000 raised from the loan and the owner; the remaining \$30 000 of that new finance covered the \$18 000 of drawings and left the bank balance \$12 000 higher. Using a loan and fresh capital to help fund a large asset purchase is normal for a business expanding its capacity, provided it can service the new loan from future operating cash.

Question 11

The \$100 000 machinery purchase was funded from two sources: the **\$72 000** of net cash generated by **operating activities**, plus a **\$40 000 loan** from Foundry Finance (a financing inflow). Together these provided \$112 000, from which the \$100 000 machinery and \$16 000 of drawings were paid, leaving the bank balance \$4 000 lower at \$26 000. Relying partly on a loan to fund a major, long-lived asset is **not a concern in itself** — it is common and appropriate to finance the purchase of machinery that will be used for many years partly with borrowings, so long as the business generates enough operating cash to make the loan repayments and interest as they fall due. Here operating cash of \$72 000 is strong, so the mix of funding looks sustainable; it would only become a concern if operating cash were weak or the business had to keep borrowing to meet its everyday obligations.

Question 12

Average current liabilities = $(\$30\,000 + \$40\,000) \div 2 = \$35\,000$. Cash Flow Cover = $\$140\,000 \div \$35\,000 = \textbf{4.0 times}$. Selby's operating cash was **four times** its average current liabilities — the business generates cash from trading well in excess of its short-term debts, and could cover those debts four times over from a single year's operating cash. This is a very strong short-term cash position, giving the business a comfortable margin to meet its current liabilities and ample flexibility to invest or repay debt from its own resources.

Question 13

2025: average current liabilities = $(\$20\,000 + \$22\,000) \div 2 = \$21\,000$; Cash Flow Cover = $\$84\,000 \div \$21\,000 = \textbf{4.0 times}$. 2026: average current liabilities = $(\$22\,000 + \$23\,000) \div 2 = \$22\,500$; Cash Flow Cover = $\$54\,000 \div \$22\,500 = \textbf{2.4 times}$. The coverage has **weakened, by 1.6 times**. The main driver is the **fall in operating cash**, from \$84 000 to \$54 000 — a drop of \$30 000, or over a third — as average current liabilities rose only modestly (from \$21 000 to \$22 500). So the weakening is driven far more by shrinking operating cash than by rising short-term debt: management should focus on why the business's trading generated so much less cash this year, since a sustained decline would leave it less able to meet its current liabilities from operations.

Question 14

Rearranging the Cash Flow Cover formula, net cash flows from operating activities = Cash Flow Cover $\times$ average current liabilities. Average current liabilities = $(\$28\,000 + \$36\,000) \div 2 = \$32\,000$. Net cash flows from operating activities = $2.5 \times \$32\,000 = \textbf{\$80\,000}$.

Question 15

Rearranging the formula, average current liabilities = net cash flows from operating activities $\div$ Cash Flow Cover = $\$90\,000 \div 3.0 = \textbf{\$30\,000}$. Since the average is (opening + closing) $\div 2$, the closing balance = $(2 \times \$30\,000) - \$26\,000 = \$60\,000 - \$26\,000 = \textbf{\$34\,000}$.

Question 16

A consistently strong operating cash flow signals that a business's **core trading is genuinely generating cash**, year after year — not just accounting profit. It means the firm can pay its suppliers, employees, lenders and owner, and fund replacement and growth assets, **from its own operations**, without depending on borrowing or selling off assets.

This matters more for **survival** than a single year's profit because profit is measured on the **accrual basis** and includes non-cash items (such as depreciation) and amounts not yet received in cash (such as credit sales still owing): a business can report a profit yet still run out of cash to pay its bills. Cash, not profit, is what actually settles debts as they fall due. A business that consistently generates strong operating cash — as Kimberley has, even in a lower-profit year — has the **liquidity** to keep trading through difficult periods, whereas one that is profitable on paper but cash-poor can fail. It also shows the lower-profit year was **not** a cash problem: the business kept converting its trading into cash regardless.

Question 17

The concern is **why** the bank balance rose, not the rise itself. Reading the three categories together:

- **Operating** activities produced a net **outflow of \$20 000** — the core business **consumed** cash rather than generating it. This is the warning sign: day-to-day trading is not paying for itself.
- The bank balance rose only because of **\$30 000 from selling equipment** (investing) and **\$25 000 of new borrowing** (financing, offset by \$18 000 of drawings) — both **one-off or unsustainable** sources.

So the \$17 000 increase in cash has been produced by **selling off an asset and taking on more debt to cover a shortfall from operations**. The business cannot keep selling equipment or borrowing indefinitely, and doing so leaves it with less productive capacity and higher loan commitments. Unless the negative operating cash flow is reversed, the higher bank balance is temporary and masks a deteriorating position — which is why the increase is a genuine cause for concern despite the healthier-looking bank balance.

Question 18

Average current liabilities = $(\$40\,000 + \$48\,000) \div 2 = \$44\,000$. Cash Flow Cover = $\$132\,000 \div \$44\,000 = 3.0$ times, up from **2.5 times** the previous year — a **strengthening of 0.5 times**, so the business now covers its current liabilities three times over from operating cash rather than two and a half.

The \$80 000 spent on trucks (investing) and the \$30 000 loan repayment (financing) were funded from the **\$132 000 of operating cash**, which covered both comfortably (\$110 000 in total). Across the year, however, the investing and financing outflows came to \$150 000 (the \$80 000 of trucks plus the \$70 000 net financing outflow of a \$30 000 loan repayment and \$40 000 of drawings) — \$18 000 more than operating cash generated — so the remaining \$18 000 was drawn from the opening bank balance, leaving \$32 000 in the bank.

Despite the \$18 000 fall in cash, Vandelay's cash management for the year was **sound**. The fall was caused by **investing in new trucks and repaying debt** — both uses that strengthen the business — funded overwhelmingly by a **strong and rising** operating cash flow. Its Cash Flow Cover improved to 3.0 times, so its ability to meet short-term debts from operations is stronger than a year ago. A lower bank balance produced by investing and debt reduction, funded from robust operating cash, is a sign of a well-managed business rather than a struggling one.

Chapter 11 Reporting for cash — 11C Cash versus profit

Theory

One of the most important — and most misunderstood — ideas in Accounting is that **cash and profit are not the same thing**. A business can report a healthy **Net Profit** for the year and still run desperately short of **cash**; another can report a **Net Loss** and yet finish the year with more cash in the bank than it started with. Understanding *why* the two differ, and being able to **explain and quantify** the difference, is what allows the owner to see both how *profitably* the business traded and whether it actually *generated the cash* it needs to survive.

