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IAS - 07

Statement of Cash Flows

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Objectives

Provision of information about the historical changes in cash and cash equivalents of an entity

Scope

- Prepare a statement of cash flows as per IAS – 07
- Present it as an integral part of its financial statements.
- Accordingly, this Standard requires all entities to present a statement of cash flows.

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Key Questions

- Did the company's profits generate sufficient funds for its continued operations?
- Is the company capable of generating funds, as opposed to profit from its trading activities?
- Why has the bank overdraft increased, despite the company having had a profitable year?

- How has the company financed its increased non-current assets? Did it finance them from non-current sources or from operating activities?
- What was done with the loan that was taken out during the year?
- How did the company meet its dividend and interest payments? Was it from operating activities, from increased borrowing or from the sale of non-current assets?

Benefits of cash flow information

Enables users to evaluate the changes in net assets of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities.

Cash flow information is useful in assessing the ability of the entity to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different entities.

It also enhances the comparability of the reporting of operating performance by different entities because it eliminates the effects of using different accounting treatments for the same transactions and events.

Definitions

Cash cash on hand + demand deposits.

Cash equivalents

Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows inflows and outflows of cash and cash equivalents.

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Operating activities

Principal revenue-producing activities of the entity and other activities that are not investing or financing activities.

Investing activities

Acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Financing activities

Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

Cash and cash equivalents

- Short-term cash commitments rather than for investment or other purposes.
- Readily convertible to a known amount of cash
- Be subject to an insignificant risk of changes in value.

Short maturity of, say, three months or less from the date of acquisition.

Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares **acquired within a short period** of their maturity and with a **specified redemption date**.

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Bank borrowings are generally considered to be financing activities. However, in some countries, bank overdrafts which are repayable on demand form an integral part of an entity's cash management. In these circumstances, bank overdrafts are included as a component of cash and cash equivalents.

Cash flows **exclude** movements between items that constitute cash or cash equivalents

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Profit VS Cash Flow

Presentation of a statement of cash flows

The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.

A single transaction may include cash flows that are classified differently. For example, when the cash repayment of a loan includes both interest and capital.

Interest element	classified as an operating activity
Capital element	classified as a financing activity.

Summarised statement of cash flows

	PKR'000
Cash flows from **operating** activities	X
Cash flows from **investing** activities	X
Cash flow from **financing** activities	X
Net increase/ (decrease) in cash and cash equivalents during period	X
Cash and cash equivalents at the beginning of period	X
Cash and cash equivalents at end of period	X

Operating activities – Key Indicator

- Operations of the entity have generated sufficient cash flows to repay loans.
- Maintain the operating capability of the entity.
- Pay dividends
- Make new investments without recourse to external sources of financing.

Operating Activities

Derivation of Cash Flow

Principal revenue generating activity

Examples of Operating Activities

Cash Receipts

- Sale of goods and the rendering of services
- Royalties, fees, commissions and other revenue
- Insurance entity for premiums and claims, annuities and other policy benefits

Cash Payments

- Suppliers for goods and services
- To and on behalf of employees
- Insurance entity for premiums and claims, annuities and other policy benefits

Examples of Operating Activities

Cash Receipts

- Contracts held for dealing or trading purposes.
- Rents and subsequent sales of rental assets
- purchase and sale of dealing or trading securities

Cash Payments

- Refunds of income taxes unless they can be specifically identified with financing and investing activities
- Manufacture or acquire assets held for rental to others and subsequently held for sale.
- Advances & loans made by financial institutions (main revenue-producing activity)

Investing Activities

Derivation of Cash Flow

Expenditures have been made for resources intended to generate future income and cash flows.

Only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities.

Examples of Investing Activities

Cash Receipts

Sales of property, plant and equipment, intangibles and other long-term assets

Sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes).

Cash Payments

Acquire property, plant and equipment, intangibles and other long-term assets. (Relating to capitalised development costs and self-constructed property, plant and equipment)

Examples of Investing Activities

Cash Receipts

Repayment of advances and loans made to other parties (other than advances and loans of a financial institution)

Sale proceed from sale of an item of property, plant & equipment

Cash Payments

Acquire equity or debt instruments of other entities and interests in joint ventures (other than instruments considered to be cash equivalents or those held for dealing or trading purposes)

Financing Activities

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Derivation of Cash Flow

Claims on future cash flows by providers of capital to the entity

Examples of Financing Activities

Cash Receipts

Proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings

Cash Payments

Lessee for the reduction of the outstanding liability relating to a lease.

