Journal of Business & Management, COES&RJ-JBM
Publisher: Centre of Excellence for Scientific & Research Journalism
Online Issue: Volume1 Number 2, April 2013
Journal homepage: http://centreofexcellence.net/J/JBM/JBM%20Mainpage.htm

Preparing Statement of Cash Flows from Taoist Perspectives

Yu-Je Lee[1], Takming University of Science and Technology, Taipei City
Jie He[2], budget division, Department of Finance, Qing Hai Province, China
Mei-Fen Wu[3], Takming University of Science and Technology, Taipei City
Ying-Qing Li[4], Guangzhou Hengyun Enterprises Holding Ltd., China
Ching-Ho Chen[5], CPA, Taipei City

Abstract
The preparation of cash-flow statement under the indirect method involves adjustments of many items. This is a highly complex process prone to errors, due to a lack of philosophical guidance. This paper finds that the concept of natural equilibrium of Chinese Taoism "… is the way of heaven to take from what has in excess in order to make good what is deficient..." can lend intellectual support to the preparation of cash flows statement under the indirect method. This approach will greatly enhance the accuracy of cash flows statement under the indirect method. This paper uses examples to illustrate the process of adjustments in the preparation of cash- flow statement under the indirect method in the context of Taoist philosophy. The results show that the philosophical perspectives of Chinese Taoism can provide strong guidance on these adjustments by achieving both efficiency and efficacy. The assurance of this "win-win" is a testimony to the philosophical contents of Taoism in the context of modern times.

Keywords: philosophical perspectives of Taoism, indirect method, cash flow statement

Introduction
The Chinese culture presents in the form of Confucian and on the root of Taoism. As the origin of the Mandarin culture, Taoism emphasizes the balance between Yin and Yang and the role of "action-less governance" in the context of objective laws. The purpose is to achieve the unification of the heaven and mankind, as well as a harmonic development of nature and human beings. Lao Tzu says in Chapter 77 of his book "The Tao Te-Ching", "it is the way of heaven to take from what has in excess in order to make good what is deficient. The human way is different; it reduces the insufficient to supplement the excessive." He argues that we should observe the law of nature and seek the balance in the nature by impairing the excess to make up for the insufficient. He believes that the way of heavens is the fairest and it should be applied to the inclusive development of human societies. Unfortunately, human beings follow the rules of the Matthew Effects". "For whosoever hath, to him shall be given, and he shall have more abundance; but whosoever hath not, from him shall be taken away even that he hath". The profound theoretical foundation and the robust arguments of Taoism can indeed provide new perspectives to the innovation in research works of accounting.

In the past, internationally accounting standards required the use of the direct method for the preparation of cash flows statement and the supplementary information under the indirect method in the footnote. Currently, IFRS suggests the use of the indirect method for the production of cash flows statement. It starts with net income, and makes adjustments of operating cash flows in the following four categories, i.e. expenses not actually paid, gains not resulting in cash receipts, profits and losses not part of operating activities and changes to the payable/receivables of operating activities (Kang, 1999).

After the required adjustments, net operating cash flows should be net income plus expenses not paid in cash minus gains not resulting in cash receipts plus non-operating expenses minus gains not resulting from operating activities plus non-cash reductions of operating assets plus additions of operating liabilities (Charitou, 1986; Bernard and Stober, 1989; Shyu, 1992).

In practice, the adjustments required for the preparation of cash-flow statement under the indirect method is very complex. Even professionals can easily make mistakes. This is due to a lack of philosophical foundation in the thinking of accounting. This study finds that the Taoist philosophy of "the way of heaven to take from what has in excess in order to make good what is deficient" can lend intellectual support to the preparation of cash-flow statement under the indirect method and greatly enhances the accuracy of such preparation. This is the main purpose of this paper.

Basic Principles

The operating cash flows are deemed as an entity that observes "the way of heaven to take from what has in excess in order to make good what is deficient". The guiding principle is the balance between Yin and Yang.

1. All the items that enhance income-generating capability are all translated into deductions in the adjustments under the indirect method.