Two different bases of measurement. The gap between cash and profit exists because the two figures are measured on **different bases**:

- **Net Profit** is measured on the **accrual basis**. Revenue is recorded when it is **earned** (when the good is sold or the service is provided), and an expense is recorded when it is **incurred** (when the resource is consumed) — regardless of whether any cash has changed hands.
- **Cash flow** is measured on the **cash basis**. A cash inflow is recorded only when money is **received** and a cash outflow only when money is **paid**, regardless of when the related revenue was earned or expense incurred.

Because the two bases recognise the same event at **different times** — and because some cash flows are never revenues or expenses at all — the Net Profit for a period will almost never equal the cash the business generated in that same period.

The reconciling items. The differences between accrual Net Profit and the cash a business actually generated fall into a small number of predictable categories.

- **Revenue earned but not yet received — credit sales.** A **credit sale** is recorded as **Sales revenue** the moment the inventory is sold, so it *increases Net Profit* immediately. The cash, however, is not received until the customer pays — often in a later period. While the amount is still owing, it sits in **Accounts Receivable**. So an *increase* in Accounts Receivable over the period means the business earned more revenue than it collected in cash: profit is **higher** than the operating cash it produced.
- **Amounts owing at the end of the period — accrued expenses and credit purchases.** An expense such as wages that has been **incurred but not yet paid** *reduces Net Profit* when it is incurred, but the cash is not paid until later; while the amount is owing it sits in an **accrued-expense liability**. A **credit purchase** of inventory works differently: it does **not** reduce profit at all when it is made — it increases the **Inventory** asset and the **Accounts Payable** liability, and profit falls only later, through **Cost of Sales**, when the goods are sold. What the two have in common is the *cash*: an **increase** in Accounts Payable or accrued expenses means the business finished the period owing more than it owed at the start, so it **paid out less cash** than the expenses and purchases it recorded. That is why an increase in these liabilities is **added** when moving from profit to operating cash.
- **Non-cash expenses — depreciation and others.** Some expenses reduce Net Profit but involve **no cash outflow at all**. **Depreciation** — the allocation of the cost of a non-current asset over its useful life — is the clearest example: it is deducted in the Income Statement, but no cash leaves the business when depreciation is recorded (the cash left when the asset was *bought*). The **Bad and Doubtful Debts** expense behaves the same way: raising the allowance debits the expense and credits the **Allowance for Doubtful Debts**, a contra-asset, so profit falls but no cash moves. So do an **inventory loss** and an **inventory write-down**. Because each reduced profit without using cash, they are **added back** when moving from profit to operating cash. Note that *writing off* a bad debt in a later period is **not** an expense at all: the write-off debits the **Allowance for Doubtful Debts** and credits **Accounts Receivable**, so it never reaches the Income Statement and there is nothing to add back (see 12B).
- **Cash paid, but not (yet) an expense.** Some cash outflows do **not** reduce Net Profit in the period they are paid. Buying **inventory** that is still on hand is a cash outflow, but it is an **asset**, not an expense, until it is sold (only then does **Cost of Sales** reduce profit). A **prepaid expense** (for example rent or insurance paid in advance) is cash paid now for a benefit consumed later. So an *increase* in Inventory or in Prepaid expenses uses cash **without** reducing this period's profit.
- **Cash flows that affect the bank but never affect profit — drawings, loans and asset purchases.** Several cash flows never appear in the Income Statement at all:

- **Drawings** by the owner reduce the bank balance but are a **distribution of profit**, not an expense — they never reduce Net Profit.
- **Repaying the principal of a loan** reduces cash but is the settlement of a **liability**, not an expense. (The **interest** on the loan *is* an expense and *does* reduce profit — do not confuse the two.)
- **Receiving a loan** or a **capital contribution** increases cash but is not revenue.
- **Purchasing a non-current asset** for cash reduces the bank but is not an expense (only its later **depreciation** touches profit); **selling** one brings in cash that is not revenue.
- **GST.** GST is collected on sales and paid on purchases and expenses, and the net amount is settled with the ATO through the **GST Clearing** account. None of these amounts is a **revenue** or an **expense** — GST collected is a **liability owed to the ATO**, not income, and GST paid reduces that liability rather than being a cost of the business. So GST flows **affect cash but never affect profit**.

Quantifying the difference. The reasons above can be set out as a **reconciling schedule** that begins with Net Profit and adjusts it, item by item, to arrive at the **Net Cash Flows from Operating Activities** — the cash the *day-to-day trading activities* of the business generated. Each adjustment simply undoes one timing or non-cash difference:

- **add** back non-cash expenses (depreciation, Bad and Doubtful Debts, inventory losses and write-downs);
- **add** an *increase* in Accounts Payable / accrued expenses (more owing at the end than at the start, so less cash was paid);
- **deduct** an *increase* in Accounts Receivable (earned but not received);
- **deduct** an *increase* in Inventory or Prepaid expenses (cash paid, not yet an expense).

A *decrease* in any of those working-capital items reverses the sign of its adjustment.

This schedule is a **conceptual tool** for understanding and quantifying *why* profit and operating cash differ, and that is how it is used here. The formal **Cash Flow Statement** that VCE requires (Chapter 11A) is prepared by the **direct method** — listing actual cash receipts and payments — never by reconciling from profit. The skill being built in this section is **explaining the distinction between cash and profit**; the schedule is a way of organising that thinking, not a required report format.