Examples of Financing Activities

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Cash Receipts

Proceeds from issuing shares or other equity instruments

Cash Payments

Owners to acquire or redeem the entity's shares

Repayments of amounts borrowed

Reporting cash flows from operating activities

(a) the **direct method**, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the **indirect method**, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

IAS : 7 - Encourage

Entities are encouraged to report cash flows from operating activities using the direct method.

ICAP Syllabus

Use indirect method

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Direct method

	PKR'000
Cash received from customers	XXX
Cash Payments to suppliers	(XXX)
Cash paid to and on behalf of employees	(XXX)
Other cash expenses	(XXX)
Cash generated from operations	XXX/(XXX)
Interest received	(XXX)
Interest Paid	(XXX)
Tax Paid	(XXX)
Dividend Paid	(XXX)
Net cash flow from operating activities	**XXX/(XXX)**

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Illustration:

Statement of cash flows: direct method	**Rs.**
Cash flows from operating activities	
Cash receipts from customers	348,800
Cash payments to suppliers	(70,000)
Cash payments to employees	(150,000)
Cash paid for other operating expenses	(30,000)
Cash generated from operations	98,800
Taxation paid (tax on profits)	(21,000)
Interest charges paid	(2,500)
Net cash flow from operating activities	75,300

Indirect method

	PKR'000
Profit before Tax	XXX
Depreciation charges	XXX
(Profit) / Loss on disposal	XXX
Interest expense	XXX
(Increase) / decrease in receivables	XXX
(Increase) / decrease in inventory	XXX
Increase / (decrease) in payables	XXX
Cash generated from operations	(XXX)/XXX
Interest received	(XXX)
Interest Paid	(XXX)
Tax Paid	(XXX)
Dividend Paid	(XXX)
Net cash flow from operating activities	**(XXX)/XXX**

Non-Cash Items

Depreciation and amortisation

Depreciation charges and amortisation charges are not cash flows. They are expenses in the statement of comprehensive income, but do not represent payments of cash.

Gains or losses on disposal of non-current assets

Gains or losses on the disposal of non-current assets are not cash flows. Effect of the gain or loss on disposal

Gain on disposal	Deduct
Losses on disposal	Add

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Example:

A company disposed of an item of equipment for Rs. 40,000. The equipment had originally cost Rs. 60,000 and the accumulated depreciation charged up to the date of disposal was Rs. 32,000.

	Rs.
Cost	60,000
Accumulated depreciation	(32,000)
Carrying value at date of disposal	28,000
Cash proceeds from sale	(40,000)
Gain on disposal	12,000

In the statement of cash flows, the gain on disposal of Rs. 12,000 is deducted as an adjustment to the operating profit.

The cash proceeds of Rs. 40,000 is included as a cash inflow under the heading: 'Cash flows from investing activities'.

Interest

Interest charged in SOCI
= Added

Actual interest paid
= Deducted

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Illustration:

	Rs.
Interest liability at the beginning of the year	X
Interest charge for the year (statement of comprehensive income figure)	X
	X
Interest liability at the end of the year	(X)
Interest paid in the year (cash)	X

Tax

	Rs.
Interest liability at the beginning of the year	X
Interest charge for the year (statement of comprehensive income figure)	X
	X
Interest liability at the end of the year	(X)
Interest paid in the year (cash)	**X**

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Example:

A company had liabilities in its statement of financial position at the beginning and at the end of 2013, as follows:

Liabilities	Interest accrual	Taxation
Beginning of 2013	Rs. 4,000	Rs. 53,000
End of 2013	Rs. 3,000	Rs. 61,000

During the year, interest charges in the statement of comprehensive income were Rs. 22,000 and taxation on profits were Rs. 77,000.

