PREPARATION OF CASH FLOW STATEMENT WITHIN ACCOUNTING SYSTEM

Thesis submitted to the

Institute of Social Sciences

in partial fulfillment of the requirements

for the degree of

Master of Arts

in

Management

by

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Fatih University

July 2003

Anne ve Babama ...

To My Parents...

FATİH ÜNİVERSİTESİ
SOSYAL BİLİMLER ENSTİTÜSÜ MÜDÜRLÜĞÜ
YÜKSEK LİSANS TEZ SINAV TUTANAĞI

08 / 08 /2003

Enstitümüz İşletme Anabilim Dalı yüksek lisans öğrencilerinden 51020108 numaralı Ender Boyar'ın hazırlayarak Enstitümüze teslim ettiği "*Preparation of Cash Flow Statement Within Accounting System*" adlı tezi, tez jüri üyeleri huzurunda .....60....... dakika süre ile savunulmuş ve sonuçta adayın tezi hakkında, ...oybirliği............ (*) ile ....kabul............... (**) kararı verilmiştir.

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AUTHOR DECLARATIONS

1. The material included in this thesis has not been submitted wholly or in part for any academic award or qualification other than that for which it is now submitted.

2. The program of advanced study of which this thesis is part has consisted of:

i) Research Methods course during the undergraduate study

ii) Examination of several thesis guides of particular universities both in Turkey and abroad as well as a professional book on this subject.

Ender Boyar

July, 2003

ABSTRACT

ENDER BOYAR **July 2003**

PREPARATION OF CASH FLOW STATEMENT WITHIN ACCOUNTING SYSTEM

Usually CFS is prepared at the end of period using income statement and beginning – ending balance sheets. However, we think that also it can be produced independent of balance sheets and income statement using parallel accounts for this purpose, which will be more useful.

Since the transactions occurred during period are recorded depending on the accrual basis; we can not prepare a CFS depending on the Adjusted trial balance as we depend for preparation of Balance Sheet & Income Statement. Therefore, we should take the income statement for the period and beginning & ending balance sheets to prepare a CFS for the period.

Our view is that it will be useful for managers to receive the CFS directly from the accounting system as we do for other financial statements instead of depending income statement & balance sheet together with some estimation usually needed when we prepare CFS at the end of accounting period. If CFS is to be prepared directly from the accounting system, then it is compulsory to follow a different method for recording the transactions during period. Therefore the starting point of our approach is to develop such a method.

Our method will be integrated to the accounting system. We will use class 8th of accounts in Turkish Uniform Chart of Accounts for the suggested method of recording transactions. In this process, the controlling (general ledger) account names will be determined in accordance with the direct method of preparation for Cash Flows from operating activities.

Key words:

Cash Flow Statement Statement of Cash Flows During Period

Financial Statement Parallel Accounts Chart of Accounts

Uniform Chart of Accounts Accounting System

KISA ÖZET

ENDER BOYAR **Temmuz 2003**

NAKİT AKIŞ TABLOSUNUN DÖNEMİÇİ MUHASEBE SÜRECİNDE HAZIRLANMASI

Nakit akış tabloları genellikle, dönembaşı ve dönemsonu bilançoları ile gelir tablosunu kullanarak dönem sonunda hazırlanmaktadır. Ancak kanaatimizce nakit akış tablosunun bilançolar ve gelir tablosundan bağımsız olarak hazırlanmasında kullanılacak bilgiler de ana ve yardımcı hesaplara yardımıyla dönem içinde muhasebe sistemine katılabilir.

İşlemler dönem içerisinde tahakkuk esasına göre kaydedilmesinden dolayı, nakit akış tablosu mizana bağlı olarak hazırlayamayız. Nakit akış tablosunun hazırlanabilmesi için dönemsonunun beklenmesi gerekir.

Bize göre, nakit akış tablosu hazırlanırken, bilanço ve gelir tablosundan alınan ve bazı öngörü ve tahminler de gerektirebilen veriler yerine bunların doğrudan sistem içerisinden alınması yöneticiler açışından daha faydalı olacaktır.

Dönem içerisinde süreçte sözkunusu verilerin derlenebilmesi için farklı bir yöntem takibi gerekmektedir. Bizim amacımız, bu yöntemin geliştirilmesidir.

Bizim yöntemimiz, mevcut tek düzen hesap planına entegre edilecektir. İşlemlerin kaydında 8 numaralı hesaplar kullanılacaktır. Kullanılacak hesap isimleri, faliyetlerle ilgili nakit akışının sunumunda kullanılan dolaysız yönteme uygun olarak belirlenmiştir.

Anahtar Kelimeler

Nakit Akış Tablosu	Nakit Akım Tablosu	Finansal Tablolar
Mali Tablolar	Yardımcı Hesaplar	Dönem İçi
Dönem Sonu	Tek Düzen Hesap Planı	Hesap Planı

LIST OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

AAA	American Accounting Association
AICPA	The American Institute of Certified Public Accountants
APB	Accounting Principles Board – USA
ASB	Accounting Standards Board – UK
CFS	Cash Flow Statement
FRS	Financial Reporting Standards – UK
FAS	Financial Accounting Standards – USA
FASB	Financial Accounting Standards Board – USA
GAAP	Generally Accepted Accounting Principle
IAS	International Accounting Standards
IASC	International Accounting Standards Committee
SCFP	Statement of Changes in Financial Position
SEC	Securities and Exchange Commission – USA
SPK	Sermaye Piyasası Kurulu
TMS	Türk Muhasebe Standardı
USA	United States of America

PREFACE

The systematic of preparation of Income statement inspired us on new method to prepare Cash Flow Statements. According to Turkish Uniform Chart of Accounts the information accumulated on the main class 6^{th} gives us Income Statement when submitted in that format. Why not we make some records during period depending on cash basis using the main class 8^{th} which will give us same result for preparing a Cash Flow Statement.

We propose to make the necessary journals when transactions occur during period to prepare the Cash Flow Statement parallel to the accrual based records.

I would like to thank my thesis advisor Professor Dr. Mustafa Dilber and Professor Dr. Necdet Şensoy for their contributions. This thesis may not have been completed without their advises. I also thank to my undergraduate Accounting lecturer Professor Dr. Orhan Sevilengül who affected me loving lectures of accounting.

INTRODUCTION

Cash flow statement is a topic, which is having greater importance in the recent years. Cash flow statement gradually replaced fund flow statement. The reason for this shift is the insufficiency of balance sheets and income statements in financial analyses.

Cash flow statements are very important for financial managers and investors since they are based on cash. Through Cash Flow Statements, financial managers and investors find the opportunity to see cash basis along with balance sheets and income statements, which are based on accrual.

Cash flow statement was generated from funds flow statement in the historical process. As known, funds flow statement can be defined in three ways. We can reach cash flow statement if we define funds as cash. Since cash flow statements have been considered in such a way from the beginning, scholars of finance could nothing to organize cash flow statements in a different way.

In this study, we aim to examine cash flow statements in a different perspective and then suggest a different kind of statement for cash flows rather than the conventional one.

Within this direction, we will use class 8th accounts of Turkish Uniform Chart of Accounts. Because these accounts are free and can be used in accordance with the requirements of business entities.

In so doing, we will utilize the logic of income statement. Accordingly, income statement can be reached organizing the class 6^{th} accounts. In this reasoning, we aim to reach cash flow statements through ascending class 8^{th} accounts.

This study consists of four sections. In section I, the theoretical background about financial statements, periodicity principle, accrual basis and cash basis, and relations between financial statements will be given.

Section II is devoted to explore the conventional understanding of cash flow statements. Herein, we use a simple case to explain the topic. Our suggested method will be introduced in section III. We also give main 8^{th} class of chart of accounts and its explanations in this section.

Finally, in section IV, we will compare the conventional and new method through a case study. By so doing, we will find the opportunity to see advantages and disadvantages of these two methods.

CHAPTER 1

1. THEORETICAL BACKGROUND

1.1. Financial Statements

1.1.1. Balance Sheet

The balance sheet is a financial statement representing the financial position of the business at one point in time. This statement includes the list of the assets, the list of the short and long-term liabilities and the equities of the businesses.

As will be explained in the accounting equity, the left side of the balance sheet covers the assets (short and long-lived assets) and the right side refers to the resources of the assets (outside resources as liabilities and inside resources as equity capital).

In other words, left side is the list of the properties of the business and the right side is the list of the payers of the properties. As an assumption; the current assets are supposed to be paid by the short-term borrowers who are shown in the short-term liabilities and the fixed assets are supposed to be paid by the long-term borrowers who are shown in the long-term liabilities or by the capital depositors.

A balance sheet heading includes the name of the business, the name of the statement and the preparation date of the statement (as the balance sheet is the snap shot of the business, there will be a single date).

The balance sheet is represented by two lines traced as a big "T". The heading information explained above will take place at the upper part of the horizontal line. The assets (current and non-current) will take place at the left side of the vertical line in the ascending order as given in the chart of accounts. The liabilities (short and long term) and the equity capital will be placed at the right side of the vertical line still in the ascending order.

The accounts used in the Income Statement will be transferred into the Balance Sheet by their periodical results (to Net Profit 590 or Net Loss 591 of the Period) to the related account in the Equity Capital accounts class.

The balance sheet equation is affected and changed by the financial transactions occurred during the period. According to the double entry bookkeeping method every transaction will be recorded on at least two accounts protecting the current equation.

As seen in journalizing the transactions, a journal record has debit and credit sides so, the accounts used mutually are representing the effects of the transaction on the properties or on the liabilities of the business.

Posting the journal record to the general ledger book means to classify the accounts used in the journal book according to the balance sheet. The accounts classified in the ledger book will have debit or credit balances and the accounts with debit balances will be representing the assets of the balance sheet and the accounts with credit balances will be representing the liabilities or the equity capital of the business. (Yarbaşı, 2001)

1.1.2. The Statement of Changes in Owner's Equity

The statement of owner's equity summarizes the increases and decreases in the amount of owner's equity during the accounting period. Increases result from earning net income and from additional investments by the owner; decreases result from net losses and from withdrawals of assets by the owner.

The owner's equity at the beginning of the period may be obtained from the ledger or from the balance sheet of the preceding period. As we have just illustrated, the amount of net income or net loss for the period is determined in the company's income statement. Additional investments by the owner may be determined by reviewing the credit column of the owner's capital account in the ledger. Withdrawals during the period are indicated by the balance in the owner's drawing account. By adjusting the beginning amount of owner's equity for the increases and decreases occurring during the period, we are able to determine the owner's equity at the end of the period. (Larson, Wild, & Chiapetta, 2002; Meigs, Williams, Haka, & Bettner, 1999)

1.1.3. Income Statement

The Income Statement shows the results of the ordinary and extraordinary operations for a given period of time. The items of the income statement, the revenues, the costs and the expenses, assigned to the period, are taken from the adjusted trial balance.

According to the "Accrual Basis Accounting System", the revenues are the positive value deserved due to an operation and the cost or the expenditure is the negative value consumed in order to obtain a surplus. In Turkish uniform accounting system, according to the Periodicity Principle (also called Matching Principle), the income obtained in a given period of time has to be compared with the expenditure of the same period of time.

An income statement heading includes the name of the business, the name of the statement and the period covered by the statement (the beginning and the ending dates must be shown clearly).

In the body of the income statement there are three fields, which are the sales, the Cost of Sales and the Expenses. The residual amount obtained by subtracting the cost of sales from the net sales is called Gross Profit (or Gross Loss if negative the amount obtained by subtracting the Expenses from the Gross profit is called Net Profit (or cold if negative)of the Period.

At the end of the periods the income statement accounts have to be closed by reversing records after preparation of the statement. These accounts are transferred to temporary summary accounts first and then to the profit or loss accounts in the equity capital accounts group of the balance sheet. Therefore, at the end of the periods, the sales, the cost of sales and the expense accounts are set back to zero.

In the preparation of the Income Statement, the rules given in the Principles of Financial Statements have to be applied. The income obtained from the main operations, the Incas obtained from other ordinary operations which are perpetual but not defined in the main operations and the income from the extraordinary operations which are for once only are indicated in different groups. So, the expenditures for the main operations, the expenditures for the ordinary operations not stated in the main operations and the expenditures for the extraordinary operations are indicate also in different groups.

It is not possible to deduct the accounts in the preparation of the financial statements. The Income or expenditure accounts indicated as "Other" cannot of exceed 20% of the group they are included. Upon they exceed, they are represents in a separate account. (Yarbaşı, 2001)

1.1.4. Statement of Cash Flows

The statement of cash flows describes the sources (inflows) and uses (outflows) of cash for a reporting period. It also reports the amount of cash at both the beginning and end of a period. The statement of cash flows is organized according to a company's major activities: operating, investing, and financing. A company must carefully manage cash if it is to survive and prosper. (Larson et al., 2002)

1.2. Periodicity Principle

The value of information is often linked to its timeliness. Useful information must reach decision makers frequently and promptly. To provide timely information, accounting systems prepare reports at regular intervals. This results in an accounting process impacted by the time period (or periodicity) principle. The time period principle assumes that an organization's activities can be divided into specific time periods such as a month, a three-months quarter, or a year. Time periods covered by statements are called accounting, or reporting, periods. Most organizations use a year as their primary accounting period. Reports covering a one-year period are known as annual financial statements. Many organizations also prepare interim financial statements covering one, three, or six months of activity.

The annual reporting period is not always a calendar year ending on December 31. An organization can adopt a fiscal year consisting of any 12 consecutive months. It is also acceptable to adopt an annual reporting period of 52 weeks.(Larson et al., 2002)

1.3. Accrual Basis and Cash Basis

Accrual basis accounting uses the adjusting process to recognize revenues when earned and to match expenses with revenues. This means that the economic effects of revenues and expenses are recorded when earned or incurred, not when cash is received or paid.