Worked model. Brookvale Traders reports a **Net Profit of \$42 000** for the year. During the year its **depreciation** was \$9 000; **Accounts Receivable increased by \$7 000**; **Accounts Payable increased by \$4 000**; **Inventory increased by \$5 000**; and **Prepaid rent increased by \$2 000**. Reconciling from profit to operating cash:

Reconciliation of Net Profit to Net Cash Flows from
Operating Activities — Brookvale Traders

	\$
Net Profit	42 000
add Depreciation (a non-cash expense)	9 000
add Increase in Accounts Payable	4 000
less Increase in Accounts Receivable	(7 000)
less Increase in Inventory	(5 000)
less Increase in Prepaid rent	(2 000)
Net Cash Flows from Operating Activities	41 000

So although Brookvale earned a \$42 000 profit, its **operating activities generated only \$41 000** of cash. That is not yet the whole story: the bank balance is also affected by cash flows that never touch profit. Suppose Brookvale also **paid \$25 000 cash for a new vehicle**, the owner **withdrew \$30 000** in drawings, and the business **repaid \$10 000** of a loan, starting the year with a \$30 000 bank balance:

Change in the bank balance — Brookvale
Traders

	\$
Net Cash Flows from Operating Activities	41 000
less Payment for vehicle (investing)	(25 000)
less Drawings (financing)	(30 000)

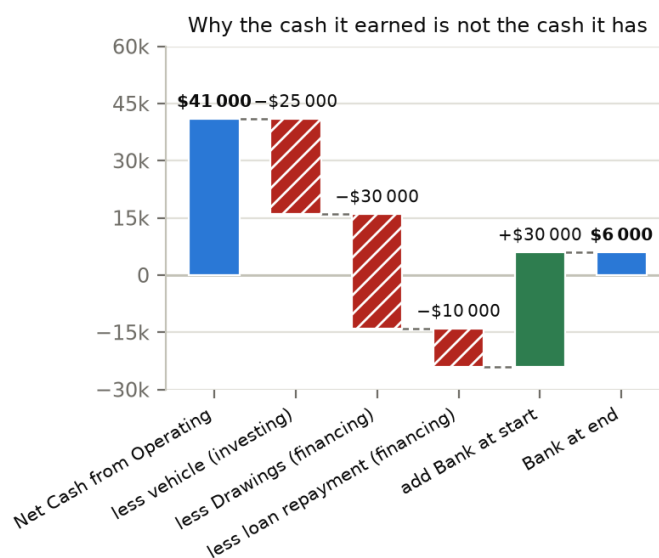
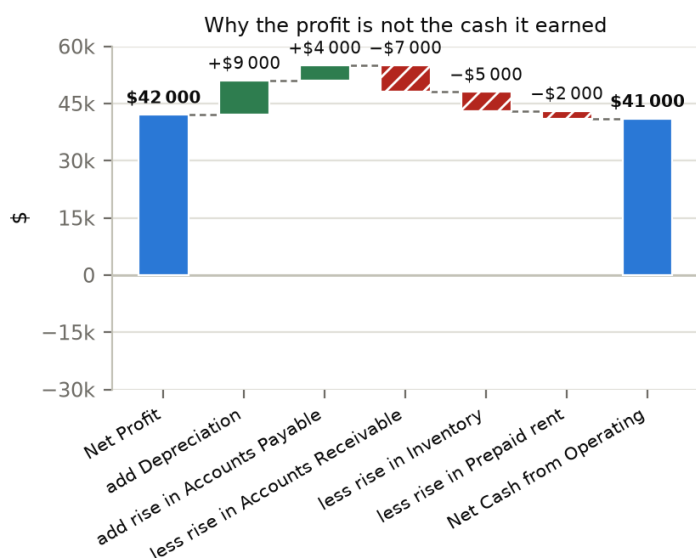
Change in the bank balance — Brookvale Traders

	\$
less Loan – repayment (financing)	(10 000)
Net decrease in the bank balance	(24 000)
add Bank balance at start	30 000
Bank balance at end	6 000

Brookvale made a **\$42 000 profit** yet its **bank balance fell by \$24 000** — from \$30 000 to just \$6 000 — because it collected less than it sold, tied up cash in inventory and a new vehicle, and paid out large drawings and a loan repayment, none of which reduced its profit. This is the classic **profitable-but-cash-poor** position, and it is exactly what the distinction between cash and profit is designed to reveal.

Cash is not profit

Brookvale Traders — a \$42 000 profit, and a bank balance that fell by \$24 000



Brookvale Traders — the bridge from a \$42 000 net profit to a \$6 000 closing bank balance

The left panel undoes the timing and non-cash differences one at a time, carrying the \$42 000 profit down to the \$41 000 of cash the trading actually generated. The right panel then adds the flows that never touch profit at all — a vehicle, drawings and a loan repayment. Both panels are drawn to the **same** scale, so the \$41 000 bar that ends the first is exactly as tall as the one that begins the second, and the gulf between a \$42 000 profit and a \$6 000 bank balance can be read in one look.

Worked examples (scaffolded)

Example 1 — reconciling Net Profit to Net Cash Flows from Operating Activities

Kew Cycles reports a Net Profit of \$35 000 for the year. During the year depreciation was \$6 000, Accounts Receivable increased by \$4 000, Accounts Payable increased by \$3 000, and Inventory decreased by \$2 000. Prepare a schedule reconciling Net Profit to Net Cash Flows from Operating Activities.

Working

Start with **Net Profit \$35 000**, the accrual result.

add Depreciation \$6 000.

add Increase in Accounts Payable \$3 000.

less Increase in Accounts Receivable \$4 000.

Comment

The reconciliation always begins with the profit figure.
A non-cash expense: it reduced profit but no cash was paid, so it is added back.

The business owes \$3 000 more than at the start, so it paid \$3 000 *less* cash than the expenses and purchases recorded.

Sales were earned but not yet received, so cash in was

Working	Comment
add Decrease in Inventory \$2 000.	\$4 000 <i>less</i> than the revenue in profit. Inventory fell, so more was sold than replaced — the business paid \$2 000 <i>less</i> cash than the Cost of Sales in profit.
Net Cash Flows from Operating Activities = 35 000 + 6 000 + 3 000 – 4 000 + 2 000 = \$42 000.	Operating cash (\$42 000) exceeds profit (\$35 000) here.

Reconciliation of Net Profit to Net Cash Flows from Operating Activities — Kew Cycles	\$
Net Profit	35 000
add Depreciation	6 000
add Increase in Accounts Payable	3 000
add Decrease in Inventory	2 000
less Increase in Accounts Receivable	(4 000)
Net Cash Flows from Operating Activities	42 000

Example 2 — a profitable business whose bank balance fell

Altona Hardware reports a Net Profit of \$28 000. During the year depreciation was \$5 000, Accounts Receivable increased by \$9 000, Inventory increased by \$6 000 and Accounts Payable increased by \$2 000. The owner also took \$18 000 in drawings, the business repaid \$8 000 of a loan and paid \$12 000 cash for new equipment. The bank balance at the start of the year was \$22 000. Reconcile to Net Cash Flows from Operating Activities, then explain what happened to the bank balance.