The amounts of interest payments and tax payments (cash flows) for inclusion in the statement of cash flows can be calculated as follows:

	Tax	Interest
	Rs.	Rs.
Liability at the beginning of the year	53,000	4,000
Taxation charge/interest charge for the year	77,000	22,000
	130,000	26,000
Liability at the end of the year	(61,000)	(3,000)
Cash paid during the year	69,000	23,000

Working capital

Current assets less Current liabilities

Current Asset = Stock + Debtor + Cash

Current Liabilities = Creditor

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Balance	Increase in balance from start to the end of the year	Decrease in balance from start to the end of the year
Receivables	Subtract from profit before tax	Add back to profit before tax
Inventory	Subtract from profit before tax	Add back to profit before tax
Payables	Add back to profit before tax	Subtract from profit before tax

Rule - 02

Working capital adjustment always relate to current assets and liabilities

Increase in current liability & Decrease in current assets = **INFLOW**

Decrease in current liability & Increase in current assets = **OUTFLOW**

Example - trade and other receivables

A company had receivables at the beginning of the year of Rs. 6,000 and at the end of the year receivables were Rs. 9,000.

During the year, sales were Rs. 50,000 in total. Purchases were Rs. 30,000, all paid in cash.

The company holds no inventories. The profit before tax for the year was Rs. 20,000 (Rs. 50,000 – Rs. 30,000).

The cash flow from operations is calculated as follows:

	Rs.
Profit before tax	20,000
Adjustments for:	
Increase in receivables (9,000 – 6,000)	(3,000)
	17,000

Allowances for doubtful debts

Add to profit before tax figure

Example - inventory

A company had inventory at the beginning of the year of Rs. 5,000 and at the end of the year the inventory was valued at Rs. 3,000. During the year, sales were Rs. 50,000 and there were no receivables at the beginning or end of the year.

Purchases were Rs. 28,000, all paid in cash.

The operating profit for the year was Rs. 20,000, calculated as follows:

	Rs.
Sales	50,000
Opening inventory	5,000
Purchases in the year (all paid in cash)	28,000
	33,000
Closing inventory	(3,000)
Cost of sales	(30,000)
Profit before tax	20,000
Adjustments for:	
decrease in inventory (5,000 – 3,000)	2,000
	22,000

Example – trade payable

A company had no inventory and no receivables at the beginning and end of the year. All its sales are for cash, and sales in the year were Rs. 50,000. Its purchases are all on credit. During the year, its purchases were Rs. 30,000. Trade payables at the beginning of the year were Rs. 4,000 and trade payables at the end of the year were Rs. 6,500.

The operating profit for the year was Rs. 20,000 (Rs. 50,000 – Rs. 30,000)

	Rs.
Profit before tax	20,000
Adjustments for:	
Increase in payables (6,500 – 4,000)	2,500
	22,500

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Illustration:

Statement of cash flows: indirect method	Rs.	Rs.
Cash flows from operating activities		
Profit before taxation	80,000	
Adjustments for:		
Depreciation and amortisation charges	20,000	
Interest charges in the statement of comprehensive income	2,300	
Gains on disposal of non-current assets	(6,000)	
Losses on disposal of non-current assets	4,500	
	100,800	
Increase/decrease in:		
Increase in trade and other receivables	(7,000)	
Decrease in inventories	2,000	
Increase in trade payables	3,000	
Cash generated from operations	98,800	
Taxation paid (tax on profits)	(21,000)	
Interest charges paid	(2,500)	
Net cash flow from operating activities		**75,300**

Cash paid for the purchase of property, plant and equipment

Illustration: Movement on non-current assets

	Rs.
Carrying amount at the start of the year	X
Depreciation	(X)
Disposals	(X)
Additions	X
Revaluation	X/(X)
Carrying amount at the end of the year	X

When there are no disposals or revaluations during the year

	Rs.
Non-current assets at the end of the year at cost	X
Non-current assets at the beginning of the year at cost	X
Additions to non-current assets	X

Example: Cash paid for property, plant and equipment

The plant and equipment of PM Company at the beginning and the end of its financial year were as follows:

	At cost	Accumulated depreciation	Net book value
	Rs.	Rs.	Rs.
Beginning of the year	180,000	(30,000)	150,000
End of the year	240,000	(50,000)	190,000

There were no disposals of plant and equipment during the year.