Including increase in investment gains, increase in financial incomes, reversal of reserve for asset impairments, increase in inventory, increase in accounts receivable or other operating receivable, gains on the disposal of non-current assets, gains on the disposal of obsolete fixed assets, gains from change in fair values of real estate (as investments) and capitalized biological assets, increase in deferred income taxes or reduction in deferred income liabilities.

2. All the items that weaken income-generating capability are all translated into additions in the adjustments under the indirect method.

   Including investment losses, increase in financial incomes, reserve for asset impairments, decrease in inventory, decrease in accounts receivable or other operating receivables, depreciation, amortization and disposal losses of fixed assets, depreciation, amortization and disposal losses of intangible assets,

losses from change in fair values of real estate (as investments) and capitalized biological assets, decrease in deferred income taxes or increase in deferred income liabilities.

Example & Analysis

On the basis of the above-mentioned principles, this paper uses an example in the study by Lu (2011) to illustrate the preparation of a cash-flow statement under the indirect method. Table 1 lists the details of the comparative balance sheet and consolidated income statement of a hypothesized company (Franz, 1986).

Table 1

Company XX
Comparative Balance Sheets
As of December 31, 2010/2011

	2011	2010
Assets		
Cash	$ 48,000	$ 45,000
Accounts receivable (net)	36,000	25,000
Deposits	48,000	60,000
Prepaid expenses	11,000	12,000
Long-term investments–equity method	80,000	66,000
Fixed assets– land	160,000	100,000
Fixed assets – buildings	180,000	0
Fixed assets – office facilities	200,000	220,000
Accumulated depreciation – fixed assets – office facilities	(40,000)	(38,000)
Total Assets	$ 723,000	$ 490,000
Liabilities		
Accounts Payable	$ 35,000	$ 25,000
Interests payable	7000	3,000
Income tax payable	13,000	10,000
Long-term borrowing	150,000	0
Long-term notes payable	120,000	140,000
Total Liabilities	$ 325,000	$ 178,000
Shareholders' Equity		
Ordinary shares	$ 300,000	$ 250,000
Capital reserves	14,000	16,000
Retained earnings	84,000	46,000
Total Shareholders' Equity	$ 398,000	312,000

Total Liabilities and Shareholders' Equity	$ 723,000	$ 490,000

Table 2

Company XX **Consolidated Income Statement** 2011		
Net Sales		$ 200,000
Cost of goods sold		(100,000)
Gross profit		$ 100,000
Operating expenses		
Wages	$ 22,000	
Depreciation	10,000	
Bad debt expenses	2,000	
Others	6,000	(40,000)
Operating profits		$ 60,000
Non-operating incomes & expenses		
Investment gains	$ 5,000	
Gain on the sale of office facilities	4,000	
Interest income	2,000	
Interest expense	(6,000)	5,000
Pre-tax earnings		$ 65,000
Income taxes		(13,000)
After-tax earnings		$ 52,000

Additional information:

1. A bad debt of $2,000 is recognized. There are no items that affect the provision for bad debts.
2. Investment gains are in the form of cash dividends.
3. The board approved the payment of cash dividends by $10,000.
4. Long-term equity investments increased by $14,000 in 2011.
5. Part of the office facilities purchased in a single batch was sold in 2011. The original cost was $20,000, accumulated depreciation $8,000, sale price $16,000.
6. The company bought back treasury stocks and cancelled. It was bought at a cost of $16,000. The original issuing price was $12,000. The surplus over the issuing cost is recognized as retained earnings.
7. At the end of 2011, the company borrowed a long-term loan of $150,000, purchased buildings for $180,000 and paid cash $30,000.
8. The company issued 600 ordinary shares at the face value of $10 to exchange a piece of land at the market price of $6,000.

Assume Company XX classifies interests received and paid as operating cash flows, cash dividends received as investing cash flows and dividends paid as financing cash flows.

Indirect Method

1. Analysis of operating cash flows

(1) The analysis on the incomes and expenses in the consolidated income statement identifies the non-cash expenses, non-cash gains and non-operating gains and losses. These items are additions/deductions accordingly. According to IAS7, the cash flows statement should disclose interests received and paid, dividends received and paid and income taxes cash flows. The adjustments should start from pre-tax earnings, rather than after-tax earnings under the indirect method. Meanwhile, interest incomes should be deducted and interest expenses should be added back (Ketz and Largay, 1987; Shyu, 1992; Wang, 1997; Lu, 2011).