Working	Comment
Net Cash Flows from Operating Activities = 28 000 + 5 000 + 2 000 – 9 000 – 6 000 = \$20 000.	Add depreciation and the rise in payables; deduct the rises in receivables and inventory.
Bank change = 20 000 – 18 000 – 8 000 – 12 000 = – \$18 000.	Drawings, the loan repayment and the equipment purchase are all cash out but none is an expense.
Bank at end = 22 000 – 18 000 = \$4 000.	The bank fell from \$22 000 to \$4 000 despite the \$28 000 profit.

Reconciliation of Net Profit to Net Cash Flows from Operating Activities — Altona Hardware	\$
Net Profit	28 000
add Depreciation	5 000
add Increase in Accounts Payable	2 000
less Increase in Accounts Receivable	(9 000)
less Increase in Inventory	(6 000)
Net Cash Flows from Operating Activities	20 000

Change in the bank balance — Altona Hardware	\$
Net Cash Flows from Operating Activities	20 000
less Payment for equipment	(12 000)
less Drawings	(18 000)
less Loan – repayment	(8 000)

Change in the bank balance — Altona Hardware	\$
Net decrease in the bank balance	(18 000)
add Bank balance at start	22 000
Bank balance at end	4 000

Altona was **profitable but cash-poor**: a \$28 000 profit produced only \$20 000 of operating cash (because credit sales and inventory tied up funds), and that \$20 000 was more than swallowed by \$18 000 of drawings, an \$8 000 loan repayment and \$12 000 of new equipment — none of which reduced the reported profit.

Worked examples (unscaffolded)

Example 3 — operating cash exceeding profit

Sorrento Marine reports a Net Profit of \$50 000. Depreciation for the year was \$8 000. Accounts Receivable increased by \$6 000, Accounts Payable decreased by \$3 000, Inventory decreased by \$4 000 and Prepaid insurance increased by \$1 000. Prepare the reconciliation to Net Cash Flows from Operating Activities.

Depreciation is added back as a non-cash expense (+8 000). The increase in Accounts Receivable is deducted (–6 000): more was earned than received. The decrease in Accounts Payable is deducted (–3 000): payables were paid down, so cash out exceeded the expenses and purchases in profit. The decrease in Inventory is added (+4 000): stock was run down rather than replaced. The increase in Prepaid insurance is deducted (–1 000): cash was paid in advance of the expense.

Reconciliation of Net Profit to Net Cash Flows from Operating Activities — Sorrento Marine	\$
Net Profit	50 000
add Depreciation	8 000
add Decrease in Inventory	4 000
less Increase in Accounts Receivable	(6 000)
less Decrease in Accounts Payable	(3 000)
less Increase in Prepaid insurance	(1 000)
Net Cash Flows from Operating Activities	52 000

∴ Sorrento Marine's operating activities generated **\$52 000** of cash — \$2 000 *more* than its \$50 000 profit — mainly because the large non-cash depreciation charge and the run-down of inventory more than offset the uncollected credit sales.

Example 4 — a loss, yet the bank balance rose

Daylesford Books reports a Net **Loss** of \$5 000. Depreciation for the year was \$12 000. Accounts Receivable decreased by \$6 000, Accounts Payable increased by \$3 000 and Inventory increased by \$4 000. The business also received a \$20 000 loan, paid \$15 000 cash for equipment and the owner withdrew \$9 000. The bank balance at the start was \$5 000. Reconcile to Net Cash Flows from Operating Activities and determine the closing bank balance.

Starting from the \$5 000 loss, the \$12 000 depreciation is added back (the loss was largely a non-cash charge). The \$6 000 fall in Accounts Receivable is added (old debtors were collected), the \$3 000 rise in Accounts Payable is added (more owing at the end than at the start, so less cash was paid out), and the \$4 000 rise in Inventory is deducted.

Reconciliation of Net Loss to Net Cash Flows from Operating Activities — Daylesford Books	\$
Net Loss	(5 000)
add Depreciation	12 000
add Decrease in Accounts Receivable	6 000
add Increase in Accounts Payable	3 000

Reconciliation of Net Loss to Net Cash Flows from
Operating Activities — Daylesford Books

	\$
less Increase in Inventory	(4 000)
Net Cash Flows from Operating Activities	12 000

Change in the bank balance — Daylesford
Books

	\$
Net Cash Flows from Operating Activities	12 000
add Loan received	20 000
less Payment for equipment	(15 000)
less Drawings	(9 000)
Net increase in the bank balance	8 000
add Bank balance at start	5 000
Bank balance at end	13 000

∴ despite a **\$5 000 loss**, Daylesford's bank balance **rose by \$8 000** to \$13 000: operations still generated \$12 000 of cash (the loss was mostly the non-cash depreciation), and a \$20 000 loan brought in cash that is not revenue. This is the **vice-versa** case — cash up while profit is negative — and it shows why cash and profit must each be examined in its own right.

Practice questions — scaffolded

Question 1

Brighton Cycles lists the following events for the year: a cash sale of inventory; a credit sale of inventory; depreciation of equipment; the owner's cash drawings; receipt of a bank loan; a cash payment for a non-current asset; cash received from an account receivable; and payment of loan interest in cash.

- Identify the items that affect **profit but not cash** this period.
- Identify the items that affect **cash but not profit** this period.
- Choosing one item from your answer to part b, explain in one sentence why it has no effect on profit.

Question 2

Camberwell Traders reports a Net Profit of \$40 000. During the year depreciation was \$7 000, Accounts Receivable increased by \$5 000, Accounts Payable increased by \$3 000 and Inventory increased by \$2 000.

- State, for each of the four items, whether it is **added** or **deducted** in reconciling profit to operating cash.
- Prepare the schedule reconciling Net Profit to Net Cash Flows from Operating Activities.
- State the Net Cash Flows from Operating Activities.

Question 3

Frankston Supplies reports a Net Profit of \$33 000. During the year depreciation was \$4 000, Accounts Receivable decreased by \$6 000, Accounts Payable decreased by \$5 000 and Inventory decreased by \$3 000.

- State, for each of the four items, whether it makes Net Cash Flows from Operating Activities **higher** or **lower** than Net Profit.
- Calculate the Net Cash Flows from Operating Activities for the year.
- Explain in one sentence why a **decrease** in Accounts Receivable makes operating cash higher than profit.

