



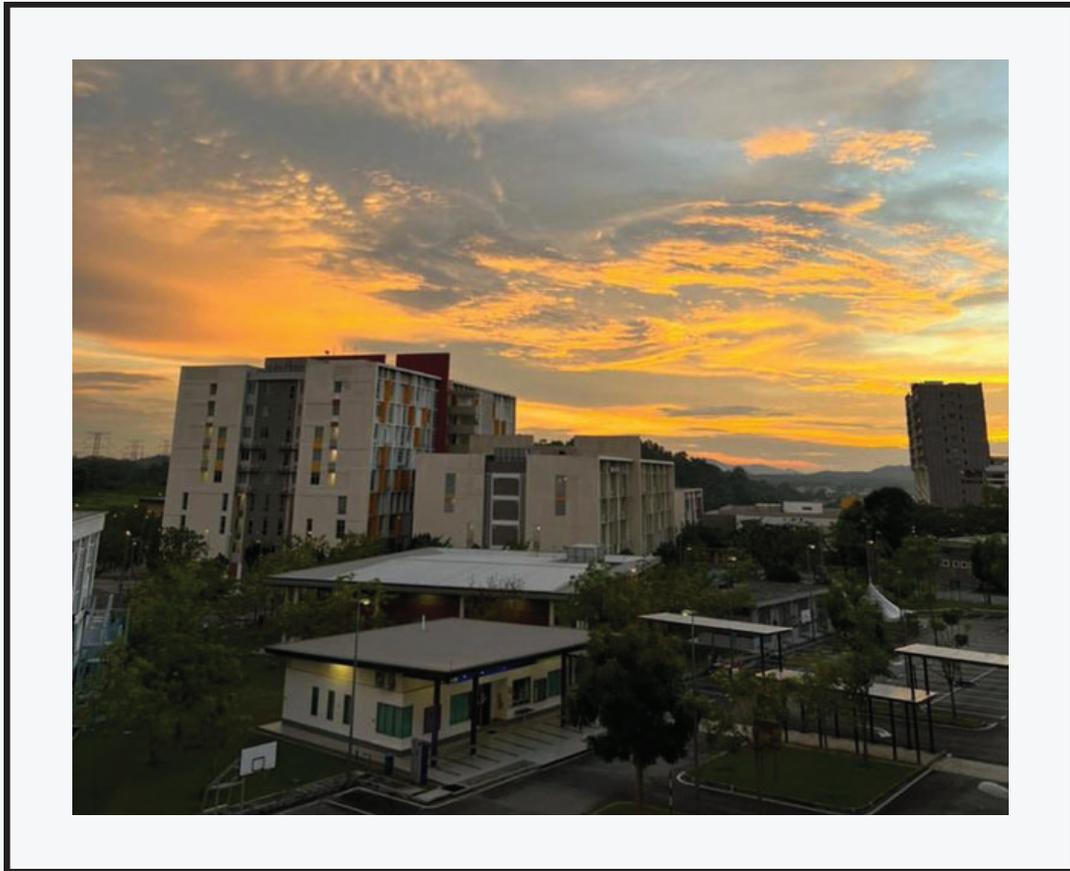
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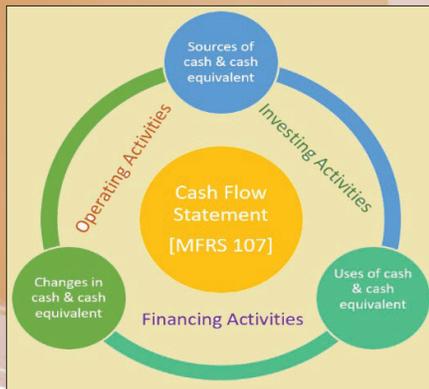
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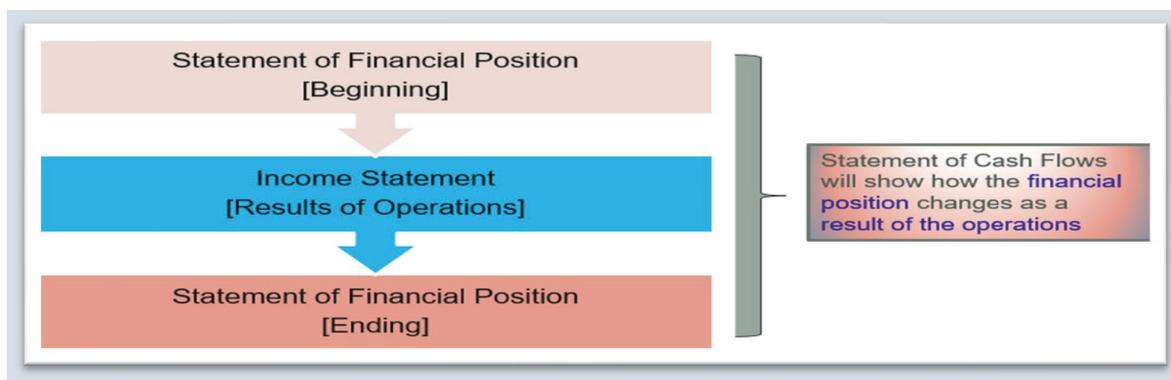
# The Statement of Cash Flows: Direct and Indirect Method

by PM Noryati Md Noor



The statement of cash flows does not always receive the same attention as the other financial statements such as the statement of profit or loss and the statement of financial position. What is a statement of cash flows? How can it contribute to the decisions made? The economic decision made by the users should incorporate an evaluation of the ability of an entity to generate cash and cash equivalent, including the timing and assurance of their generation. There is a need to know the sources and uses of cash, so owner/management can optimize any limited resources.

