

STATEMENT OF CASH FLOWS

IAS 7



Introduction

- SCF, when used with the rest of the FSs provides information that enables users to evaluate :
 - changes in net assets of entity,
 - its financial structure (including its liquidity and solvency) &
 - its ability to affect amount and timing of cash flows in order to adapt to changing circumstances & opportunities.

Introduction

- Cash flow information is used in assessing
 - ability of the entity to generate cash & cash equivalents &
 - due to lack of subjectivity & judgment inherent in other components of FSs;
 - enables users to develop models to assess & compare PV of the future cash flows of different entities.
(remember value of entity is reflected by PV of future cfs)

Introduction

- What about drawbacks of SCF?
 - volatile & may be influenced by external factors e.g.
 - upswings & downswings in the economy may not always reliably predict future cash flows
 - by completely eliminating accrual accounting
 - effects of credit transactions on probable future cash in & out flows undermined

Key terminology

- Cash
 - cash on hand &
 - demand deposits
- Cash equivalents
 - short-term, highly liquid investments that are:
 - readily convertible to known amounts of cash &
 - which are subject to insignificant risk of change

Key terminology

- Cash flows are inflows & outflows of cash & cash equivalents

Presentation of SCF

- Cash flows are categorized under three headings:
 - operating activities
 - investing activities
 - financing activities

Presentation of SCF

- Operating activities
 - are principal revenue producing activities;
&
other activities that are not investing/
financing

Presentation of SCF

- Investing activities

- are acquisition & disposal of long term assets &

- other investments not in CEs. Only expenditures that result in a recognised asset in SFP are eligible for classification as investing activities.

Presentation of SCF

- Financing activities
 - are those that result in changes in size & composition of the contributed equity & borrowings of the entity

Presentation of SCF

- Cash flows from interest and dividends received & paid should be disclosed separately, but an entity can choose under which of the three headings to present them, as long as classification is consistent from one period to another.

Presentation of SCF

- Cash flows from taxes on income should be disclosed separately under the operating activities heading, unless they specifically relate to items presented under the other two headings.

Presentation methods

- How are SCFs presented (2 methods)
 - Direct method (cash generated from operations)
 - cash receipts from customers
 - cash paid to customers & employees

Presentation methods

- indirect method
 - presents a reconciliation between profit before tax & cash generated from operations by:
 - reversing non-cash I & E (e.g. depn)
 - reversing I & E items separate disclose (e.g. interest expense)
 - adjust changes in WC (deduct increase in acc receivable)

Presentation methods: Example – indirect & direct method

Indirect method	
Cash flows from operating activities	
Profit before tax	250000
Adjustments:	
Depreciation	15000
Gain on disposal of equipment	-2500
Investment income	-5000
Finance cost	20000
Net changes in working capitl	<u>3000</u>
Cash generated from operations	<u>280500</u>

Presentation methods : Example – indirect & direct method

Direct method	
Cash flows from operating activities	
Cash receipts from customers	950000
Cash paid to suppliers	<u>669500</u>
Cash generated from operations	<u>280500</u>

Presentation methods

- Which of the 2 methods?
 - IAS7 allows both but encourages direct method as it involves extra disclosure of useful info (e.g. cash receipts from customers & cash paid to suppliers & employees)
 - most preparers of FS prefer to use the indirect method rather than the recommended direct method.

Presentation methods

- It is only the operating activities section of the statement of cashflow that is affected by shake. Irrespective of which method is used, the investing & financing sections of the statement of cash flow remain the same

Consolidated statement of cash flows

- ❑ Where consolidated financial statements are prepared, a consolidated statement of cash flow should also be presented.
- ❑ Consolidated statement of cash flows should disclose only those flows to/from parties outside the group.