Question 4

Geelong Timber reports a Net Profit of \$46 000 for the year and **Net Cash Flows from Operating Activities of \$39 000**. Depreciation was \$8 000; Accounts Receivable increased by \$11 000; Inventory increased by \$7 000; Accounts Payable increased by \$3 000. The owner withdrew \$24 000, the business repaid \$12 000 of a loan and paid \$20 000 cash for a vehicle. The bank balance at the start was \$25 000.

- Explain, referring to **two** of the four items listed, why operating cash of \$39 000 is \$7 000 lower than the reported Net Profit.
- Calculate the overall change in the bank balance and the bank balance at the end of the year.
- Explain how Geelong Timber made a \$46 000 profit yet finished the year with a lower bank balance.

Question 5

Ballarat Books reports a Net **Loss** of \$8 000. Depreciation was \$15 000; Accounts Receivable decreased by \$5 000; Accounts Payable increased by \$4 000; Inventory increased by \$6 000. The owner contributed \$10 000 of additional capital, the business paid \$9 000 cash for equipment and the owner withdrew \$5 000. The bank balance at the start was \$3 000.

- Prepare the schedule reconciling Net Loss to Net Cash Flows from Operating Activities.
- Calculate the overall change in the bank balance and the bank balance at the end of the year.
- Explain how the bank balance rose even though the business made a loss.

Question 6

Mildura Fresh is a profitable business whose owner is worried about a shortage of cash.

- Identify **two** reasons a profitable business may still be short of cash.
- State whether the **GST collected** on the business's cash sales affects profit, cash, or both, and justify your answer.
- Explain why **depreciation** is added back when reconciling Net Profit to Net Cash Flows from Operating Activities.

Practice questions — unscaffolded

Question 7

Torquay Surf reports a Net Profit of \$52 000. During the year depreciation was \$9 000, Accounts Receivable increased by \$8 000, Accounts Payable increased by \$5 000, Inventory increased by \$4 000 and Prepaid expenses increased by \$1 000. Calculate the Net Cash Flows from Operating Activities for the year, and explain, with reference to **two** of the five items, why it differs from Net Profit by only \$1 000.

Question 8

Warrnambool Wholesale reports a Net Profit of \$60 000. Depreciation was \$11 000; Accounts Receivable decreased by \$7 000; Accounts Payable increased by \$6 000; Inventory decreased by \$5 000; Prepaid expenses decreased by \$2 000. Calculate the Net Cash Flows from Operating Activities and explain, with reference to at least **three** of the five items, why operating cash so greatly exceeds profit.

Question 9

Portsea Traders lists the following events for the year: a credit sale of inventory; depreciation of the delivery van; the owner's cash drawings; a loan received from the bank; a GST settlement paid to the ATO; the purchase of a non-current asset for cash; a cash payment for wages; and a cash sale of inventory. Identify which items affect **cash but not profit** and which affect **profit but not cash**, and explain why the two cash-sale/wages items belong in neither list.

Question 10

Bendigo Bikes reports a Net Profit of \$55 000. Depreciation was \$10 000; Accounts Receivable increased by \$14 000; Inventory increased by \$9 000; Accounts Payable increased by \$4 000. The owner withdrew \$28 000, the business repaid \$15 000 of a loan and paid \$18 000 cash for equipment. The bank balance at the start was \$20 000. Prepare the

reconciliation to Net Cash Flows from Operating Activities, then calculate the change in the bank balance and the bank balance at the end of the year.

Question 11

Echuca Crafts reports a Net **Loss** of \$12 000 for the year, yet **Net Cash Flows from Operating Activities of \$13 000**. Depreciation was \$18 000; Accounts Receivable decreased by \$9 000; Accounts Payable increased by \$5 000; Inventory increased by \$7 000. The business received a \$25 000 loan, paid \$22 000 cash for a vehicle and the owner withdrew \$6 000. The bank balance at the start was \$4 000. Explain how the business generated \$13 000 of operating cash in a year in which it reported a \$12 000 loss, then calculate the change in the bank balance and the bank balance at the end of the year.

Question 12

Hamilton Stores generated **Net Cash Flows from Operating Activities of \$48 000** for the year. Its reconciling items were: depreciation \$7 000; an increase in Accounts Receivable of \$5 000; an increase in Accounts Payable of \$3 000; and an increase in Inventory of \$2 000. Working backwards, calculate the business's **Net Profit** for the year.

Question 13

During the year Colac Provisions collected \$4 000 of GST on its cash sales, paid \$3 000 of GST on its purchases and expenses, and paid a \$2 000 GST settlement to the ATO. State, for each of the three items, whether it affects **profit**, **cash**, or **both**, and explain why GST never affects profit.

Question 14

Swan Hill Traders reports a Net Profit of \$38 000. During the year depreciation was \$6 000, Accounts Receivable increased by \$4 000, Prepaid advertising increased by \$3 000, accrued wages increased by \$2 000 and Inventory decreased by \$1 000. Calculate the Net Cash Flows from Operating Activities, and **distinguish** between the effect of the increase in accrued wages and the effect of the increase in Prepaid advertising on the difference between cash and profit.

Question 15

Wangaratta Furniture reports a Net Profit of \$60 000 for the year, but the owner reports that the business “cannot pay its suppliers”. During the year depreciation was \$8 000, Accounts Receivable increased by \$30 000 (the business extended generous credit terms to win sales) and Inventory increased by \$25 000 (the owner overstocked). The owner also withdrew \$40 000 and repaid \$20 000 of a loan. The bank balance at the start was \$50 000. Calculate the Net Cash Flows from Operating Activities and the closing bank balance, and **discuss** why the business is short of cash despite its profit, suggesting two strategies that would improve its cash position.

Question 16

Traralgon Tools reports a Net Profit of \$44 000 and Net Cash Flows from Operating Activities of \$47 000 for the year. Its known reconciling items were: depreciation \$9 000 (added); an increase in Accounts Receivable of \$6 000 (deducted); and an increase in Accounts Payable of \$4 000 (added). The only other operating adjustment was a movement in Inventory. Calculate the change in Inventory for the year and state whether Inventory increased or decreased.

Question 17

“A business that reports a profit every year can never fail.” Discuss whether this statement is correct, with reference to the difference between cash and profit and to the **going concern** assumption, and explain why users of the reports need cash flow information as well as profit.