Cash basis accounting means that revenues are recognized when cash is received and expenses are recorded when cash is paid. For example, if a business provides services in December but does not receive cash from clients until January, then cash basis accounting reports this revenue in January. This means that cash basis net income for a period is the difference between cash receipts and cash payments. Cash basis accounting for the income statement, b alance sheet, and statement of changes in owner's equity is not consistent with accepted accounting principles. It is commonly held that accrual accounting better indicates business performance than information about cash receipts and payments. Accrual accounting also increases the comparability of financial statements from one period to another. Yet many companies and users of statements still find cash basis accounting useful for several internal reports and business decisions. While accrual basis accounting is generally accepted for external reporting, information about cash flows is also useful and is the reason companies must report a statement of cash flows.(Larson et al., 2002)

1.4. Relations between Financial Statements

The statement of financial position (balance sheet), the income statement, and the statement of cash flows are all based on the same underlying transaction information, but they present different "views" of the company. They should not be thought of as alternatives to each other; rather, all are important in terms of presenting key financial information about the company.

The following diagram explains how the three financial statements relate to the period of time they cover. The horizontal line represents time. At the beginning and ending points in time, the company prepares a statement of financial position that gives a static look in financial terms o where the company stands. The other two financial statements cover the intervening period of time between the two balance sheets and help explain important changes that occurred during the period.

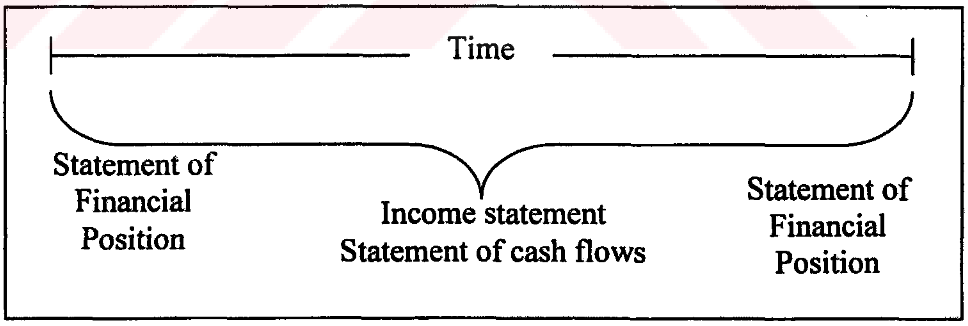

Figure 1-1 Financial statements related to the accounting
Source: (Meigs et al., 1999)

If we understand where a company stands financially at two points in time, and if we understand the changes that occurred during the intervening period in terms of the company's profit-seeking activities and its cash, we know a great deal about the company that is of value in assessing the future cash flows of the company-information that is useful to investors, creditors, management, and others.

Because the balance sheet, income statement, and statement of cash flows are derived from the same underlying financial information, they are said to articulate, or relate closely to each other. The following diagram indicates relationships three financial statements. (Sensoy, 2002)

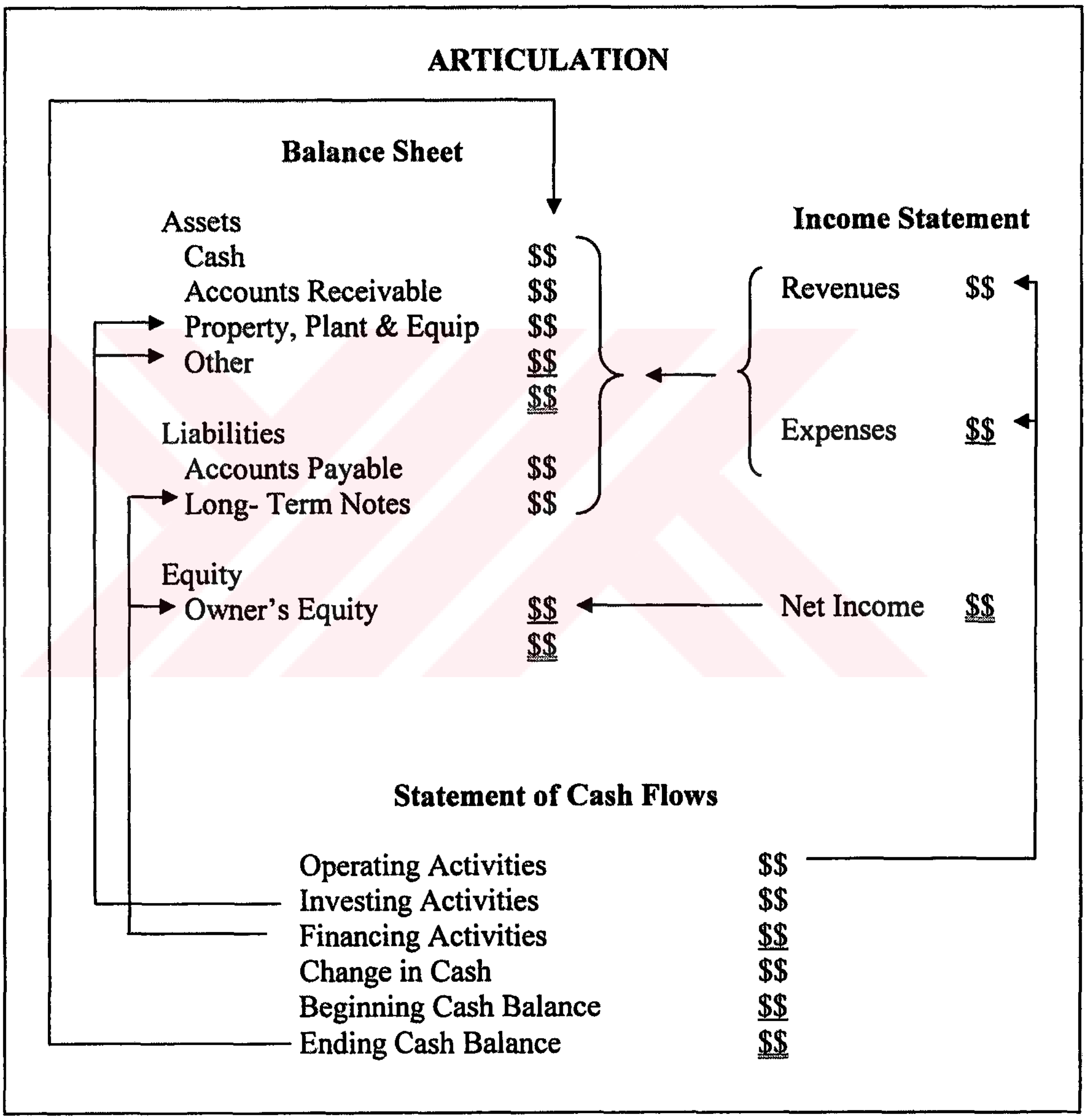

Figure 1-2 Articulation

Source: (Meigs et al., 1999)

The balance sheet represents an expansion of the accounting equation and explains the various categories of assets, liabilities, and owner's equity. The income statement explains changes in financial position that result from profit – generating transactions in terms of revenue and expense transactions. The resulting number, net income represents an addition to the owner's equity in the enterprise. The statement of cash flows explains the ways cash increased and decreased during the period in terms of the enterprise's operating, investing, and financing activities. This relationship among the financial statement is called articulation. (Meigs et al., 1999)

CHAPTER 2

2. STATEMENT OF CASH FLOWS

2.1. History of Cash Flow Statement

In 1960's and 1970's statement of cash flows was used under the name of funds flow reporting and it was used by financial statement users and accounting theorist, for long time. Also, the authoritative regulatory bodies were requiring inclusion of fund flow statements in companies financial reports.(Hoskin, 1997)

The term funds is always associated with cash or working capital. Not many companies used the cash on cash equivalents concepts of funds in those times. Rather, "funds" was used more. However, the differences, which cause in the reporting formats and in the statements caused incomparability among these statements.

For this reason, in statement of concepts No. 5 the FASB concluded that cash flows should be stated in the financial statements and footer. In 1987 it was named as "STATEMENT OF CASH FLOW".

Nowadays, it is very common for a company to provide statement of cash flow. However it is not required in some countries, such as Germany and Netherlands. It is worth mentioning that this concept is also used as "STATEMENT OF CHANGES IN FINANCIAL POSITION"

The main activity of this concept is that it uses working capital and it is constituted of assets and liabilities and it is used for daily operating on the firm. Thus to sustain sufficient amount of working capital is very important for the company. (Holmes & Sugden, 1994; Hoskin, 1997; Lanny, Flaherty, & O'connor, 1998)

In fact, cash flow statements are the format of Statement of Changes in Financial Position which funds are defined as cash. (Sensoy, 2002)

Using of cash flow statements in Turkey began in 29.01.1989 in the official newspaper and according to which it is necessary for companies that have total assets, above 2.757,6 billion Turkish Lira or total sales 6.128 billion Turkish Lira to report statement of cash flow. This amount, is as of year 2002. (1$ = 1.463.000 TL in 27.05.2003) For the companies whose assets and sales are below this before mentioned amount it is recommended to prepare cash flow statements. However, the companies that are registered in SPK (Turkish SEC) cash flow statements reporting is necessary.(Selek, 1997; Sensoy, 2002)

2.2. Usefulness of Cash Flow Statement

The purpose of statement of cash flows is to provide information about cash payments and cash receipts of the entity, and also to provide information about financing and investing activities of the company. The contribution of statement of cash flows to the investors, creditors and others is as follows:

- It helps to see company's ability to generate cash flow.
- It helps to see company's ability to pay dividends.
- To see why there is differences between net income and related net cash flows from operating activities.
- To see the changes of cash and cash equivalents between the beginning and the end of the period.
- Is financing obtained through the issuance of securities dept an equity?
- Is cash obtained for disposal of long lived assets?
- How long can the company operate at a loss and generate cash inflows?
- Is company making capital expenditures to modernize equipment?
- Solvency, liquidity and financial flexibility of the company.

To sum up, statement of cash flows helps its users to evaluate company's ability in short and long term basis.(Lanny et al., 1998; Meigs et al., 1999; Smith, Robert, & William, 1989)

2.3. Cash and Cash Equivalents

Cash equivalents are short –term and highly liquid investments. The most common of these are money market funds, commercial paper and treasury bills.(Hoskin, 1997; Meigs et al., 1999)

2.4. Major Parts of Cash Flows

The cash flow is grouped into three major categories and these categories include (1) operating activities, (2) investing activities, and (3) financing activities. (Meigs et al., 1999) I will now try to relate cash flow within these categories.

Statement of cash flow should be related to activity format. According to this activity format cash inflows and outflows are grouped according to operating, investing and financing activities. Following I will explain each of these activities each briefly. Firstly, operating activities are focused on company's revenue generating activities and also cash effects of transactions and economic events that are included in income. Lending money and collection of loans, buying and selling assets and buying and selling securities. Lastly financing activities are focused on borrowing money and repaying the borrowed money, and obtaining resources from owners and providing them with dividends. (Lanny, Flaherty, & O'connor, 1989)

SFAS 95 mentions the cash flows of the companies and their classification. As mentioned before, the components are distinguished according to financing, investing, and operating activities. (Hoskin, 1997)

Structure of the Statement of Cash Flows

Statement of cash flows is divided into three sections:

1. Cash flows from operating activities
2. Cash flows from investing activities
3. Cash flows from financing activities

How these statements are prepared can be easily understood if we give an example.(Smith et al., 1989)

International Perspective from Other Countries

According to US GAAP the cash flows are categorized differently than in other countries.

In UK GAAP cash flows are categorized into five sections. Under FRS1 these five section are (a) operating activities; (b) returns on investments and servicing of finance;) (c) taxation, (d) investing activities; and (e) financing activities. It is different compared to SFAS 95 which requires only three categories as mentioned before (a) operating; (b) investing; and (c) financing.

Cash flows that are coming from taxation and returns on investments and servicing of finance are grouped as operating activities in SFAS 95 dividends are recognized as financing activity in SFAS 95. Additionally, short term borrowings with maturities less than 90 days are included in cash and cash equivalent statements.

In Canada, cash flows are grouped into three categories under operating, investing, and financing activities. The main difference is that dividends can appear both in the financing and operating sections. It is not required supplemental disclosure of interest and tax payments under Canadian GAAP.

In Mexico, its GAAP requires financial statements to be adjusted according to the inflation. It is worth mentioning that, SFAS 95 does not point out how these gains and losses from adjustment should be adjusted. (Hoskin, 1997)

2.4.1. Cash Flows From Operating Activities

The operating activities are mainly concerned with the cash effects of revenue and expense transactions. Operating activities include the cash effects of those transactions that are reported in the income statement. For better grasping this concept, credit sales effects is mentioned. Credit sales are reported in the income statement in the period when the sales occur. But it is well known that the cash is collected later. Hence, if these sales and cash collection occur in different periods than the income statement and statement of cash flow will be different from each other. Moreover, these could be similar differences between the recognition of an expense and the cash payment. Cash flows from operating activities include:

Cash Receipts

- Collections from customers for sales of goods and services
- Interest and dividends received
- Other receipts from operations, as, for example, proceeds from settlement of litigation

Cash Payments

- Payments to suppliers of merchandise and services, including payments to employees
- Payments of interest Payments of income taxes
- Other expenditures relating to operations, as, for example, payments in settlement of litigation

It is important to mention that receipts and payments of interest are classified as operating activities. (Meigs et al., 1999)

Operating activities are known as covering all other transactions that are not covered by financing or investing activities. Typically, cash flows from the sales of goods and services are included in operating section. Other transaction that are grouped under operating activities are current assets and current liabilities. Collection of revenues is the major cash inflow. On the other hand the major cash outflow is the payment to suppliers. Also, taxes are noted in the operating section under SFAS 95. (Hoskin, 1997)

Critical Importance of Cash Flows from Operating Activities

If the company is to survive it must generate positive net cash flows in the long run. If the company has negative cash inflow it can not get cash from other sources. The operating activities section is the main indicator for a firm in terms of raising cash. If the company does not generate cash from its operating activities then creditors and stockholders would not invest in a company. Also, company can not provide cash from plant assets, investments, and other assets. (Meigs et al., 1999)

Operating activities include the activities of producing and delivering goods and providing services. There are two ways to prepare the operating activities: direct and indirect method. Direct method includes the major classes of cash receipts and cash payments such as cash from customers, interest, and dividend, cash paid to employees and suppliers. Direct method is supported by FASB. There is also use of indirect method which is allowed by the board of FASB. (Smith et al., 1989)

Next, I will consider the indirect method.