The essence of the of statement cash flow is governed by the Malaysian Reporting Standards 107 (MFRS107). Regardless of the nature of the revenue-producing activities of an entity, the information on the sources, uses, and changes of the cash flows will enable the users to “...*evaluate the changes in net assets of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities*” (MFRS107, paragraph 3). Cash flows refer to inflows and outflows of cash and cash equivalents. The following terms are extracted from paragraph 6 of MFRS107: **Cash** comprises of cash on hand and demand deposits and **cash equivalents** are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value (normally 3 months or less).



A statement of cash flow, when used in conjunction with the rest of the financial statements, provides information useful in assessing the ability of the entity to generate cash and cash equivalents from the three sources, which are the operating, investing, and financing activities (Table 1).

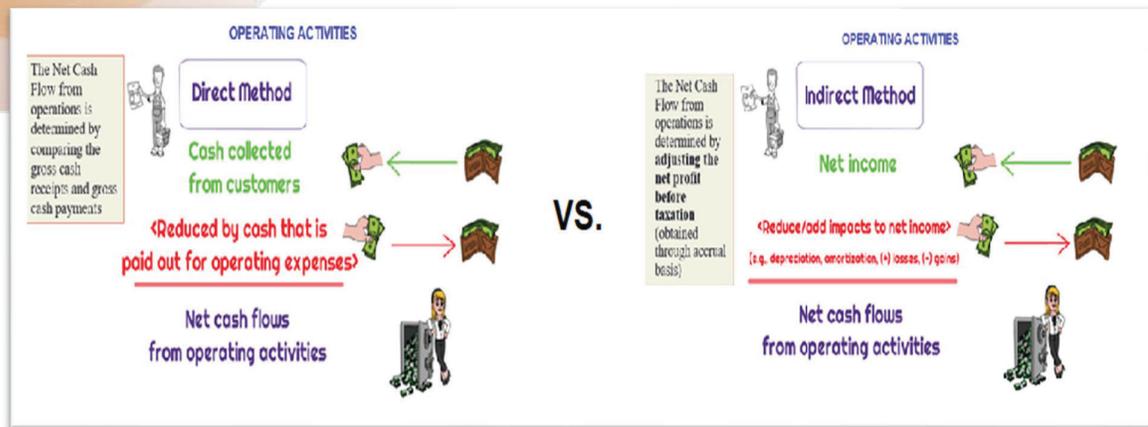
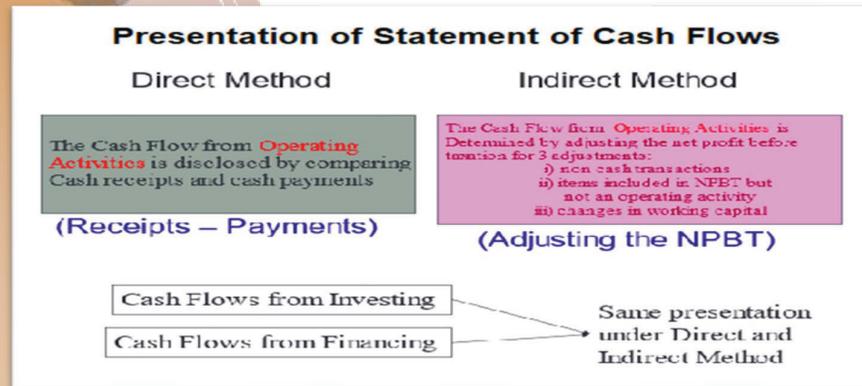
**Table 1: The Three Cash Flows Activities**

Operating Activities	Investing Activities	Financing Activities
The main activity of producing revenues and the costs incurred to produce the revenues	Involves the acquisition (other than cash equivalents) and disposal of non-current assets	Involves obtaining and repaying of financial resources from owners and other providers of long-term capital on which the providers get return.
Indicates how sufficient cash is generated through the main activity to sustain operations, meets obligations, contribute to investing, pay dividend and repay loans	Assess the extent of company's expansion and the implications on the future cash flow or income and the resulting return on the investment.	Assess the sources of funds from owners & 3 <sup>rd</sup> parties and the related costs to sustain supply of funds.
<ul style="list-style-type: none"> <li>• Sales of goods</li> <li>• Receipts from customers</li> <li>• Purchases of goods</li> <li>• Payment to supplier</li> <li>• Payment of cost for running the business operations (operating expenses)</li> <li>• Administrative costs</li> <li>• Distribution costs</li> </ul>	<ul style="list-style-type: none"> <li>• Acquire Non-current assets and long- term investment.</li> <li>• Acquire short term investment which does not qualify as cash equivalent (more than three months)</li> <li>• Disposal/sale of NCA</li> <li>• Receipt for Investment Income</li> </ul>	<ul style="list-style-type: none"> <li>• Receipts from issue of shares, debentures, loans, and other borrowings</li> <li>• Repayment of loan</li> <li>• Payments of cash dividends</li> </ul>

There are two methods of preparing the statement of cash flows which include the direct and indirect method. Paragraph 19 of the MFRS107 stated that *“Entities are encouraged to report cash flows from operating activities using the direct method. The direct method provides information which may be useful in estimating future cash flows, and which is not available under the indirect method.”* Thus, entity may choose its preferred method.

The presentation and difference between the two methods is in the reporting of the cash flows from operating activities as presented in Figure 1.

Figure 1



**References**

<https://www.universalcpareview.com>

Malaysian Financial Reporting Standard 107 (MFRS 107), Statement of Cash Flows. Malaysian Accounting Standards Board.