Question 18

Shepparton Produce reports a Net Profit of \$72 000 for the year ended 30 June 2026. During the year depreciation was \$14 000; Accounts Receivable increased by \$10 000; Accounts Payable increased by \$7 000; Inventory increased by \$8 000; and Prepaid expenses increased by \$5 000. The owner contributed \$15 000 of additional capital, the business paid \$30 000 cash for equipment, repaid \$10 000 of a loan and the owner withdrew \$32 000. The bank balance at the

start of the year was \$9 000. Prepare the schedule reconciling Net Profit to Net Cash Flows from Operating Activities, then calculate the overall change in the bank balance and the bank balance at the end of the year.

Answers

1.
 - a. Credit sale of inventory; depreciation of equipment (profit, not cash). b. Owner's drawings; receipt of a bank loan; cash payment for a non-current asset; cash received from an account receivable (cash, not profit). c. See solutions.
2.
 - a. add depreciation & increase in Accounts Payable; deduct increase in Accounts Receivable & increase in Inventory. c. Net Cash Flows from Operating \$43 000
3.
 - a. Higher: depreciation, decrease in Accounts Receivable, decrease in Inventory; lower: decrease in Accounts Payable. b. Net Cash Flows from Operating \$41 000 c. See solutions
4.
 - a. See solutions b. Decrease \$17 000; closing bank \$8 000 c. See solutions
5.
 - a. Net Cash Flows from Operating \$10 000 b. Increase \$6 000; closing bank \$9 000 c. See solutions
6. See solutions
7. Net Cash Flows from Operating \$53 000 (explain)
8. Net Cash Flows from Operating \$91 000 (explain)
9. See solutions
10. Net Cash Flows from Operating \$46 000; bank decrease \$15 000; closing bank \$5 000
11. Bank increase \$10 000; closing bank \$14 000 (explain)
12. Net Profit \$45 000
13. None affects profit; all affect cash (see solutions)
14. Net Cash Flows from Operating \$40 000 (distinguish)
15. Net Cash Flows from Operating \$13 000; bank decrease \$47 000; closing bank \$3 000 (discuss)
16. Inventory increased by \$4 000
17. See solutions
18. Net Cash Flows from Operating \$70 000; bank increase \$13 000; closing bank \$22 000

Fully-worked solutions

Question 1

- a. **Credit sale of inventory** and **depreciation of equipment** affect profit but not cash: the credit sale is recorded as Sales revenue when the goods are sold (no cash yet received), and depreciation is an expense that involves no cash outflow.
- b. **Owner's cash drawings, receipt of a bank loan, cash payment for a non-current asset** and **cash received from an account receivable** all affect cash but not profit: each is a receipt or payment of cash that is not a revenue or an expense of the period.
- c. (Example, drawings.) Drawings are a **withdrawal of the owner's equity** — a distribution to the owner — not a cost incurred in earning revenue, so they reduce the bank balance but are never reported as an expense and do not reduce Net Profit. (The cash payment for a non-current asset likewise buys an **asset**, not an expense; the receipt from an account receivable collects a debt arising from a **prior** period's sale; the loan receipt increases a **liability**.)

Question 2

- a. **add** Depreciation (non-cash expense); **add** Increase in Accounts Payable (more owing at the end than at the start, so less cash paid); **deduct** Increase in Accounts Receivable (earned, not yet received); **deduct** Increase in Inventory (cash paid, not yet an expense).

b and c.

Reconciliation of Net Profit to Net Cash Flows from
Operating Activities — Camberwell Traders

	\$
Net Profit	40 000
add Depreciation	7 000
add Increase in Accounts Payable	3 000
less Increase in Accounts Receivable	(5 000)
less Increase in Inventory	(2 000)
Net Cash Flows from Operating Activities	43 000

Net Cash Flows from Operating Activities = 40 000 + 7 000 + 3 000 – 5 000 – 2 000 = **\$43 000**.

Question 3

- Higher** than Net Profit: the \$4 000 **depreciation** (an expense that used no cash at all); the \$6 000 **decrease in Accounts Receivable** (more cash was collected from customers than was sold to them on credit); and the \$3 000 **decrease in Inventory** (stock on hand was sold rather than replaced, so less cash was paid for inventory than the Cost of Sales deducted from profit). **Lower** than Net Profit: the \$5 000 **decrease in Accounts Payable** (the business paid suppliers more than it bought from them, so cash out exceeded the expenses and purchases recorded).
- Net Cash Flows from Operating Activities = 33 000 + 4 000 + 6 000 + 3 000 – 5 000 = **\$41 000**.
- A **decrease** in Accounts Receivable means the business **collected more cash from customers than it made in credit sales** during the period, so the cash received from operations was *greater* than the sales revenue included in profit.

Question 4

- (Any two of the four items.) The **\$11 000 increase in Accounts Receivable** means \$11 000 of sales were earned — and so included in Net Profit — but not collected in cash this period, so operating cash is that much lower than profit. The **\$7 000 increase in Inventory** is cash paid for stock still on hand at year's end: it is an **asset**, and will not reduce profit until it is sold as Cost of Sales, so it uses cash without reducing profit. Working the other way, the **\$8 000 depreciation** reduced profit without any cash outflow, and the **\$3 000 increase in Accounts Payable** left the business owing more to suppliers at the end than at the start, so it paid out that much less cash. On balance (+8 000 + 3 000 – 11 000 – 7 000 = –7 000) operating cash of **\$39 000** sits \$7 000 below the \$46 000 profit.

Change in the bank balance — Geelong
Timber

	\$
Net Cash Flows from Operating Activities	39 000
less Payment for vehicle	(20 000)
less Drawings	(24 000)
less Loan – repayment	(12 000)
Net decrease in the bank balance	(17 000)
add Bank balance at start	25 000
Bank balance at end	8 000

The bank balance **decreased by \$17 000**, from \$25 000 to **\$8 000**.

- The \$46 000 profit generated only \$39 000 of operating cash, because \$11 000 of sales and \$7 000 of inventory were tied up rather than turned into cash. That \$39 000 was then more than absorbed by a \$20 000 vehicle purchase, \$24 000 of drawings and a \$12 000 loan repayment — **cash outflows that are not expenses** and so did not reduce the reported profit. Profit measures trading performance; it does not measure what the business did with its cash.