2.4.1.1. Indirect method

Indirect method reconciles net income for the period to cash flows from operating activities by removing effects of changes in items as receivables, payables, inventories, prepaid and accruals.

Compared to direct method indirect method is used much more because it is easier to learn (Smith et al., 1989) Companies reporting cash flows using indirect format 97%, direct format 3% (Wild, Bernstein, & Subramanyam, 2001)

To see clearly, how the indirect method works we take ABC Company and its balance sheet as of December 31, 2002, illustrated in Table 2 -1.

Table 2-1 : Balance Sheet of ABC Company, Dec., 31, 2002

ABC Company Balance Sheet December 31, 2002		
Cash	9.000.000 TL	
Account Receivable	20.000.000 TL	
Inventory	10.000.000 TL	
Net Property, Plant, and Equipment	30.000.000 TL	
Investment	5.000.000 TL	
Total Assets		**74.000.000 TL**
Account Payable	6.000.000 TL	
Common Stock	50.000.000 TL	
Retained Earnings	18.000.000 TL	
Total Liabilities and Stockholders' Equity		**74.000.000 TL**

The company had five transactions for 2003; these transaction were, in general journal entry form:

Account Receivable	40.000.000	
Sales		40.000.000
To record sales on account.		
Cost of Goods Sold	25.000.000	
Inventory		25.000.000
To record the cost of inventory sold.		
Cash	45.000.000	
Account Receivable		45.000.000
To record the collection of accounts receivable.		
Inventory	35.000.000	
Account Payable		35.000.000
To record acquisition of inventory.		
Account Payable	32.000.000	
Cash		32.000.000
To record payment of accounts payable.		
Expenses	5.000.000	
Accumulated Depreciation		5.000.000
To record depreciation expenses		

After these transactions are recorded, ABC Company prepares an income statement and comparative balance sheets.

Table 2-2 : Income Statement of ABC Company, Jan., 1, 2003 - Dec., 31, 2003

ABC Company Income Statement January 1, 2003 - December 31, 2003	
Sales	40.000.000 TL
Cost of Goods Sold	(25.000.000)TL
Depreciation expenses	(5.000.000)TL
Net Income	**10.000.000 TL**

Table 2-3 : Comparative Balance Sheet of ABC Company, Dec., 31, 2003

ABC Company Comparative Balance Sheet December 31, 2003	**2003**	**2002**
Cash	22.000.000 TL	9.000.000 TL
Account Receivable	15.000.000 TL	20.000.000 TL
Inventories	20.000.000 TL	10.000.000 TL
Net Property, Plant, and Equipment	30.000.000 TL	30.000.000 TL
Less: Acc. Depr	(5.000.000)TL	
Investment	5.000.000 TL	5.000.000 TL
Total Assets	**87.000.000 TL**	**74.000.000 TL**
Accounts Payable	9.000.000 TL	6.000.000 TL
Common Stock	50.000.000 TL	50.000.000 TL
Retained Earnings	28.000.000 TL	18.000.000 TL
Total Liabilities and Stockholders' Equity	**87.000.000 TL**	**74.000.000 TL**

Table 2-4 : CFS (indirect) of ABC Company, Jan., 1, 2003 - Dec., 31, 2003

ABC Company Statement of Cash Flows January 1, 2003 - December 31, 2003	
Cash Flows from Operating Activities: Adjustment to reconcile Net Income to Net Cash Provided by Operating Activities:	
Net Income	10.000.000 TL
Depreciation Expenses	5.000.000 TL
Decrease in Account Receivable	5.000.000 TL
Increase in Inventory	(10.000.000)TL
Increase in Accounts Payable	3.000.000 TL
Net Cash Provided by Operating Activities	**13.000.000 TL**
Cash and Cash Equivalents at Beginning of Year	9.000.000 TL
Cash and Cash Equivalents at End of Year	**22.000.000 TL**

As the expense regarding inventory, Cost of Goods Sold is 25.000.000 TL. But the amount of cash *paid* for this purpose was 32.000.000 TL, which is higher 7.000.000 TL. And that is precisely the sum of the differences between the inventory increase (10.000.000 TL) and the accounts payable increase (3.000.000 TL).

By adding or subtracting the differences in the Accounts Receivable, Inventory, and Account Payable accounts (actually, all the current items other than cash) to the net income for the period, a reconciliation can be made between the net income figure and the amount of cash flows from operations for the period.

The following analysis show how changes in the current accounts can be added or subtracted from net income to determine the amount of cash flows from operations:

Table 2-5 : Analysis of difference between accrual and cash basis

	Accrual Basis	Cash Basis	Difference	Decrease Accounts Receivable	Increase Inventory	Increase Accounts Payable	Depreciation Expenses
Sales / Cash from Customers	40.000.000	45.000.000	5.000.000	+5.000.000			
Expenses / Cash outflow to operations	30.000.000	32.000.000	2.000.000		-10.000.000	+3.000.000	+5.000.000
Net Income	10.000.000	13.000.000	3.000.000	+5.000.000	-10.000.000	+3.000.000	+5.000.000

The difference between accrual-basis sales 40.000.000 TL and cash basis sales of 45.000.000 TL is 5.000.000 TL, the decrease in account receivable. The difference between accrual-basis expenses of 30.000.000 TL and cash-basis expenses of 32.000.000 TL is 2.000.000 TL, which matches the 10.000.000 TL increase in inventories, 3.000.000 TL increase in account payable and the 5.000.000 TL depreciation expenses. The difference between accrual-basis net income of 10.000.000 TL and cash-basis net income of 13.000.000 TL is 3.000.000 TL, the sum of the increases and decreases to the current accounts.

The net income figure (10.000.000 TL) is adjusted by adding 5.000.000 TL for the decrease in accounts receivable. In addition, the increase in inventory of 10.000.000 TL must be subtracted, in accounts payable of 3.000.000 TL and the increase Depreciation Expenses 5.000.000 TL must be added to net income to determine the 13.000.000 net cash flows from operating activities. The 13.000.000 TL is the difference between the December 31, 2003, cash balance of 22.000.000 and the December 31, 2002, cash balance of 9.000.000 TL.

2.4.1.2. Direct method

Under the direct method company is allowed to make a choice in terms of that it can collect data so as to report cash receipts and cash payments by classifications or it can convert year – end financial data from accrual basis to a cash basis. (Smith et al., 1989)

Table 2-6 : Converting Accrual Operations to Cash Basis, Beginning Balances

ABC Company
Converting Accrual Operations to Cash Basis
Beginning Balances

Cash			Accounts Payable	
Beg.bal.	9.000.000		Beg.bal.	6.000.000
End.bal.	22.000.000		End.bal.	9.000.000

Account Receivable			**Common Stock**	
Beg.bal.	20.000.000		Beg.bal.	15.000.000
End.bal.	15.000.000		End.bal.	15.000.000

Inventory			**Retained Earnings**	
Beg.bal.	10.000.000		Beg.bal.	18.000.000
End.bal.	20.000.000		End.bal.	28.000.000

Net Property, Plant and Equipment			**Accumulated Depreciation**	
Beg.bal.	30.000.000		Beg.bal.	0
End.bal.	30.000.000		End.bal.	5.000.000

Investment			**Sales**	
Beg.bal.	5.000.000			
End.bal.	5.000.000			

Expenses	

To convert accrual sales to cash sales requires an assumption that all sales for the period are made on account. The total sale from the income statement was 40.000.000 TL. If that amount is posted as a credit to the Sales, account it must also be posted as a debit to the Account Receivable account.

Since the beginning balance is 20.000.000 TL, credit sale amount to 40.000.000 TL, and the ending balance is 15.000.000 TL, 45.000.000 TL must have been collected (20.000.000 TL + 40.000.000 TL = 60.000.000 TL due -15.000.000 TL ending balance = 45.000.000 TL). 45.000.000 TL credit in Account Receivable and a corresponding debit to the Cash account.

The inventory account had a beginning balance of 10.000.000 TL and an ending balance of 20.000.000 TL, and the cost of the inventory sold was 25.000.000 TL. Thus must have been 35.000.000 of inventory acquired on account, causing a debit to Inventory and a credit Accounts Payable.

The beginning balance of Account Payable was 6.000.000 TL purchases acquired on account amounted to 35.000.000 TL, and the ending balance of Account Payable was 9.000.000 TL. Therefore, 32.000.000 TL of the accounts must have been paid in Cash.

Table 2-7 : Converting Accrual Operations to Cash Basis, Converting Sales and Expenses

ABC Company
Converting Accrual Operations to Cash Basis
Converting Sales and Expenses

Cash

Beg.bal.	9.000.000		
Collections	45.000.000	Payments	32.000.000
End.bal.	22.000.000		

Accounts Payable

		Beg.bal.	6.000.000
Payments	32.000.000	Purchases	35.000.000
		End.bal.	9.000.000

Account Receivable

Beg.bal.	20.000.000		
Sales	40.000.000	Collections	45.000.000
End.bal.	15.000.000		

Common Stock

		Beg.bal.	15.000.000
		End.bal.	15.000.000

Inventory

Beg.bal.	10.000.000		
Purchases	35.000.000	Expenses	25.000.000
End.bal	20.000.000		

Retained Earnings

		Beg.bal.	18.000.000
		End.bal.	28.000.000

Net Property, Plant and Equipment

Beg.bal.	30.000.000		
End.bal.	30.000.000		

Accumulated Depreciation

		Beg.bal.	0
		Depr. Exp	5.000.000
		End.bal.	5.000.000

Investment

Beg.bal.	5.000.000		
End.bal.	5.000.000		

Sales

		Sales	40.000.000

Expenses (COGS)

Expenses	25.000.000		
Depr. Exp	5.000.000		
Expenses	30.000.000		

Table 2-8 : CFS (direct) of ABC Company, Jan.,1, 2003 - Dec., 31, 2003

ABC Company
Statement of Cash Flows
January 1, 2003 - December 31, 2003

Cash Flows from Operating Activities	
Cash Received from Customers	45.000.000 TL
Cash Paid to Suppliers	(32.000.000) TL
Net Cash Provided by Operating Activities	**13.000.000 TL**
Cash and Cash Equivalents at Beginning of Year	9.000.000 TL
Cash and Cash Equivalents at End of Year	**22.000.000 TL**

If a company use direct method, the cash flow from operating activities must be calculated under indirect method and shown in a schedule under the none of reconciliation of net income to net cash flows from operating. The main reason for this different schedule is that to have articulation between income statement and statement of cash flows. Articulation means relation in this concept.(Smith et al., 1989)

2.4.1.3. Comparison between direct and indirect method

Actually, the two methods of computing operating activities are very similar since both methods are based on the same accounting data, computations are similar and the most significant accrual – based income statement amounts into cash flows by adjusting for changes in balance sheets.

Format is the only difference between the two methods. The format provides different type of information. Direct method informs these readers of the nature and money amounts of the specific cash inflows and outflows. On the other hand, indirect method emphasizes how cash flows from operating activities differ from net income. (Meigs et al., 1999)

Indirect method is used more frequently because users find it more logical since calculation begins with net income and operating cash flows is easily linked to net income. So users can better understand how income flows are correlated with cash flows. The main abjections against the indirect method are that the major sources of cash inflows and outflows from operating activities are not reported and also users of financial statement can make mistakes easily when adjusting net income with net cash which is provided by operating activities. For example, depreciation is viewed as a source of funds or cash because it is added to net income under indirect method.

Proponents of direct approach argue that it is less confused so that it shows cash inflows from customers and others, and cash outflows for merchandise, salaries, interest, taxes and operating items. Moreover, it provides more information since the requirement for direct analysis to be accompanied by indirect reconciliation.

Lastly, direct approach is more understandable and also statement of cash flows is more logical and simple because these cash flows ore not subject to recognition, measurement or estimation issues. Another, interesting point is that much of the mystery cash flows reporting can be attributed to indirect approach. (Lanny et al., 1998)

2.4.2. Cash Flows From Investing Activities

Transactions involving plant assets, intangible assets, and investments are primarily the cash flows of investing activities. The followings are cash flows that are related to investing activities;

Cash Receipts

Cash proceeds from selling investments or plant assets

Cash proceeds from collecting principal amounts on loans

Cash Payments

Payments to acquire investments or plant assets

Amounts advanced to borrowers (Meigs et al., 1999)

The accounts in balance sheets that are classified as long term assets, are included under investing activities. Some of these transactions to be mentioned would be investment in property, plant, and equipment and its sale, and also investment in long-term marketable securities.(Hoskin, 1997)

Lastly, FASB includes investing activities such as making and collecting loans, acquiring and disposing of debt, plant, and equipment.

In order to show investing activities two more accounts are added to ABC Company's balance sheet. These account are Net property, Plant, and Equipment; and Investments

Table 2-9 Balance Sheet of ABC Company, Dec., 31, 2002

ABC Company Balance Sheet, December 31, 2002		
Cash	9.000.000 TL	
Account Receivable	20.000.000 TL	
Inventory	10.000.000 TL	
Net Property, Plant, and Equipment	30.000.000 TL	
Investment	5.000.000 TL	
Total Assets		**74.000.000 TL**
Account Payable	6.000.000 TL	
Common Stock	50.000.000 TL	
Retained Earnings	18.000.000 TL	
Total Liabilities and Stockholders' Equity		**74.000.000 TL**

Cash flows from operating activities remain the same as before and the following three additional transactions occur:

Cash	8.000.000	
Net Property, Plant, and Equipment		8.000.000
To record the sale of certain equipment at its book value.		
Net Property, Plant, and Equipment	4.000.000	
Cash		4.000.000
To record the acquisition of equipment.		
Investments	2.000.000	
Cash		2.000.000
To record the acquisition of bonds to be held as a long-term investment		

The sale of the equipment was made at book value. None of these transactions affect the income statement, so net income remains the same. But the 2003 balance sheet will change, as will the cash flows statement.