The analysis is as follows:

+	Depreciation	$10,000
+	Bad debts	$2,000
-	Investment gains	($5,000)
-	Gain from sale of office facilities	($4,000)
-	Interest income	($2,000)
+	Interest expenses	$6,000

The adjustments start with pre-tax earnings. There is no specific term for the interim result.

(2) The calculation of changes (i.e. additions or deductions) in current assets and current liabilities associated with operating activities (Wild and Kwok, 2011). The analysis is as follows:

- Increase in accounts receivable ($13,000) ($36,000+$2,000)-$25,000=13,000
- \+ Decrease in inventory $12,000 ($48,000-$60,000)=($12,000)
- \+ Decrease in prepaid expenses $ 1,000 ($11,000-$12,000)=($1,000)
- \+ Increase in accounts payable $10,000 ($35,000-$25,000)=$10,000

The result of these adjustments added to the interim result above (1) is the operating cash flows.

(3) The confirmation of interests received and paid and cash flows concerning income taxes to be disclosed.

Cash outflows associated with interests payments

= $6,000+$3,000-$7,000

=$2,000

Cash inflows associated with interest receipts = interests income + interests receivable at the beginning of the period – interests receivable at the end of the period

= $2,000+$0-$0 =$2,000

Cash outflows associated with income tax payments = income tax expense + income taxes payable at the beginning of the period- income taxes payable at the end of the period

= $13,000+$10,000-$13,000 =$10,000

The additions and deductions of the results to the above cash flows by operating are the final results for net cash inflows/outflows in operating activities (Zhu, 1995).

2. The analysis of investing cash flows

+	Investment gains (dividends received)	$5,000
+	Sale of office facilities	$16,000
-	Increase in long-term equity investments	($14,000)
-	Purchase of buildings	($30,000)

3. Analysis of financing cash flows

-	Dividends paid	($10,000)
-	Purchase of treasury stocks and cancellation	($16,000)
-	Repayment of long-term notes payable	($20,000)

The repayment of long-term notes payable was not provided. Rather, it was derived by comparing the balance sheets of 2010 and 2011.

4. Analysis of additional information

(1) Non-cash investment and financing transactions

The issue of 600 ordinary shares at the face value of $10 per share exchange land at a market price of $6,000.

(2) Investing and financing activities that affect both cash items and non-cash items

The long-term loan from the bank at $150,000 purchase buildings for $180,000. The shortfall of $30,000 paid with cash.

5. Beginning to produce cash flows statement

Below is the cash flows statement of Company XX under the indirect method (Allen, 1985; Ainsworth, 1988).

Table 3

Company XX **Statement of Cash Flows (Indirect Method)** 2011		
Cash flows from operating activities		
Pre-tax earnings-net	$ 65,000	
Adjustments		
Depreciation	*10,000*	
Bad debts	*2,000*	
Investment gains	*(5,000)*	
Gains on sale of office facilities	*(4,000)*	
Interest income	*(2,000)*	
Interest expenses	*6,000*	
	$ 72,000	
Increase in accounts receivable	*(13,000)*	
Decrease in inventory	*12,000*	
Decrease in prepaid expenses	*1,000*	
Increase in accounts payable	*10,000*	
Operating cash flows	*$ 82,000*	
Interests received	*2,000*	
Interests paid	*(2,000)*	
Income taxes paid	(10,000)	$ 72,000
Net cash inflows in operating activities		
Cash flows from investing activities		
Investment gains (dividends received)	$ 5,000	
Sale of office facilities	16,000	
Increase in long-term equity investments	(14,000)	
Purchase of buildings	(30,000)	
Net cash outflows in investing activities		(23,000)
Cash flows from financial activities		
Dividends paid	$ (10,000)	
Bought back Treasury stocks & cancellation	(16,000)	
Repayments of long-term notes payable	(20,000)	
Increase in cash and cash equivalent		(46,000)
Add: cash and cash equivalent at the beginning of the period		$ 3,000 45,000
Cash and cash equivalent at the end of the period		$ 48,000
Non-cash investing and financing activities:		

Issue of 600 ordinary shares to exchange land		$ 60,000
Cash paid and long-term bank loan borrowed to purchase buildings:		
Buildings		$ 180,000
Long-term borrowing		(150,000)
Cash repayments		$ 30,000

[7]This information was not provided. However, this paper believed it was the repayment of long-term notes payable for $20,000. It was also the final number for cash balance.