Question 5

Reconciliation of Net Loss to Net Cash

Flows from Operating Activities —

Ballarat Books

	\$
Net Loss	(8 000)
add Depreciation	15 000
add Decrease in Accounts Receivable	5 000
add Increase in Accounts Payable	4 000
less Increase in Inventory	(6 000)
Net Cash Flows from Operating Activities	10 000

Change in the bank balance — Ballarat Books

	\$
Net Cash Flows from Operating Activities	10 000
add Capital contribution	10 000
less Payment for equipment	(9 000)
less Drawings	(5 000)
Net increase in the bank balance	6 000
add Bank balance at start	3 000
Bank balance at end	9 000

The bank balance **increased by \$6 000**, from \$3 000 to **\$9 000**.

- c. The \$8 000 loss was largely caused by the **\$15 000 non-cash depreciation** charge, so operations still generated \$10 000 of cash. On top of that, a **\$10 000 capital contribution** brought in cash that is not revenue. Together these outweighed the \$9 000 equipment purchase and \$5 000 of drawings, so the bank rose even though the business was unprofitable.

Question 6

- a. Any two of: cash is tied up in **rising Accounts Receivable** (credit sales not yet collected) or in **rising Inventory** (overstocking); large **drawings** by the owner; **repaying loan principal**; buying **non-current assets** for cash. Each reduces cash without reducing profit.
- b. GST collected on cash sales affects **cash only**. When the sale is made the business receives the GST as part of the banking, increasing the bank balance, but the GST is a **liability owed to the ATO** (recorded in GST Clearing), not revenue of the business — so it never appears in the Income Statement and does not affect profit.
- c. **Depreciation** is a non-cash expense: it allocates part of the cost of a non-current asset to the period as an expense, reducing Net Profit, but **no cash leaves the business** when it is recorded (the cash was paid when the asset was purchased). Because it reduced profit without using cash, it is **added back** to convert accrual profit into the cash operations actually generated.

Question 7

Net Cash Flows from Operating Activities = 52 000 + 9 000 (depreciation) + 5 000 (increase in Accounts Payable) – 8 000 (increase in Accounts Receivable) – 4 000 (increase in Inventory) – 1 000 (increase in Prepaid expenses) = **\$53 000**.

The five adjustments very nearly cancel one another, which is why operating cash sits only \$1 000 above the \$52 000 profit. (Any two items, explained.) The **\$9 000 depreciation** reduced profit but no cash left the business when it was recorded — the cash had already gone when the asset was bought — so it is added back and pushes operating cash *above* profit. Pulling the other way, the **\$8 000 increase in Accounts Receivable** means \$8 000 of the Sales revenue included in profit was earned but never collected this period, so it leaves operating cash *below* profit. Together with

the \$5 000 rise in payables and the \$4 000 and \$1 000 of cash tied up in inventory and prepayments, the adjustments net to just **+\$1 000**.

Question 8

Net Cash Flows from Operating Activities = 60 000 + 11 000 + 7 000 + 6 000 + 5 000 + 2 000 = **\$91 000** — \$31 000 more than the reported Net Profit.

Operating cash so greatly exceeds profit because **every one of the five adjustments is an add-back**. (Any three, explained.) **Depreciation of \$11 000** reduced profit but used no cash at all, so it is added straight back. The **\$7 000 decrease in Accounts Receivable** means the business collected \$7 000 more cash from customers than it made in credit sales, so cash in exceeded the Sales revenue in profit. The **\$5 000 decrease in Inventory** means stock on hand was sold rather than replaced, so the business paid \$5 000 less cash for inventory than the Cost of Sales deducted from profit. Adding to this, the **\$6 000 increase in Accounts Payable** left the business owing more to suppliers at the end of the year than at the start (cash retained rather than paid out), and the **\$2 000 decrease in Prepaid expenses** was an expense consumed this period but paid for in an earlier one. Not one of these releases of cash added anything to profit.

Question 9

Cash but not profit: the owner's cash drawings; the loan received from the bank; the GST settlement paid to the ATO; the purchase of a non-current asset for cash. Each is a cash flow that is not a revenue or an expense — drawings distribute equity, the loan and its repayment are liabilities, GST belongs to the ATO, and the asset purchase buys an asset (only its later depreciation is an expense).

Profit but not cash: the credit sale of inventory (Sales revenue earned, cash not yet received) and the depreciation of the delivery van (an expense with no cash outflow).

The **cash sale of inventory** and the **cash payment for wages** belong in **neither** list because each affects **both** profit and cash in the **same period**: the cash sale records Sales revenue and receives cash at once, and the wages payment records an expense and pays cash at once, so there is no timing difference between the two figures.

Question 10

Reconciliation of Net Profit to Net Cash Flows from
Operating Activities — Bendigo Bikes

	\$
Net Profit	55 000
add Depreciation	10 000
add Increase in Accounts Payable	4 000
less Increase in Accounts Receivable	(14 000)
less Increase in Inventory	(9 000)
Net Cash Flows from Operating Activities	46 000

Change in the bank balance — Bendigo
Bikes

	\$
Net Cash Flows from Operating Activities	46 000
less Payment for equipment	(18 000)
less Drawings	(28 000)
less Loan – repayment	(15 000)
Net decrease in the bank balance	(15 000)
add Bank balance at start	20 000
Bank balance at end	5 000

Operating cash was **\$46 000**; the bank balance **decreased by \$15 000**, from \$20 000 to **\$5 000**.

Question 11

The \$12 000 loss and the \$13 000 of operating cash differ by \$25 000, and each of the four items explains part of that gap. By far the largest is the **\$18 000 depreciation**: it was deducted in the Income Statement — and on its own turned the year's trading into a reported loss — but no cash left the business when it was recorded, so it is added back. The **\$9 000 decrease in Accounts Receivable** means the business collected \$9 000 more from customers than it sold to them on credit, bringing in cash that was not this year's revenue. The **\$5 000 increase in Accounts Payable** means it finished the year owing suppliers more than at the start, so it paid out \$5 000 less cash than the expenses and purchases it recorded. Only the **\$7 000 increase in Inventory** worked the other way — cash paid for stock still on hand, an asset that is not yet an expense. Net: $-12\,000 + 18\,000 + 9\,000 + 5\,000 - 7\,000 = \textbf{\$13 000}$ of operating cash despite the loss.