The net effect of these investing activities was to add 2.000.000 TL (8.000.000 TL – 4.000.000 TL – 2.000.000 TL) to the cash balance and 2.000.000 TL to the Investment account, and to deduct 4.000.000 TL from Net Property, Plant, and Equipment account.

Table 2-10 Comparative Balance Sheet of ABC Company, Dec., 31, 2003

ABC Company Comparative Balance Sheet December 31, 2003		
	2003	**2002**
Cash	24.000.000 TL	9.000.000 TL
Account Receivable	15.000.000 TL	20.000.000 TL
Inventories	20.000.000 TL	10.000.000 TL
Net Property, Plant, and Equipment	26.000.000 TL	30.000.000 TL
Less: Acc. Depr	(5.000.000) TL	
Investment	7.000.000 TL	5.000.000 TL
Total Assets	**87.000.000 TL**	**74.000.000 TL**
Accounts Payable	9.000.000 TL	6.000.000 TL
Common Stock	50.000.000 TL	50.000.000 TL
Retained Earnings	28.000.000 TL	18.000.000 TL
Total Liabilities and Stockholders' Equity	**87.000.000 TL**	**74.000.000 TL**

Table 2-11 : CFS (indirect) of ABC Company, Jan., 1, 2003 - Dec., 31, 2003

ABC Company Statement of Cash Flows (Indirect Method) January 1, 2003 - December 31, 2003		
Cash Flows from Operating Activities:		
Net Income		10.000.000 TL
Adjustment to reconcile Net Income to Net Cash Provided by Operating Activities:		
Decrease in Account Receivable		5.000.000 TL
Increase in Inventory		(10.000.000) TL
Increase in Accounts Payable		3.000.000 TL
Depreciation Expenses		5.000.000 TL
Net Cash Provided by Operating Activities		**13.000.000 TL**
Cash Flows from Investing Activities:		
Proceeds from Disposal of Equipment	8.000.000 TL	
Purchase of Equipment	(4.000.000) TL	
Purchase of Investment Bonds	(2.000.000) TL	
Net Cash Provided by Investing Activities		**2.000.000 TL**
Net Increase in Cash and Cash Equivalents		15.000.000 TL
Cash and Cash Equivalents at Beginning of Year		9.000.000 TL
Cash and Cash Equivalents at End of Year		24.000.000 TL

Cash has increased by 15.000.000 TL this year. Cash has increased by 13.000.000 TL due to activities associated with the normal operations of the company. And in addition, cash has increased by 2.000.000 due to investing activities: the purchase of bonds and equipment and the disposal of other equipment.

2.4.3. Cash Flows From Financing Activities

The following items are cash flows that are classified under financing activities:

Cash Receipts

- Proceeds from both short-term and long-term borrowing
- Cash received from owners (as, for example, from issuing stock)

Cash Payments

- Repayment of amounts borrowed (excluding interest payments)
- Payments to owners, such as cash dividends

Repayment of amounts barrowed is related to repayment of loans. Also, it is worth mentioning that interest payments are considered under the section of operating activities. (Meigs et al., 1999)

In term of defining the concept of financing activities it can be stated that all activities which include obtaining resources from owners and other investors and also repaying owners and investors. Long – term liabilities or others equity ore the typical accounts to be classified as financing activities. Issuing common stock, bonds, mortgages, and other borrowings one the most common cash inflows. On the other side, dividends on stock, repurchase of stock, and repayment of dept are the cash outflows. It is critical to mention that cash flow of interest on debt is included in operating section compared to SFAS 95 in which it is included under financing. (Hoskin, 1997)

Financing activity, according to the FASB, includes obtaining resources from owners and providing them with a return on, and a return of, their investments, as well as borrowing money and repaying amounts borrowed. (Smith et al., 1989)

To illustrate cash flows from financing activities we will add only two more transactions to the last section of the cash flows statement.

Cash	10.000.000	
Common Stock		10.000.000
To record the issuance of common stock.		
Retained Earnings	3.000.000	
Cash		3.000.000
To record the payment of dividends.		

These transactions, together with those from the previous examples, will result in the following balance sheet and cash flows statements:

Table 2-12 Comparative Balance Sheet of ABC Company, Dec., 31, 2003

ABC Company Comparative Balance Sheet December 31, 2003		
	2003	**2002**
Cash	31.000.000 TL	9.000.000 TL
Account Receivable	15.000.000 TL	20.000.000 TL
Inventories	20.000.000 TL	10.000.000 TL
Net Property, Plant, and Equipment	26.000.000 TL	30.000.000 TL
Less: Acc. Depr	(5.000.000) TL	
Investment	7.000.000 TL	5.000.000 TL
Total Assets	**94.000.000 TL**	**74.000.000 TL**
Accounts Payable	9.000.000 TL	6.000.000 TL
Common Stock	60.000.000 TL	50.000.000 TL
Retained Earnings	25.000.000 TL	18.000.000 TL
Total Liabilities and Stockholders' Equity	**94.000.000 TL**	**74.000.000 TL**

Table 2-13 : CFS (indirect) of ABC Company, Jan., 1, 2003 - Dec., 31, 2003

ABC Company Statement of Cash Flows (Indirect Method) January 1, 2003 - December 31, 2003		
Cash Flows from Operating Activities:		
Net Income		10.000.000 TL
Adjustment to reconcile Net Income to		
Net Cash Provided by Operating Activities:		
Decrease in Account Receivable		5.000.000 TL
Increase in Inventory		(10.000.000) TL
Increase in Accounts Payable		3.000.000 TL
Depreciation Expenses		5.000.000 TL
Net Cash Provided by Operating Activities		**13.000.000 TL**
Cash Flows from Investing Activities:		
Proceeds from Disposal of Equipment	8.000.000 TL	
Purchase of Equipment	(4.000.000) TL	
Purchase of Investment Bonds	(2.000.000) TL	
Net Cash Provided by Investing Activities		**2.000.000 TL**
Cash Flows from Financing Activities:		
Proceeds from Issuing Common Stock	10.000.000 TL	
Dividends Paid	(3.000.000) TL	
Net Cash Provided by Financing Activities		**7.000.000 TL**
Net Increase in Cash and Cash Equivalents		22.000.000 TL
Cash and Cash Equivalents at Beginning of Year		9.000.000 TL
Cash and Cash Equivalents at End of Year		31.000.000 TL

The cash flows statement tells us that during 2003, ABC Company has had and increase in its Cash account of 22.000.000 TL: 13.000.000 TL came from operations, 2.000.000 TL from investing, and 7.000.000 TL from financing activities.

The ABC Company example developed each of the three sections by first showing the transactions that affected that activity.

The cash flows statement is made after the accounting period has ended and after the income statement and balance sheets have been prepared. This makes it more difficult to prepare the cash flows statement.

Why Are Receipts and Payments of Interest Classified as Operating Activities?

FASB decided to consider interest payments and dividends receipt as operating activity because they wanted to relate cash flows from operating activities to reflect the cash effects of revenue and expense transactions which enter into income. So as dividend, interest revenue and expense are related to net income, all these are included in operating activities. Since payments of dividends do not enter into determination of net income the are classified as financing activities. (Meigs et al., 1999)

2.5. Preparation of Cash Flow Statement

2.5.1. Preparation of Cash Flow Statement at the end of period

Statement of cash flow can be prepared in one of two ways: the T-account approach or the worksheet approach. The T-account approach is easier and faster but it is not as formal as the worksheet approach, and it does not provide documentation of the cash flows analysis. (Smith et al., 1989)

2.5.1.1. Reconstruction (T accounts)

In using T-account approach T-account for each balance sheet item should be established and beginning and ending balances should placed. It is necessary to prepare very comprehensive T-account for cash since it contains all the information for the preparation of the statement. Entries are recorded so as to reproduce the transactions during the period. Whenever cash is involved it is placed cash T-account in the proper section either operating, investing or financing.

T-account approach is very suitable which these are large number of transactions in a complex situation. (Smith et al., 1989)

Table 2-14 Income Statement of ABC Company, Jan., 1, 2003 – Dec., 31, 2003

ABC Company Income Statement January 1, 2003 - December 31, 2003	
Sales	40.000.000 TL
Cost of Goods Sold	(25.000.000)TL
Depreciation expenses	(5.000.000)TL
Net Income	**10.000.000 TL**

Table 2-15 Comparative Balance Sheet of ABC Company, Dec., 1, 2003

ABC Company Comparative Balance Sheet December 31, 2003		
	2003	**2002**
Cash	31.000.000 TL	9.000.000 TL
Account Receivable	15.000.000 TL	20.000.000 TL
Inventories	20.000.000 TL	10.000.000 TL
Net Property, Plant, and Equipment	26.000.000 TL	30.000.000 TL
Less: Acc. Depr	(5.000.000) TL	
Investment	7.000.000 TL	5.000.000 TL
Total Assets	**94.000.000 TL**	**74.000.000 TL**
Accounts Payable	9.000.000 TL	6.000.000 TL
Common Stock	60.000.000 TL	50.000.000 TL
Retained Earnings	25.000.000 TL	18.000.000 TL
Total Liabilities and Stockholders' Equity	**94.000.000 TL**	**74.000.000 TL**

Table 2-16 Statement of Retained Earnings of ABC Company, Dec., 31, 2003

ABC Company Statement of Retained Earnings Year Ended December 31, 2003	
Balance, Jan. 1, 2002	18.000.000 TL
Add: Net Income for the Year	10.000.000 TL
Deduct: Dividends Paid during 2003	-3.000.000 TL
Balance, Dec. 31, 2003	25.000.000 TL

The starting point for the T-account approach is to set up T-accounts for each balance sheet account and enter the beginning balance (BB) and ending balance (EB) as illustrated as follows:

Table 2-17 CFS T-Account Approach (Before Analysis) for ABC Company

ABC Company
Statement of Cash Flows
T-Account Approach
(Before Analysis)

Cash

BB	9.000.000	
Cash from Operating		
Cash from Investing		
Cash from Financing		
EB	31.000.000	

Account Receivable

BB	20.000.000		
EB	15.000.000		

Inventories

BB	10.000.000		
EB	20.000.000		

Net Property, Plant, and Equipment

BB	30.000.000		
EB	26.000.000		

Acc. Depreciation

		BB	0
		EB	5.000.000

Investment

BB	5.000.000		
EB	7.000.000		

Accounts Payable

		BB	6.000.000
		EB	9.000.000

Common Stock

		BB	50.000.000
		EB	60.000.000

Retained Earnings

		BB	18.000.000
		EB	25.000.000

Description and Analysis Transactions;

Transaction 1 : Reported income for the year was 10.000.000 TL as seen in the statement of retained earnings. The initial assumption is that all revenue involved an inflow of cash and all expenses involved an outflow of cash. Adjustments will be made to determine the actual cash flows. Since a positive net income figure is reported, an inflow is the initial assumption. The entry then is to debit Cash, to reflect the assumed increase in cash and to credit Retained Earnings.

Cash

BB	9.000.000	
	Cash from	***Operating***
1	10.000.000	

Retained Earnings

	BB	18.000.000
	1	10.000.000

1	Cash Flows from Operating Act.	10.000.000	
	Retained Earnings		10.000.000

Transaction 2 : When the Accounts Receivable account decreases during the year, this means that less accrual revenue has been earned than the amount of cash received. Thus, the accrual net income figure will be lower than the cash income figure. For this reason, we must add the decrease in receivables from the net income figure, by debit the cash flows from operating activities section of Cash in the analysis entry.

Cash

BB	9.000.000	
	Cash from	***Operating***
1	10.000.000	
2	5.000.000	

Accounts Receivable

BB	20.000.000		
		2	5.000.000
EB	15.000.000		

2	Cash Flows from Operating Act.	5.000.000	
	Accounts Receivable		5.000.000

Transaction 3 : The increase in the Inventories account indicates that during the year ABC Company bought 10.000.000 TL (20.000.000 – 10.000.000) more inventory than it sold. The 10.000.000 TL accrual net income figure must be reduced since the amount of purchases of merchandise is 10.000.000 TL greater than the cost of the good sold on the accrual basis.

Cash

BB	9.000.000		
	Cash from	***Operating***	
1	10.000.000		
2	5.000.000		
		3	10.000.000

Inventories

BB	10.000.000		
3	10.000.000		
EB	20.000.000		

3	Inventories	10.000.000	
	Cash Flows from Operating Act.		10.000.000

Transaction 4 : An increase in the Account Payable account indicates that cash inflow this period made in a prior period. The 10.000.000 TL accrual net income must be reduced by this additional cash inflow that does not appear on the income statement. This is accomplished by debiting the cash flows from operating activities section of Cash in the analysis entry.

Cash

BB	9.000.000		
	Cash from	***Operating***	
1	10.000.000		
2	5.000.000		
		3	10.000.000
4	3.000.000		

Accounts Payable

		BB	6.000.000
		4	3.000.000
		EB	9.000.000

4	Cash Flows from Operating Act.	3.000.000	
	Accounts Payable		3.000.000

Transaction 5 : Depreciation expense for the period was recorded by debiting Depreciation Expense, a noncash entry, and crediting Accumulated Depreciation. The analysis debits the cash flows from operating activities section of Cash to accomplish the objective of adding back this noncash item to net income. Accumulated Depreciation is credited because this was the original noncash account credited. Depreciation in not a source of cash. Depreciation adjusted the net income figure from the income statement by an item that did not involve cash to determine the income from operating activities on a cash basis. Assume a company has cash sales of 6.000.000 TL and the only expense it has is 1.000.000 of depreciation. That would be a net income of 5.000.000 TL. In order to determine the amount of cash flows from operations we have to add back the 1.000.000 TL depreciation to the accrual basis net income figure of 5.000.000 TL to arrive at the 6.000.000 TL cash flows from operations.