The above example demonstrates the adjustments to cash inflows and outflows associated with cash flows from operating activities for the presentation of cash flows statement (Table 3) of Company XX under the indirect method. The application of the Taoist philosophy allows financial report producers or readers to easily determine the required adjustments from operating activities for net cash inflows/outflows for operating activities. Of course, the prerequisite is to correctly classify the individual accounting items to be adjusted under the following five categories (Table 4).

Table 4 Criteria for Cash-Flow Adjustments Associated with Operating Activities

Principle	Adjustments of operating activities	Cash flows from operating activities
(1) Impairing the excess	Increase of assets Increase of equity Increase of earnings Decrease of liabilities Decrease of expenses	Cash outflows (-)
(2) Filling in the insufficient	Decrease of assets Decrease of equity Decrease of earnings Increase of liabilities Increase of expenses	Cash inflows (+)

Conclusions

The above example demonstrates the strong guidance of the philosophy of Chinese Taoism on the adjustments of cash flow items under the indirect method. Its central and fundamental is, "it is the way of heaven to take from what has in excess in order to make good what is deficient. The human way is different; it reduces the insufficient to supplement the excessive." This is an innovative approach to calculating operational inflows and outflows. It can shorten the time required for adjustments and ensures both the efficacy and efficiency of the adjustments. It is a testimony to the vitality and creativity of the focus on balance

and harmony between heaven and humankind in the tradition of Chinese Taoism, even in the context of modern times.

References

1. Ainsworth, P. L. (1988), The Information Content of Cash Flow Data: An Empirical Investigation, Ph.D. Dissertation, The University of Nebraska, USA.
2. Allen, G. L. (1985), An Empirical Investigation of the Complementary Value of a Statement of Cash Flows in A Set of Published Financial Statements, Ph.D. Dissertation, North Texas State University.
3. Bernard, V. and T. Stober (October 1989), The Nature and Amount of Information in Cash Flows and Accruals, The Accounting Review.
4. Charitou, A. G. (1986), The Information Content of Accrual and Cash Flow Measures: A Cross-Sectional Valuation Study, Ph.D. Dissertation, The Pennsylvania State University.
5. Franz, D. (1986), The Information Content of Cash Flow Measures: An Empirical Analysis, Ph.D. Dissertation. The Pennsylvania State University.
6. Lu Wen-Long (2011), Accounting Principles, Hwa Li Publishing Co., Taiwan
7. Kang Ya-hsiang (1999), The Information Content of Cash Flows Financial Statement under Indirect Method, Thesis for Master's Degree, Graduate Institute of Accounting, National Taiwan University, Taiwan
8. Ketz, J. E. and J. A. Largay III (June 1987), Reporting Income and Cash Flows From Operations, Accounting Horizons.
9. Shyu, Jiing-Liang (1992), Information Contents and Preparation of Cash Flows Statements by Listed Companies in Taiwan, Thesis for PhD's degree, Graduate Institute of Business Management, National Chengchi University, Taiwan
10. Wang Yi-wei (1997), Information Contents of Working Capital Utilization and Increasing Cash Flows, Thesis for Master's Degree, Graduate Institute of Accounting, National Chengchi University, Taiwan
11. Wild, J. J., and Kwok, W. (2011), Financial Accounting: Information for Decisions, The McGraw-Hill Companies, Inc.
12. Zhu Li-lun (1995), Classification of Cash Flows and Information Contents, Science and Technology Information Center, National Science Council National Science Council, Executive Yuan, Taiwan

xxxxxxxxxxx