Change in the bank balance — Echuca

Crafts	\$
Net Cash Flows from Operating Activities	13 000
add Loan received	25 000
less Payment for vehicle	(22 000)
less Drawings	(6 000)
Net increase in the bank balance	10 000
add Bank balance at start	4 000
Bank balance at end	14 000

The bank balance **increased by \$10 000**, from \$4 000 to **\$14 000**, helped by the \$25 000 loan.

Question 12

Working backwards, Net Cash Flows from Operating Activities = Net Profit + depreciation – increase in Accounts Receivable + increase in Accounts Payable – increase in Inventory. The reconciling items net to $+7\,000 - 5\,000 + 3\,000 - 2\,000 = \textbf{+3 000}$. So Net Profit = Net Cash Flows from Operating Activities – 3 000 = $\$48\,000 - \$3\,000 = \textbf{\$45 000}$. (Check: $45\,000 + 7\,000 - 5\,000 + 3\,000 - 2\,000 = 48\,000$.)

Question 13

None of the three items affects profit; all three affect cash. GST collected on cash sales (\$4 000) is cash **in**, GST paid on purchases and expenses (\$3 000) is cash **out**, and the GST settlement to the ATO (\$2 000) is cash **out** — a net cash outflow of \$1 000 across the three. GST never affects profit because **GST is not the business's revenue or expense**: GST collected is a **liability owed to the ATO** (recorded in GST Clearing) and GST paid **reduces that liability** rather than being a cost of trading. The business merely collects GST on the ATO's behalf and remits the net amount, so GST flows appear in the cash records but never in the Income Statement.

Question 14

Net Cash Flows from Operating Activities = $38\,000 + 6\,000$ (depreciation) + $2\,000$ (increase in accrued wages) + $1\,000$ (decrease in Inventory) – $4\,000$ (increase in Accounts Receivable) – $3\,000$ (increase in Prepaid advertising) = **\$40 000**.

Distinguishing the two items. The **\$2 000 increase in accrued wages** is an expense that has been **incurred but not yet paid**: the whole wages expense has already reduced Net Profit, but \$2 000 of it was still owing at balance day, so that much cash never left the business. It is therefore **added**, and it makes operating cash *higher* than profit. The **\$3 000 increase in Prepaid advertising** is the exact opposite: cash has been **paid in advance of the expense being incurred**, so the bank has already fallen while the benefit — and therefore the expense — belongs to a later period. It is therefore **deducted**, and it makes operating cash *lower* than profit. One is an expense without a payment; the other is a payment without an expense.

Question 15

Net Cash Flows from Operating Activities = $60\,000 + 8\,000$ (depreciation) – $30\,000$ (increase in Accounts Receivable) – $25\,000$ (increase in Inventory) = **\$13 000**.

Change in the bank balance — Wangaratta Furniture	\$
Net Cash Flows from Operating Activities	13 000
less Drawings	(40 000)
less Loan – repayment	(20 000)
Net decrease in the bank balance	(47 000)
add Bank balance at start	50 000
Bank balance at end	3 000

Discussion. Although Wangaratta reported a strong **\$60 000 profit**, its operating activities generated only **\$13 000** of cash, because the profit was earned largely on **credit** (Accounts Receivable rose \$30 000) and a further \$25 000 of cash was locked up in **excess inventory** — both of which reduce cash without reducing profit. That \$13 000 was then overwhelmed by **\$40 000 of drawings** and a **\$20 000 loan repayment**, cash outflows that never appear in the Income Statement. The result is a bank balance that has fallen to just **\$3 000**, leaving the business unable to pay suppliers even though it is profitable. Two strategies that would improve the cash position: (i) **tighten credit terms and collect receivables faster** (or offer a settlement discount) to convert credit sales into cash sooner; and (ii) **reduce inventory to match demand** so cash is not tied up in unsold stock. The owner could also **moderate drawings** or **reschedule the loan repayment** to ease the immediate shortfall.

Question 16

Net Cash Flows from Operating Activities = Net Profit + depreciation – increase in Accounts Receivable + increase in Accounts Payable + inventory movement. The known items give $44\,000 + 9\,000 - 6\,000 + 4\,000 = \mathbf{\$51\,000}$ before the inventory adjustment. Since Net Cash Flows from Operating Activities is only \$47 000, the inventory movement must be $\$47\,000 - \$51\,000 = \mathbf{-\$4\,000}$; a negative (deducted) adjustment of \$4 000 corresponds to an **increase in Inventory of \$4 000** (cash was paid to build up stock that is not yet an expense). (Check: $44\,000 + 9\,000 - 6\,000 + 4\,000 - 4\,000 = 47\,000$.)

Question 17

The statement is **incorrect**. Profit and cash are measured on different bases: a business can report a profit every year (revenues earned exceeding expenses incurred) and still **run out of cash** if its profit is tied up in uncollected receivables and unsold inventory, or if its cash is drained by drawings, loan repayments and asset purchases that never reduce profit. A business that cannot pay its debts as they fall due will fail regardless of its reported profit — which directly threatens the **going concern** assumption (the assumption that the business will continue operating into the foreseeable future). Because of this, users need **cash flow information as well as profit**: the Income Statement shows how *profitably* the business traded, but only the cash records show whether it generated the cash needed to pay suppliers, employees, lenders and the owner. Relying on profit alone would give a misleading picture of the business's ability to survive, so the two reports are **complementary** — each answers a question the other cannot.

Question 18

Reconciliation of Net Profit to Net Cash Flows from Operating Activities — Shepparton Produce	\$
Net Profit	72 000
add Depreciation	14 000
add Increase in Accounts Payable	7 000
less Increase in Accounts Receivable	(10 000)
less Increase in Inventory	(8 000)
less Increase in Prepaid expenses	(5 000)
Net Cash Flows from Operating Activities	70 000

Change in the bank balance —

Shepparton Produce

\$

Net Cash Flows from Operating Activities	70 000
add Capital contribution	15 000
less Payment for equipment	(30 000)
less Loan – repayment	(10 000)
less Drawings	(32 000)
Net increase in the bank balance	13 000
add Bank balance at start	9 000
Bank balance at end	22 000

Net Cash Flows from Operating Activities = 72 000 + 14 000 + 7 000 – 10 000 – 8 000 – 5 000 = **\$70 000**. After the \$15 000 capital contribution, \$30 000 equipment purchase, \$10 000 loan repayment and \$32 000 of drawings, the bank balance **increased by \$13 000**, from \$9 000 to **\$22 000** at 30 June 2026.