Cash

BB	9.000.000		
	Cash from	***Operating***	
1	10.000.000		
2	5.000.000		
		3	10.000.000
4	3.000.000		
5	5.000.000		

Acc. Depreciation

		BB	0
		5	5.000.000
		EB	5.000.000

5	Cash Flows from Operating Act.	5.000.000	
	Acc. Depreciation		5.000.000

Transaction 6 : A sales of Net Property was recorded during this years. Net Property is credited in the analysis entry to show 4.000.000 TL decrease in this account. The cash flows from investing activities section of Cash is debited to reflect the inflow of cash.

	Cash				Net Property, Plant, and Equipment		
BB	9.000.000			BB	30.000.000		
	Cash from	***Operating***				6	4.000.000
1	10.000.000			EB	26.000.000		
2	5.000.000						
		3	10.000.000				
4	3.000.000						
5	5.000.000						
	Cash from	***Investing***					
6	4.000.000						

6	Cash Flows from Investing Act.	4.000.000	
	Net Property, Plant, and Equipment		4.000.000

Transaction 7 : Investment is debited in the analysis entry to show the 2.000.000 TL increase in this account. The cash flows from investing activities section of Cash is credited to reflect the outflow of cash. The cash flows from operating activities section is not affected since the purchases of investment is not reflected on the income statement.

	Cash				Investment	
BB	9.000.000			BB	5.000.000	
	Cash from	***Operating***		7	2.000.000	
1	10.000.000			EB	7.000.000	
2	5.000.000					
		3	10.000.000			
4	3.000.000					
5	5.000.000					
	Cash from	***Investing***				
6	4.000.000					
		7	2.000.000			

7	Investment	2.000.000	
	Cash Flows from Investing Act.		2.000.000

Transaction 8 :ABC Company sold stock for 10.000.000 TL. This inflow of cash is reflected in the cash flows from financing activities section of Cash. The analysis entry shows the inflow as a debit and the credit to Common Stock.

Cash

BB	9.000.000		
	Cash from	***Operating***	
1	10.000.000		
2	5.000.000		
		3	10.000.000
4	3.000.000		
5	5.000.000		
	Cash from	***Investing***	
6	4.000.000		
		7	2.000.000
	Cash from	***Financing***	
8	10.000.000		

Common Stock

		BB	50.000.000
		8	10.000.000
		EB	60.000.000

8	Cash Flows from Financing Act.	10.000.000	
	Common Stock		10.000.000

Transaction 9 : The statement of retained earnings shows that a 3.000.000 TL dividend was paid in 2003. This represents an outflow of cash, specially, cash flows from financing activities. Retained Earnings is debited in the analysis entry and this will explain, together with the net income entry 1, how Retained Earnings went from the beginning balance of 18.000.000 to the ending balance of 25.000.000 TL. The credit to the Cash account under Cash Flows from Financing Activities now completes all the transactions for the period.

Cash

BB	9.000.000		
	Cash from	***Operating***	
1	10.000.000		
2	5.000.000		
		3	10.000.000
4	3.000.000		
5	5.000.000		

Retained Earnings

		BB	18.000.000
		1	10.000.000
9	3.000.000		
		EB	25.000.000

	Cash from	Investing	
6	4.000.000		
		7	2.000.000
	Cash from	**Financing**	
8	10.000.000		
		9	3.000.000

9	Retained Earnings	3.000.000	
	Cash Flows from Financing Act.		3.000.000

Table 2-18 CFS (indirect method) of ABC Company, Jan., 1, 2003 – Dec., 31, 2003

ABC Company Statement of Cash Flows (Indirect Method) January 1, 2003 - December 31, 2003		
Cash Flows from Operating Activities:		
Net Income		10.000.000 TL
Adjustment to reconcile Net Income to Net Cash Provided by Operating Activities:		
Decrease in Account Receivable		5.000.000 TL
Increase in Inventory		(10.000.000) TL
Increase in Accounts Payable		3.000.000 TL
Depreciation Expenses		5.000.000 TL
Net Cash Provided by Operating Activities		**13.000.000 TL**
Cash Flows from Investing Activities:		
Sale of Equipment	4.000.000 TL	
Purchase of Investment Bonds	(2.000.000)TL	
Net Cash Provided by Investing Activities		**2.000.000 TL**
Cash Flows from Financing Activities:		
Proceeds from Issuing Common Stock	10.000.000 TL	
Dividends Paid	(3.000.000) TL	
Net Cash Provided by Financing Activities		**7.000.000 TL**
Net Increase in Cash and Cash Equivalents		22.000.000 TL
Cash and Cash Equivalents at Beginning of Year		9.000.000 TL
Cash and Cash Equivalents at End of Year		31.000.000 TL

2.5.1.2. Worksheet method

Worksheet of four columns is necessary when applying worksheet approach. The first and last column show the beginning and ending account balances. The middle columns are for the summary of debit and credit analysis entries and these explain the balance sheet from beginning, balance to the ending balance. On the bottom of the ending balance. On the bottom of the worksheet analysis entries are entered again so as to generate statement of cash flows. (Smith et al., 1989)

Table 2-19 Comparative Balance Sheet of ABC Company, Dec., 31, 2003

ABC Company Comparative Balance Sheet December 31, 2003				
	Jan. 1, 2003 Balance	Summary of 2003 Entries		**Dec. 31, 2003 Balance**
		Debit	Credit	
Debits				
Cash	9.000.000			31.000.000
Account Receivable	20.000.000			15.000.000
Inventories	10.000.000			20.000.000
Net Property, Plant, and Equipment	30.000.000			26.000.000
Investment	5.000.000			7.000.000
Total Debits	**74.000.000**			**99.000.000**
Credits				
Accumulated Depreciation	0			5.000.000
Accounts Payable	6.000.000			9.000.000
Common Stock	50.000.000			60.000.000
Retained Earnings	18.000.000			25.000.000
Total Credits	**74.000.000**			**99.000.000**

Table 2-20 Comparative Balance Sheet of ABC Company, Dec., 31, 2003

ABC Company Comparative Balance Sheet December 31, 2003				
	Jan. 1, 2003 Balance	Summary of 2003 Entries		**Dec. 31, 2003 Balance**
		Debit	Credit	
Debits				
Cash	9.000.000	22.000.000		31.000.000
Account Receivable	20.000.000		5.000.000	15.000.000
Inventories	10.000.000	10.000.000		20.000.000
Net Property, Plant, and Equipment	30.000.000		4.000.000	26.000.000
Investment	5.000.000	2.000.000		7.000.000
Total Debits	**74.000.000**			**99.000.000**
Credits				
Accumulated Depreciation	0		5.000.000	5.000.000
Accounts Payable	6.000.000		3.000.000	9.000.000
Common Stock	50.000.000		10.000.000	60.000.000
Retained Earnings	18.000.000		7.000.000	25.000.000
Total Credits	**74.000.000**			**99.000.000**
Summary Entries Totals		34.000.000	34.000.000	
CFO Activities				
Net Income		10.000.000		
Add: Increase Acc. Payable		3.000.000		
Decrease Acc. Receivables		5.000.000		
Increase Depreciation Expense		5.000.000		
Deduct : Increase Inventories			10.000.000	
CFI Activities				
Add: Cash from sale Net Property		4.000.000		
Deduct :Increase investment			2.000.000	
CFF Activities				
Add : Cash from Sale of Common Stock		10.000.000		
Deduct: Cash Used to Pay Dividends			3.000.000	
Summary Entries Subtotals		37.000.000	15.000.000	
Net Increase in Cash			**22.000.000**	
Summary Entries Totals		37.000.000	37.000.000	

CHAPTER 3

3. PREPARATION OF CASH FLOW STATEMENT WITHIN ACCOUNTING SYSTEM

3.1. Problem Statement

Usually CFS is prepared at the end of period using income statement and beginning – ending balance sheets. However, we think that also it can be produced independent of balance sheets and income statement using parallel accounts for this purpose, which will be more useful.

Since the transactions occurred during period are recorded depending on the accrual basis; we cannot prepare a CFS depending on the adjusted trial balance as we depend for preparation of Balance Sheet & Income Statement. Therefore, we should take the income statement for the period and beginning & ending balance sheets to prepare a CFS for the period.

Our view is that it will be useful for managers to receive the CFS directly from the accounting system as we do for other financial statements instead of depending income statement & balance sheet together with some estimation usually needed when we prepare CFS at the end of accounting period. If CFS is to be prepared directly from the accounting system, then it is compulsory to follow a different method for recording the transactions during period. Therefore the starting point of our approach is to develop such a method.

3.2. Introducing the Suggested System

Since 1994, Turkish Uniform Chart of Accounts is being used in Turkey. Our method will be integrated to this system.

Two ways can be suggested to collect information will be used to prepare CFS during period:

- to use controlling parallel accounts under 8th
- to use subsidiary accounts under each cash-relevant controlling account.

In this way, it becomes possible to follow the cash flows immediately and in detail.

We prefer to use parallel controlling accounts in the method suggested to record transactions. Because theoretically, parallel accounts will be more clear and informative instead of integrating the cash information under present controlling accounts using their subsidiaries.

We will use class 8th of accounts in Uniform Chart of Accounts* (Sensoy, 1994) for the suggested method of recording transactions. In this process, the controlling (general ledger) account names will be determined in accordance with the direct method of preparation for Cash Flows from operating activities.

Subsidiary accounts of the suggested controlling accounts can also be produced when necessary. We confront three main cash flow groups: operating, investing and financing.

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* The uniform chart of accounts composes ten classes of accounts starting from 1 to 9 and 0. Among these classes, 8 and 0 is free to be used for any purpose.
1. Current Assets
2. Long Lived Assets
3. Short Term Liabilities
4. Long Term Liabilities
5. Owner's Equity
6. Income Statement Accounts
7. Factory Accounts
8. --- Free ---
9. Memorandum Accounts
0. --- Free ---

3.3. How does the system work

Suggested system depends on cash basis, which is integrated parallel to the accrual basis.

However, accrual basis is the accepted basis according to the generally accepted accounting principles. (Sensoy, 2002) In addition to the current system, we will add the journal records relating to cash by using parallel accounts.

For instance;

Company sold merchandise 100 million TL. Half of the amount is collected in cash and half is on credit n/30.

The journal record of this example will be as follows:

Cash	50.000.000	
Account Receivable	50.000.000	
Sales		100.000.000
To record sales on account.		

In this record, cash flow is only 50 million TL. So, our parallel account record will be as follows:

Cash – Operating Activities	50.000.000	
Cash Received from Customers		50.000.000

Although the total sales are 100 million TL, according to cash basis, we provided only 50 million TL from our customer. The remaining amount will be recorded when it will be collected as cash.

3.4. The names of accounts will be used accounting to Turkish Uniform Chart of Accounts for this purpose

	80			**CASH FLOW**
		801		Cash – Operating Activities
		802		Cash – Investing Activities
		803		Cash – Financing Activities
	81			**CASH FLOW FROM OPERATING ACTIVITIES**
		810		**Cash Received from Customers**
		811		**Income & Profit From Other Operations**
			0	Dividends from Participations
			1	Dividends from Affiliated Companies
			2	Interest Income
			3	Commission income
			4	Canceled allowances
			5	Profits on Sales of Marketable Securities
			6	Foreign Currency Transaction Gain
			9	Other Operating Income & Profit
		812		**Cash Paid to Suppliers**
		813		**Operating Expenses**
			0	Research & Development Expenses
			1	Marketing Selling & Distrib. Exp.
			2	General Administration Expenses
		814		**Expenses & Losses From Other Operations**
			3	Commission expenses
			5	Loss on Sales of Marketable Securities
			6	Foreign Currency Transaction Loss
			9	Other Operating Expenses & Losses
		815		**Financing Expenses**
		816		**Gain on Sales of Tangible Assets**
		817		**Loss on Sales of Tangible Assets**
		818		**Cash Flows from Other Operations**
			0	Sales of Marketable Securities
			1	Value Added Tax (V.A.T.)
		819		
	82			**CASH FLOW FROM INVESTING ACTIVITIES**
		820		**Sales of Financial Assets**
			0	
		821		**Sales of Tangible Assets**
			0	
		822		**Sales of Other Fixed Assets**
		823		**Other Cash Collections**
			0	
		824		**Purchase of Financial Assets**
		825		**Purchase of Tangible Assets**
		826		**Purchase of Other Fixed Assets**
		827		**Other Payments**
	83			**CASH FLOW FORM FINANCING ACTIVITIES**
		830		**Changes in Short Term Liabilities**
		831		**Changes in Long Term Liabilities**
		832		**Changes in Capital**
			0	Capital Increase
		833		**Changes in Reserves**
		834		**Dividends paid**

Table 3-1 Turkish Uniform Chart of Accounts for class 8

3.5. The explanation of accounts will be used for the suggested method of recording

The following sub-classes of accounts are used:
80 CASH FLOW
81 CASH FLOW FROM OPERATING ACTIVITIES
82 CASH FLOW FROM INVESTING ACTIVITIES
83 CASH FLOW FROM FINANCING ACTIVITIES

80 numbered sub-class account title is called as Cash Flow and works as parallel account. This is consisted of three controlling (general ledger) accounts as given below. These accounts are working like cash account. When cash is debited, also these accounts are debited, or vice versa.

801 Cash - Operating Activities
802 Cash - Investing Activities
803 Cash - Financing Activities

81 numbered sub-class account title is called as Cash Flow from Operating. In this group, operating activities are categorized in detail.

82 numbered sub-class account title is called as Cash Flow from Investing. In this group operating activities are categorized in detail.

83 numbered sub-class account title is called as Cash Flow from Financing. In this group, operating activities are categorized in detail.

If we list the accounts from 81 to 83 in order, then we reach to CFS.

3.6. Difficulties

3.6.1. Cost of preparation

Since each financial statement brings additional costs, this system will also bring an extra cost. This additional cost may be cost of time and cost of money. If the system is transferred to the electronic base then the costs may be minimized.

3.6.2. Problems with recording checks

Recording the checks, which have a maturity date, may be problematic in suggested method. The problem is related with the recognition time of checks. There may be two different times for recognition checks: when it is drawn or when it is paid. If we recognize it when it is drawn, then it should not be recognized when the check is paid. If we decide to recognize it when it is paid, then we should not recognize the check when it is drawn. We prefer the first one. Because check should be considered as cash, according to accounting standards. (SPK)

However, on the date which we prepare the CFS we should review the "checks on hand" and "checks given" and separate those having maturity longer than 3 months as of the date CFS is prepared.

CHAPTER 4

4. CASE STUDY APPLYING THE SUGGESTED METHOD

X Company
Balance Sheet, January 1, 2002

Cash	30 000	Bank Loans	100 000
Banks	100 000	Payables to suppliers	200 000
Merchandise	300 000	Provision for Taxes	40.000
Marketable Securities	100 000	Prepaid income taxes	(20.000)
Participations	100 000	Capital	1 000 000
Buildings	500 000	Retained Earnings	50 000
Fixtures	130 000	Legal Reserves	30 000
Vehicles	400 000		
Accumulated Depreciation	(280 000)		
VAT carried forward	20 000		
Total	1 400 000	Total	1 400 000

Table 4-1 Balance Sheet of X Company, Jan., 1, 2002

1. The company purchased merchandise for 60 000 TL. 20 000 is paid in cash and for remainder signed a short-term note.

2. The sales of some shares on hands for cash 120 000 TL.

3. The company sells merchandise for 80 000 TL. 50 000 TL is collected in cash, and receives short-term note 20 000 TL. Remaining part is by credit.

4. 20 000 TL.-part of sold merchandise returned back. In response, 20 €-check was given to customers. Rate of exchange: 1 € = 1.100 TL.

5. Income tax return is submitted and income tax is paid in cash after prepaid is offset.

6. All fixtures are sold for the purpose of being renewed 100 000 TL in cash. Accumulated depreciation of fixed assets is 40 000 TL.

7. To our staff Ali Güngör, wage for December is accrued depending on payroll.

   Gross pay 20 000 TL,
   Income tax 7000 TL.,
   Stamp duty 1 000 TL,
   Social Security Insurance Premium
   - Employer's share 4 000 TL,
   - Employee's share 3 000 TL,

   Unemployment Premium
   - Employer's share 2 000 TL.
   - Employee's share 1 000 TL,

   Our staff works in management department.
   Net wage is paid in cash to the employee by boss.

8. The company paid 10.000 TL interest for loan.

9. The company paid 12.000.000 TL for four-months-rent in cash on 01.11.2002. The accounts are adjusted and financial statements prepared quarterly.

10. The company paid dividends to its shareholders 20.000 TL in cash.

11. The capital is increased by 200.000 TL. And Mr. Osman Yılmaz paid 100.000 TL and gave some merchandise costing 100.000 TL.

12. A 60.000 TL contract is signed with a customer for giving maintenance service to that company for 3 month on 01.12.02002 and total amount is collected in cash.

13. The company paid prepaid income tax 5.000 TL. in cash

14. 10.000 TL note receivable is sued. For Doubtful Trade Receivable allowance is 30 %.

15. Merchandise is sold for 200.000 TL which the amount is deposited to our bank account by the customer.

Note:

- VAT rate is 10 %.
- The company uses Periodic Inventory System.

0	100 Cash	30.000	
	102 Banks	100.000	
	110 Marketable Securities	100.000	
	153 Merchandise	300.000	
	242 Participations	100.000	
	252 Buildings	500.000	
	254 Vehicles	400.000	
	255 Fixtures & Fittings	130.000	
	190 VAT carried forward	20.000	
	371 Prepaid income taxes	20.000	
	257 Accumulated Depreciation		280.000
	300 Bank Loans		100.000
	320 Payables to suppliers		200.000
	370 Provision for Taxes		40.000
	500 Capital		1.000.000
	540 Legal Reserves		30.000
	570 Retained Earnings		50.000
1	153 Merchandise	60.000	
	191 VAT credit account	6.000	
	100 Cash		26.000
	321 Notes Payable		40.000
2	100 Cash	120.000	
	110 Marketable Securities		100.000
	645 Gain on sales of securities		20.000
3	100 Cash	50.000	
	120 Receivables from customers	18.000	
	121 Notes Receivable	20.000	
	600 Domestic sales revenue		80.000
	391 VAT Received		8.000
4	610 Returns on sales	20.000	
	191 VAT credit account	2.000	
	103 Checks drawn & money orders		22.000
5	370 Provision for Taxes	40.000	
	371 Prepaid income taxes		20.000
	360 Taxes payable		20.000
	360 Taxes payable	20.000	
	100 Cash		20.000
6	100 Cash	110.000	
	257 Accumulated Depreciation	40.000	
	255 Fixtures & Fittings		130.000
	391 VAT Received		10.000
	549 Special funds		10.000
7	770 General administration costs	26.000	
	360 Taxes payable		8.000
	361 Social security withholdings payable		10.000
	335 Payables to personnel		8.000
	335 Payables to personnel	8.000	
	331 Payables to owners		8.000

8	780 Financing costs	10.000	
	100 Cash		10.000
9	770 General administration costs	6.000	
	180 Prepaid expenses	6.000	
	100 Cash		12.000
10	570 Retained Earnings	20.000	
	100 Cash		20.000
11	100 Cash	100.000	
	153 Merchandise	100.000	
	500 Capital		200.000
12	100 Cash	66.000	
	600 Domestic sales revenue		20.000
	391 VAT Received		6.000
	380 Revenue collected in advance		40.000
13	193 Prepaid income taxes	5.000	
	100 Cash		5.000
14	128 Doubtful receivables	10.000	
	121 Notes Receivable		10.000
	654 Expenses regarding allowances	3.000	
	129 Allowance for doubtful receivables		3.000
15	102 Banks	220.000	
	600 Domestic sales revenue		200.000
	391 VAT Received		20.000

X Company,
Unadjusted Trial Balance
December 31, 2002

		Totals Amounts		Balance Amounts	
Acc. No	**Accounts**	**debit**	**credit**	**debit**	**credit**
100	Cash	476.000	93.000	383.000	
102	Banks	320.000		320.000	
103	Checks drawn & money orders		22.000		22.000
110	Marketable Securities	100.000	100.000		
120	Receivables from customers	18.000		18.000	
121	Notes Receivable	20.000	10.000	10.000	
128	Doubtful receivables	10.000		10.000	
129	Allowance for doubtful receivables		3.000		3.000
153	Merchandise	460.000		460.000	
180	Prepaid expenses	6.000		6.000	
190	VAT carried forward	20.000		20.000	
191	VAT credit account	8.000		8.000	
193	Prepaid income taxes	5.000		5.000	
242	Participations	100.000		100.000	
252	Buildings	500.000		500.000	
254	Vehicles	400.000		400.000	
255	Fixtures & Fittings	130.000	130.000		
257	Accumulated Depreciation	40.000	280.000		240.000
300	Bank Loans		100.000		100.000
320	Payables to suppliers		200.000		200.000
321	Notes Payable		40.000		40.000
331	Payables to owners		8.000		8.000
335	Payables to personnel	8.000	8.000		
360	Taxes payable	20.000	28.000		8.000
361	Social security withholdings payable		10.000		10.000
370	Provision for Taxes	40.000	40.000		
371	Prepaid income taxes	20.000	20.000		
380	Revenue collected in advance		40.000		40.000
391	VAT Received		44.000		44.000
500	Capital		1.200.000		1.200.000
540	Legal reserves		30.000		30.000
549	Special funds		10.000		10.000
570	Retained Earnings	20.000	50.000		30.000
600	Domestic sales revenue		300.000		300.000
610	Returns on sales	20.000		20.000	
645	Gain on sales of securities		20.000		20.000
654	Expenses regarding allowances	3.000		3.000	
770	General administration costs	32.000		32.000	
780	Financing costs	10.000		10.000	
	TOTAL	2.786.000	2.786.000	2.305.000	2.305.000

Table 4-2 Trial Balance of X Company, Dec., 31, 2002

Information for end of period adjustments :

16. VAT adjustments for December.

17. Rediscount interest rate is 60 %. Notes Receivable n/60, notes payable n/90.

18. Bank paid checks drawn (20.- €). Payment date rate of exchange is 1€ = 1.300 TL.

19. Our banks' statement show us our total amount is 295.000 TL and balance differences stem from interest.

20. Cost of goods available on hand as 31.12.2002 is 375.000 TL but some goods are damaged with cost 25.000 TL and market 5.000 TL.

21. One of the buildings with cost 250.000 TL is damaged in earthquake. Its accumulated depreciation is 50.000 TL. The insurance company paid 250.000 for this building.

22. Revaluation rate is 60 %.

23. Depreciation rate is 5 % for buildings and 20 % for other tangible assets.

24. The income of our associated company which we keep 25% of its voting shares is 40.000 TL. Also that company has 20.000 increase in its revaluation surplus for 2002. The associated company paid 50% of its profit as dividends.

25. Provision for Income tax is calculated as 40% of net profit.

16	391 VAT Received	44.000	
	191 VAT credit account		8.000
	190 VAT carried forward		20.000
	360 Taxes payable		16.000
17	657 Rediscount interest expense	1.000	
	122 Rediscount of notes receivable		1.000
	322 Rediscount for notes payable	6.000	
	647 Gain on rediscount of Notes Payable		6.000
18	103 Checks drawn & money orders	22.000	
	656 Loss on sales of foreign exchanges	4.000	
	102 Banks		26.000
19	102 Banks	1.000	
	642 Interest revenue		1.000
20	621 Cost of merchandise sold	85.000	
	153 Merchandise		85.000
	157 Other Inventories	25.000	
	153 Merchandise		25.000
	654 Expenses regarding allowances	20.000	
	158 Allowance for inventories		20.000
21	100 Cash	250.000	
	257 Accumulated Depreciation	50.000	
	252 Buildings		250.000
	679 Other extra-ordinary revenue & income		50.000
22	252 Buildings	150.000	
	254 Vehicles	240.000	
	257 Accumulated Depreciation		114.000
	522 Revaluation surplus		276.000
23	770 General administration costs	152.000	
	257 Accumulated Depreciation		152.000
24	242 Participations	15.000	
	523 Revaluation surplus in result of revaluation made by participations		5.000
	640 Dividends from stock investments in participations		10.000
	100 Cash	5.000	
	242 Participations		5.000
	632 General administration costs	184.000	
	660 Financing costs	10.000	
	770 General administration costs		184.000
	780 Financing costs		10.000

	690 Revenue & expense summary account	327.000	
	610 Returns on sales		20.000
	621 Cost of merchandise sold		85.000
	632 General administration costs		184.000
	654 Expenses regarding allowances		23.000
	656 Loss on sales of foreign exchanges		4.000
	657 Rediscount interest expense		1.000
	660 Financing costs		10.000
	600 Domestic sales revenue	300.000	
	640 Dividends from stock investments in participations	10.000	
	642 Interest revenue	1.000	
	645 Gain on sales of securities	20.000	
	647 Gain on rediscount of Notes Payable	6.000	
	679 Other extra-ordinary revenue & income	50.000	
	690 Revenue & expense summary account		387.000
	690 Revenue & expense summary account	30.000	
	691 Company income taxes of the period		24.000
	692 Net income or loss of the period		36.000
25	691 Company income taxes of the period	24.000	
	370 Provision for Taxes		24.000
	371 Prepaid income taxes	5.000	
	193 Prepaid income taxes		5.000
	692 Net income or loss of the period	36.000	
	590 Net income of the period		36.000

X Company
Adjusted Trial Balance
December 31, 2002

		Total Amounts		Balance Amounts	
Acc. No	**Accounts**	**debit**	**credit**	**debit**	**credit**
100	Cash	731.000	93.000	638.000	
102	Banks	321.000	26.000	295.000	
103	Checks drawn & money orders	22.000	22.000		
110	Marketable Securities	100.000	100.000		
120	Receivables from customers	18.000		18.000	
121	Notes Receivable	20.000	10.000	10.000	
122	Rediscount of Notes Receivable		1.000		1.000
128	Doubtful receivables	10.000		10.000	
129	Allowance for doubtful receivables		3.000		3.000
153	Merchandise	460.000	110.000	350.000	
157	Other Inventories	25.000		25.000	
158	Allowance for inventories		20.000		20.000
180	Prepaid expenses	6.000		6.000	
190	VAT carried forward	20.000	20.000		
191	VAT credit account	8.000	8.000		
193	Prepaid income taxes	5.000	5.000		
242	Participations	115.000	5.000	110.000	
252	Buildings	650.000	250.000	400.000	
254	Vehicles	640.000		640.000	
255	Fixtures & Fittings	130.000	130.000		
257	Accumulated Depreciation	90.000	546.000		456.000
300	Bank Loans		100.000		100.000
320	Payables to suppliers		200.000		200.000
321	Notes Payable		40.000		40.000
322	Rediscount for notes payable (-)	6.000		6.000	
331	Payables to owners		8.000		8.000
335	Payables to personnel	8.000	8.000		
360	Taxes payable	20.000	44.000		24.000
361	Social security withholdings payable		10.000		10.000
370	Provision for Taxes	40.000	64.000		24.000
371	Prepaid income taxes	25.000	20.000	5.000	
380	Revenue collected in advance		40.000		40.000
391	VAT Received	44.000	44.000		
500	Capital		1.200.000		1.200.000
522	Revaluation surplus		276.000		276.000
523	Revaluation surplus in result of revaluation made by participations		5.000		5.000
540	Legal reserves		30.000		30.000
549	Special funds		10.000		10.000
570	Retained Earnings	20.000	50.000		30.000
590	Net income of the period		36.000		36.000
600	Domestic sales revenue	300.000	300.000		
610	Returns on sales	20.000	20.000		
621	Cost of merchandise sold	85.000	85.000		
632	General administration costs	184.000	184.000		

640	Dividends from stock investments in participations	10.000	10.000		
642	Interest revenue	1.000	1.000		
645	Gain on sales of securities	20.000	20.000		
647	Gain on rediscount of Notes Payable	6.000	6.000		
654	Expenses regarding allowances	23.000	23.000		
656	Loss on sales of foreign exchanges	4.000	4.000		
657	Rediscount interest expense	1.000	1.000		
660	Financing costs	10.000	10.000		
679	Other extra-ordinary revenue & income	50.000	50.000		
690	Revenue & expense summary account	387.000	387.000		
691	Company income taxes of the period	24.000	24.000		
692	Net income or loss of the period	36.000	36.000		
770	General administration costs	184.000	184.000		
780	Financing costs	10.000	10.000		
	TOTALS	1.355.000	1.355.000	0	0

Table 4-3 Adjusted Trial Balance of X Company, Dec., 31, 2002

Table 4-4 Balance Sheet of X Company, Dec., 31, 2002

X Company Balance Sheet, December 31, 2002	31.12.2002	31.12.2001	balance
I. CURRENT ASSETS	1.328.000	550.000	778.000
A. Liquid Assets	933.000	130.000	803.000
1. Cash on Hand	638.000	30.000	608.000
2. Cash in Bank	295.000	100.000	195.000
B. Marketable Securities	0	100.000	-100.000
1. Marketable Equity Securities	0	100.000	-100.000
C. Operational Accounts Receivables	34.000	0	34.000
1. Receivables from customers	18.000	0	18.000
2. Notes Receivable	10.000	0	10.000
4. Other Operational Receivables	10.000	0	10.000
5. Rediscount of Notes Receivable(-)	-1.000	0	-1.000
6. Allowance for Doubtful Receivables (-)	-3.000	0	-3.000
E. Inventories	355.000	300.000	55.000
4. Merchandise inventory	350.000	300.000	50.000
6. Other Inventories	25.000	0	25.000
7. Allowance for Inventory Market Value Drop(-)	-20.000	0	-20.000
F. Other Current Assets	6.000	20.000	-14.000
II. LONG LIVED ASSETS	694.000	850.000	-156.000
C. Stock Investments	110.000	100.000	10.000
3. Participations	110.000	100.000	10.000
D. Tangible Assets	584.000	750.000	-166.000
3. Buildings	400.000	500.000	-100.000
5. Vehicles	640.000	400.000	240.000
6. Fixtures	0	130.000	-130.000
8. Accumulated Depreciation (-)	-456.000	-280.000	-176.000
TOTAL ASSETS	**2.022.000**	**1.400.000**	**622.000**
I. SHORT TERM LIABILITIES	435.000	320.000	115.000
A. Short Term Financing Liabilities	100.000	100.000	0
1. Bank Loans	100.000	100.000	0
B. Operational Liabilities	234.000	200.000	34.000
1. Short term payables to suppliers	200.000	200.000	0
2. Short term notes payable	40.000	0	40.000
5. Rediscount for Notes payable (-)	-6.000	0	-6.000
C. Other Liabilities	82.000	0	82.000
1. Payables to Shareholders	8.000	0	8.000
5. Taxes Duties & Deductions Payable	34.000	0	34.000
7. Other Liabilities Payables	40.000	0	40.000
E. Provision for Taxes	19.000	20.000	-1.000
III. OWNER'S EQUITY	1.587.000	1.080.000	507.000
A. Paid in Capital	1.200.000	1.000.000	200.000
D. Capital Surplus	281.000	0	281.000
1. Revaluation Surplus	276.000	0	276.000
2. Revaluations Surplus of Participations	5.000	0	5.000
E. Income Reserves	40.000	0	40.000
1. Legal Reserves	30.000	30.000	0
3. Special funds	10.000	0	10.000
F. Net Income of the Period	36.000	0	36.000
H. Retained Earnings	30.000	50.000	-20.000
TOTAL LIABILITIES	**2.022.000**	**1.400.000**	**622.000**

X Company
Income Statement , January 1, 2002 - December 31, 2002

A. SALES REVENUE	**300.000**
1. Domestic Sales Revenue	300.000
2. Exports Sales Revenue	
3. Government grants related to income	
B. RETURNS & ALLOWANCES (-)	**(20.000)**
1. Returns on Sales (-)	(20.000)
2. Cash Discounts (-)	
3. Other reductions (-)	
C. NET SALES	**280.000**
D. COST OF GOODS SOLD (-)	**(85.000)**
GROSS PROFIT (LOSS)	**195.000**
E. PERİOD EXPENSES (-)	**(184.000)**
1. Research & Development Expenses (-)	
2. Marketing Selling & Distrib. Exp. (-)	
3. General Administrative Expenses (-)	(184.000)
OPERATING PROFIT (LOSS)	**11.000**
F. ORDINARY NON-OPERATING REVENUE & INCOME	**37.000**
1. Dividends from Participations	10.000
2. Dividends from Affiliated Companies	
3. Interest Revenue	1.000
4. Other Ordinary Revenue & Income	26.000
G. ORDINARY NON-OPERATING EXPENSES & LOSSES (-)	**(28.000)**
H. FINANCING EXPENSES (-)	**(10.000)**
1. Expenses Incurred for Short Term Financing (-)	(10.000)
2. Expenses Incurred for Long Term Financing (-)	
PROFIT BEFORE EXTRAORDINARY ITEMS & TAX	**10.000**
I. EXTRA ORDINARY INCOME & PROFIT	**50.000**
1. Reversal of Provisions	
2. Prior Year Income & Profit	
3. Other Extraordinary Income & Profit	50.000
J. EXTRA ORDINARY EXPENSES & LOSSES (-)	**0**
1. Idle Division Expenses & Losses (-)	
2. Prior Year Expenses & Losses (-)	
3. Other Extraordinary Exp. & Losses (-)	
NET INCOME OF THE PERİOD BEFORE TAX	**60.000**
K. TAX & OTHER LEGAL LIABILITIES (-)	**(24.000)**
NET PROFIT AFTER TAX	**36.000**

Table 4-5 Income Statement of X Company, Jan.,1, 2002 – Dec., 31, 2002

4.1. The Preparation Of Cash Flow Statement By Using Reconstruction Method

Additional information :

a) All the fixed assets are sold. Accumulated depreciation is 40.000 TL.

b) Half of the buildings is damaged in earthquake and insurance company paid the money. Accumulated depreciation is 50.000 TL.

c) Tangible assets are revaluated and increases as follow:

a. Buildings	150.000
b. Vehicles	240.000
c. Accumulated depreciation	114.000
d. Revaluation	276.000

d) Depreciation expenses 152.000

e) The new partner who gave 100 000 TL cash and 100 000 merchandise, was accepted by the company. (increase in capital)

f) From affiliates received 5.000 TL. dividends in cash.

4.1.1. Adjusting the T accounts:

Tangible Fixed Assets

Beg. Bal. 1.030.000	
	130.000 250.000
390.000	
1.420.000	380.000
Balance :	1.040.000

Participations

Beg. Bal. : 100.000	
	5.000
Balance :	95.000

Accumulated Depreciation

	Beg. Bal. 280.000
40.000 50.000	
	114.000
90.000	394.000 152.000
90.000	546.000
Balance :	(456.000)

a	Cash – Investing Activities Accumulated Depreciation Tangible Fixed Assets	90.000 40.000	 130.000
b	Cash – Investing Activities Accumulated Depreciation Tangible Fixed Assets	200.000 50.000	 250.000
c	Tangible Fixed Assets Noncash Activities	390.000	 390.000
	Noncash Activities Accumulated Depreciation Revaluation Surplus of Fixed Assets	390.000	 114.000 276.000
d	Cash – Operating Activities Accumulated Depreciation	152.000	 152.000
e	Cash – Financing Activities Inventories Capital	100.000 100.000	 200.000
f	Cash – Operating Activities Participations	5.000	 5.000

4.1.2. Reconstructed Entries:

Marketable Securities

Beg. Bal. 100.000	
End. Bal. :	100.000
Bal.Sh.Amount :	0
Balance :	100.000

1	Cash – Operating Activities	100.000	
	Marketable Securities		100.000

Short Term Trade Receivables

Beg. Bal. 0	
End. Bal. :	0
Bal.Sh.Amount :	34.000
Balance :	34.000

2	Short Term Trade Receivables	34.000	
	Cash – Operating Activities		34.000

Inventories

Beg. Bal. 300.000	
100.000	
End. Bal. :	400.000
Bal.Sh.Amount :	355.000
Balance :	(45.000)

3	Cash – Operating Activities	45.000	
	Inventories		45.000

Participations

Beg. Bal. 100.000	
	5.000
End. Bal. :	95.000
Bal.Sh.Amount :	110.000
Balance :	15.000

4	Participations	15.000	
	Revaluations Surplus of Participations		5.000
	Cash – Operating Activities		10.000

Other Current Assets

Beg. Bal. : 20.000	
End. Bal. :	20.000
Bal.Sh.Amount :	6.000
Balance :	(14.000)

5	Cash – Operating Activities	14.000	
	Other Current Assets		14.000

Trade Payables

	Beg. Bal. : 200.000
End. Bal. :	200.000
Bal.Sh.Amount :	234.000
Balance :	34.000

6	Cash – Operating Activities	34.000	
	Trade Payables		34.000

Payables to Shareholders

	Beg. Bal.	0
End. Bal. :		0
Bal.Sh.Amount :		8.000
Balance :		8.000

7	Cash – Financing Activities	8.000	
	Payables to Shareholders		8.000

Other Short Term Payables

	Beg. Bal.	0
End. Bal. :		0
Bal.Sh.Amount :		74.000
Balance :		74.000

8	Cash – Operating Activities	74.000	
	Other Short Term Payables		74.000

Provision for Taxes

	Beg. Bal. :	20.000
End. Bal. :		20.000
Bal.Sh.Amount :		19.000
Balance :		(1.000)

9	Provision for Taxes	1.000	
	Cash – Operating Activities		1.000

Special Reserves

	Beg. Bal.	0
End. Bal. :		0
Bal.Sh.Amount :		10.000
Balance :		10.000

10	Cash – Investing Activities	10.000	
	Special Reserves		10.000

Current Year Income

	Beg. Bal.	0
End. Bal. :		0
Bal.Sh.Amount :		36.000
Balance :		36.000

11	Cash – Operating Activities	36.000	
	Current Year Income		36.000

Retained Earnings

	Beg. Bal.	50.000
End. Bal. :		50.000
Bal.Sh.Amount :		30.000
Balance :		(20.000)

12	Retained Earnings	20.000	
	Cash – Financing Activities		20.000

Cash – Operating Activities						415.000
Depreciation Expense	d	152.000	Increase Trade Receivables	34.000	2	
Marketable Securities Sold	1	100.000	Participations	5.000		
Other Current Assets	4	14.000	Income Tax	1.000		
Increase Trade Payables	5	34.000				
Increase Other Trade Payables	7	74.000				
Current Year Income	10	36.000				
Decrease Inventories	3	45.000				
Total		455.000	*Total*	40.000		
Cash – Investing Activities						300.000
Tangible Assets Sold	a	90.000				
Tangible Assets Insurance	b	200.000				
Increase Special Reserves		10.000				
Total		300.000				
Cash – Financing Activities						88.000
Increase Other Trade Payables	6	8.000	Retained Earnings	20.000		
Increase Capital	e	100.000				
Total		108.000		20.000		
Noncash Activities						0
Revaluation Surplus	c	390.000	Revaluation Surplus	390.000		
						803.000

Table 4-6 CFS according to reconstruction method

X Company
Statement of Cash Flows
Reconstruction method

I- CASH FLOW FROM OPERATING ACTIVITIES				415.000
A-Cash from Operations			278.000	
1- Cash from Sales		246.000		
a) Net Sales	280.000			
b) Increase Trade Receivables	(34.000)			
2- Cash From Other Operations		32.000		
a) Income & Profit From Other Operations	37.000			
b) Revenues that do not result in cash inflows in the period	(5.000)			
B- Cash Outflows From Other Operating			(76.000)	
1- Cash Outflows Related to Costs		146.000		
a) Cost of Goods Sold	85.000			
b) Decrease In Inventories (-)	(45.000)			
d) Increase In Trade Payables (-)	(34.000)			
e) Expenses Not Requiring Cash Outflow (-)	(152.000)			
2- Cash Outflows Related to Operating Exp.		(184.000)		
c) General Administrative Expenses	184.000			
3- Cash Outflows From Other Op. Exp.& Losses		(28.000)		
a) Expenses & Losses From Other Operations	28.000			
b) Expenses Not Requiring Cash Outflow (-)				
4- Cash Outflows for Financial Expenses		(10.000)		
C- Cash Outflows From Extraord. Exp.& Losses			50.000	
1- Cash From Extraordinary Income & Profit		50.000		
a) Extraordinary Income & Profit	50.000			
b) Income & Profit Not Requiring Cash Inflow				
2- Cash Outflows From Extraord. Exp.& Losses				
D-Cash Flow from Changes in Current Assets and Short Term Liabilities			187.000	
1-Increase Current Assets (-)				
2-Decrease Current Assets		114.000		
Marketable Securities Sales	100.000			
Others	14.000			
3-Increase in Short Term Liabilities		74.000		
Taxes Payable	34.000			
Income Accruals	40.000			
4-Derease in Short Term Liablities		(1.000)		
E-Cash Outflow from Tax & Other Legal Liabilities			(24.000)	
II- CASH FLOW FROM INVESTING ACTIVITIES				300.000
A-Cash Inflow from Investing Activities			300.000	
1- Long Term Financial Assets Sales				
2- Tangible Assets Sales	300.000			
B-Cash Outflow from Investing Activities				
1- Long Term Financial Assets Purchase				
2- Tangible Assets Purchase				
III- CASH FLOW FROM FINANCING ACTIVITIES				88.000
A- Cash Inflow from Financing Activities			108.000	
1- Increase In Short Term Liabilities	8.000			
2- Increase In Long Term Liabilities				
3- Increase In Capital	100.000			
4-Premium on Issue of Shares				
B- Cash Outflow from Financing Activities			(20.000)	
1- Decrease In Short Term Liabilities (-)				
2- Decrease In Long Term Liabilities (-)				
3- Paid Dividends	(20.000)			
4-Decrease in Capital (-)				
IV- NET INCREASE IN CASH				803.000
V- CASH AT BEGINNING OF YEAR				130.000
VI- CASH AT END OF YEAR				933.000

Table 4-7 CFS of X Company, Prepared depending Bal. Sheet and Income Statement.

4.2. The Preparation Of Cash Flow Statement By Suggested Method

The entries below are added next to the each entry, which has cash effect. The entry numbers here show, the entry numbers that these will be added to the entry made during period.

1	812 Cash Paid to Suppliers	20.000	
	818.1 VAT	6.000	
	801 Cash – Operating Activities		26.000
2	801 Cash – Operating Activities	120.000	
	818.0 Marketable Securities Sales		100.000
	811.5 Profits on Sales of Marketable Securities		20.000
3	801 Cash – Operating Activities	50.000	
	818.1 VAT		8.000
	810 Cash Received from Customers		42.000
4	810 Cash Received from Customers	20.000	
	818.1 VAT	2.000	
	801 Cash – Operating Activities		22.000
5	819 Income Taxes	20.000	
	801 Cash – Operating Activities		20.000
6	802 Cash – Investing Activities	100.000	
	801 Cash – Operating Activities	10.000	
	821 Sales of Tangible Assets		100.000
	818.1 VAT		10.000
9	813.2 General Administration Expenses	12.000	
	801 Cash – Operating Activities		12.000
8	815 Financing Expenses	10.000	
	801 Cash – Operating Activities		10.000
10	834 Dividends paid	20.000	
	803 Cash – Financing Activities		20.000
11	803 Cash – Financing Activities	100.000	
	832.0 Capital Increase		100.000
12	801 Cash – Operating Activities	66.000	
	810 Cash Received from Customers		60.000
	818.1 VAT		6.000
13	819 Income Taxes	5.000	
	801 Cash – Operating Activities		5.000
15	801 Cash – Operating Activities	220.000	
	810 Cash Received from Customers		200.000
	818.1 VAT		20.000
19	814. 6 Loss on sales of foreign exchanges	4.000	
	801 Cash – Operating Activities		4.000
20	801 Cash – Operating Activities	1.000	
	811.2 Interest Income		1.000
21	802 Cash – Investing Activities	250.000	
	821 Sales of Tangible Assets		200.000
	816 Profits on Sales of Tangible Assets		50.000
25	801 Cash – Operating Activities	5.000	
	811.0 Dividend Income From Affiliates		5.000

801 Cash – Operating Activities

120.000	26.000
50.000	22.000
10.000	20.000
66.000	10.000
220.000	5.000
1.000	12.000
5.000	4.000
472.000	99.000

802 Cash – Investing Activities

100.000	
250.000	
350.000	

803 Cash – Financing Activities

100.000	20.000

If we list the accounts from 810 to 839 in order, then we reach CFS. The accounts which balances debit means cash outflow, the accounts which balances credit means cash inflow.

818. 1 VAT

6.000	8.000
2.000	10.000
	6.000
	20.000
8.000	42.000

818.0 Marketable Securities Sales

	100.000

811 Income & Profit from Other Operations

	20.000
	1.000
	5.000
	26.000

821 Tangible Assets Sales

	100.000

810 Cash from Customers

20.000	42.000
	60.000
	200.000
20.000	302.000

816 Profits on Sales of Tangible Assets

	50.000

813 Operating Expense

12.000	

832 Capital

	100.000

814 Expenses & Loses fro Other Operations

4.000	

819 Income Taxes

20.000	
5.000	

815 Financial Expenses

10.000	

834 Dividends Paid

	20.000

812 Cash Paid to Suppliers

20.000	

X Company
Statement of Cash Flows
Suggested method

I- CASH FLOW FROM OPERATING ACTIVITIES				373.000
A- Cash from Operations			308.000	
1- Cash from Sales		282.000		
Cash from Customers	282.000			
2- Cash From Other Operations		26.000		
Dividends Income	5.000			
Interest Income	1.000			
Profits on Sales of Marketable Securities	20.000			
B- Cash Outflows From Other Operating			(46.000)	
1- Cash Outflows Related to Costs		(20.000)		
Cash Paid to Suppliers	(20.000)			
2- Cash Outflows Related to Operating Exp.		(12.000)		
3- Cash Outflows From Other Op. Exp.& Losses		(4.000)		
4- Cash Outflows for Financial Expenses		(10.000)		
C- Cash Outflows From Extraord. Exp.& Losses				
1- Cash From Extraordinary Income & Profit				
2- Cash Outflows From Extraord. Exp.& Losses				
D- Cash Flow from Changes in Current Assets and Short Term Liabilities			136.000	
Marketable Securities Sales	100.000			
VAT	36.000			
E- Cash Outflow from Tax & Other Legal Liabilities			(25.000)	
II- CASH FLOW FROM INVESTING ACTIVITIES				350.000
A- Cash Inflow from Investing Activities				
Tangible Assets Sales	350.000			
B- Cash Outflow from Investing Activities				
III- CASH FLOW FROM FINANCING ACTIVITIES				80.000
A- Cash Inflow from Financing Activities			100.000	
B- Cash Outflow from Financing Activities			(20.000)	
IV- NET INCREASE IN CASH				803.000
V- CASH AT BEGINNING OF YEAR				130.000
VI- CASH AT END OF YEAR				933.000

Table 4-8 CFS of X Company, Prepared from the accounting system.

4.3. Comparison of Our Suggested Method with Reconstruction Method

4.3.1. Comparison

	Reconstruction Method	Suggested Method
Cash Flow From Operating Activities	415.000	373.000
Cash Flow From Investing Activities	300.000	350.000
Cash Flow From Financing Activities	88.000	80.000
TOTAL	803.000	803.000

If we evaluate the above results, the total amount is same that is 803.000 TL. However, the impact of this method is on the classification of cash flows. To clarify this position in the above mentioned example it can be noticed that under reconstruction method cash from operating is 415.000 TL. However, according to suggested method it is 373.000 TL.

In the same manner, while under reconstruction method cash from investing activities is 300.000 TL. and cash from financing activities is 88.000 TL under our suggested method cash from investing is 350.000 TL and cash from investing is 80.000 TL.

4.3.2. Reconciliation

	Reconstruction Method	Suggested Method	Balance
Cash Flow From Operating Activities	415.000	373.000	42.000
Cash Flow From Investing Activities	300.000	350.000	(50.000)
Cash Flow From Financing Activities	88.000	80.000	8.000
TOTAL	803.000	803.000	0

Reconstruction CFF:

Cash Flow From Financing Activities (reconstruction method)	88.000	
Increase in payable but not requiring cash inflow (Payables to Owners)	-8.000	a
Cash Flow From Financing Activities (suggested method)	80.000	

Reconstruction CFI:

Cash Flow From Investing Activities (reconstruction method)		300.000	
Investing but not requiring cash inflow (special fund)		-10.000	
Gain on sales of Building 250.000 (250-200)	c	50.000	d
Gain on sales of Fixtures 100.000 (100-90)		10.000	
Cash Flow From Investing Activities (suggested method)		350.000	

Reconstruction CFO:

Cash Flow From Operating Activities (reconstruction method)	415.000	
Differences from CFF	8.000	b
Differences from CFI	(50.000)	e
Cash Flow From Operating Activities (suggested method)	393.000	

a) 8.000 is deducted from CFF because there is no real cash inflow from owner.

b) 8.000 is added to CFO because there is no real cash outflow for wages.

c) 10.000 gain on sales of fixtures which is recognized as "special fund" has been taken into account when CFS is prepared at the end of period. Therefore it is deducted from 300.000 once and add again as gain on sales of fixtures.

d) Gain on sales of building is not taken into account when CFS is prepared at the end of period but taken into account when done during period since it is known on transaction date.

e) 50.000 gain on sales of building is CFI however goes under CFO when CFS is prepared at the end of period, since included to the accrual income automatically. Therefore we deduct it from CFO to reconcile CFS at the end to CFS during period.

Table 4-9 A mathematical overview of changes in all accounts in the result of related transaction

	Cash	Marketable Securities	Operational Accounts Receivable	Inventories	Prepaid expenses & Accrued Revenue Receivables	Other Current Assets	Stock Investments	Tangible Assets	Operational Liabilities	Other Liabilities	Taxes & Other Governmental Payables	Provisions for Known Liabilities & Unrealized estimated expenses	Accrued expense payables & Revenue collected in advance	Other Short Term Liabilities	Paid-in Capital	Capital Surplus	Income Reserves	Retained Earnings	Net Income of the Period
	10	**11**	**12**	**15**	**18**	**19**	**24**	**25**	**32**	**33**	**36**	**37**	**38**	**39**	**50**	**52**	**54**	**57**	**59**
1	-26			60		6			-40										
2	120	-100																	
3	50		38											-8					
4	-22					2													
5											-20	20							
	-20										20								
6	110							-90						-10			-10		
7										-8	-18								
8	-10																		
9	-12				6														
10	-20																	20	
11	100			100											-200				
12	66												-40	-6					
13	-5					5													
			-3																
15	220													-20					
16						-28					-16			44					
17			-1																
									6										
18	-4																		
19	1																		
20				-85															
				-20															
21	250							-200											
22								276								-276			
23								-152											
24							15									-5			
	5						-5												
25												-24							
						-5						5							
																			-36
Total	803	-100	34	55	6	-20	10	-166	-34	-8	-34	1	-40	0	-200	-281	-10	20	-36

Sales Revenue	Cost of Goods Sold	Period Expenses	Ordinary non-operating Revenue & Income	Ordinary non-operating Expenses & Loses	Financing Expenses	Extra - Ordinary Revenues & Income	Net income (loss) of the Period
60	**62**	**63**	**64**	**65**	**66**	**67**	**69**
			-20				
-80							
20							
		26					
					10		
		6					
-20							
				3			
-200							
				1			
			-6				
				4			
			-1				
	85						
				20			
						-50	
		152					
			-10				
	-85	-184		-28	-10		307
280			37			50	-367
							24
							36
0	0	0	0	0	0	0	0

4.3.3. Financial Ratios

The impact of these differences on the financial ratios regarding cash flow will be as follows:

4.3.3.1. Cash Flows from Operations to Current Liabilities

This measure provides evidence of the company of the company's ability to cover its currently maturing liabilities from normal operations. (Meigs, Williams, Haka, & Bettner, 2002)

Calculated as: Cash Flows from Operating Activities / Current Liabilities

Reconstruction Method: 415.000 / 435.000 = **0, 95**

Suggested Method: 373.000 / 435.000 = **0, 86**

4.3.3.2. Current Cash Dept Coverage Ratio

Measures what percent of average current liabilities can be settled with cash flowing from operations. The higher the ratio, the better. Research suggests should be 40% or more. (Clark, 2003)

Calculated as: CFO / Average Current Liabilities

Reconstruction Method:

415.000 / [(435.000 + 320.000)/2] = 415.000 / 377.500 = **1, 10**

Suggested Method:

373.000 / [(435.000 + 320.000)/2] = 373.000 / 377.500 = **0, 99**

4.3.3.3. Cash Long-Term Coverage Ratio

Measures what percent of average total liabilities can be settled with cash flowing from operations. The higher the ratio, the better. (Clark, 2003)

Calculated as: CFO / Average Total Liabilities

Reconstruction Method:

415.000 / [(2.022.000 + 1.400.000) / 2] = 415.000 / 1.711.000 = **0,24**

Suggested Method:

373.000 / [(2.022.000 + 1.400.000) / 2] = 373.000 / 1.711.000 = **0,22**

To sum up, according to the results of this data the financial analysis will give different results.

CONCLUSION

The suggested method brings us some advantages by preparation depending on the accounting system. One of them is that CFS can be prepared any time you whish without a need to wait for other main statements. CFS can be detailed in every stage of the period accordingly, because of having net data in details. It is easier to prepare compared to preparing CFS depending on balance sheet and income statement, because it will be retrieved from accounting system. CFS thus supply clear data for accountants and financial analysts.

They will be qualified enough to be one of principal statements rather than being a derivative financial statement, because of being prepared without relating to balance sheet and income statement. These systems rely on clear data without requiring blurred estimates.

Suggested system depends on cash basis, which is integrated within the accrual basis accounting system. In addition to the current generally accepted system, we are adding the journal records relating to cash by using parallel accounts. Main class 8^{th} of Turkish Uniform Chart of Accounts is used for this purpose.

We have to evaluate the differences occurred after application of suggested method. All financial analyses, which are related to cash flow statement will be wrong because of these differences. As a result of these mistakes, financial managers are disable to evaluate by making comments on companies financial structure of companies. Because of this process, investors may decide on wrong investments.

This system is suitable for the new developments. Firstly, this system is convenient for different format of CFS, because parallel accounts will be ready any time any way to be used.

Different formats of CFS according to different Financial Reporting Systems of countries all around the word can be prepared depending on our suggested system.

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