When there are disposals during the year

	Rs.
Assets at cost at the end of the year	X
Assets at cost at the beginning of the year	X
	X
Disposals during the year: original asset cost	X
Purchases	X

Example: Disposal

The motor vehicles of PM Company at the beginning and the end of its financial year were as follows:

	At cost	Accumulated depreciation	Net book value
	Rs.	Rs.	Rs.
Beginning of the year	150,000	(105,000)	45,000
End of the year	180,000	(88,000)	92,000

During the year a vehicle was disposed of for a gain of Rs. 3,000. The original cost of this asset was Rs. 60,000. Accumulated depreciation on the asset was Rs. 45,000.

When there are revaluations during the year

	Rs.
At cost or valuation, at the end of the year	X
At cost or valuation, at the beginning of the year	X
	X
Add: Cost/re-valued amount of assets disposed of in the year	X
Subtract: Any upward asset revaluation during the year (or deduct a downward revaluation)	(X)
Purchases during the year	**X**

Disposal

	Rs.
At cost (or re-valued amount at the time of disposal)	X
Accumulated depreciation, at the time of disposal	(X)
Net book value/carrying amount at the time of disposal	X
Gain or (loss) on disposal	X
Net disposal value (= **assumed cash flow**)	**X**

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Cash paid for the purchase of investments and cash received from the sale of investments

Illustration: Movement on investments

	Rs.
Carrying amount at the start of the year	X
Disposals	(X)
Additions	X
Revaluation	X/(X)
Carrying amount at the end of the year	**X**

Cash from new share issues

	Rs.
Share capital + Share premium at the end of the year	X
Share capital + Share premium at the beginning of the year	X
Cash obtained from issuing new shares in the year	**X**

Cash from new loans/cash used to repay loans

	Rs.
Loans at end of year (current and non-current liabilities)	X
Loans at beginning of year (current and non-current liabilities)	X
Cash inflow or outflow	X

Dividend payments to equity shareholders

	Rs.
Retained earnings at the beginning of the year	X
Profit for the year after tax	X
Any other transfer into the account	X
Increase in the retained earnings reserve	X
Retained earnings at the end of the year	(X)
Equity dividend payments	**X**

Financing of a sole proprietor or a partnership

	Rs.
Capital at the beginning of the year	X
Profit (loss) for the year after tax	X/(X)
Capital introduced	X
Drawings	(X)
Capital at the end of the year	**X**

Direct Method - Specimen

Illustration:

	Rs.	Rs.
Cash flows from operating activities		
Cash receipts from customers	X	
Cash paid to suppliers	(X)	
Cash paid employees	(X)	
Cash generated from operations	***X***	
Interest paid	(X)	
Income taxes paid	(X)	
Net cash from operating activities		X
Cash flows from investing activities		
Purchase of property, plant and equipment	(X)	
Proceeds from sale of equipment	X	
Interest received	X	
Dividends received	X	
Net cash used in investing activities		X
Cash flows from financing activities		
Proceeds from issue of share capital	X	
Proceeds from long-term borrowings	X	
Dividends paid	(X)	
Net cash used in financing activities		X
Net increase in cash and cash equivalents		X
Cash and cash equivalents at beginning of period		X
Cash and cash equivalents at end of period		X

Indirect Method - Specimen

Illustration:

	Rs.	Rs.
Cash flows from operating activities		
Profit before taxation	X	
Adjustments for:		
Depreciation	X	
Investment income	(X)	
Interest expense	X	
Operating profit before working capital changes	X	
Increase in trade and other receivables	(X)	
Decrease in inventories	X	
Decrease in trade payables	(X)	
Cash generated from operations	X	
Interest paid	(X)	
Income taxes paid	(X)	
Net cash from operating activities		X
Cash flows from investing activities		
Purchase of property, plant and equipment	(X)	
Proceeds from sale of equipment	X	
Interest received	X	
Dividends received	X	
Net cash used in investing activities		X
Cash flows from financing activities		
Proceeds from issue of share capital	X	
Proceeds from long-term borrowings	X	
Dividends paid	(X)	
Net cash used in financing activities		X
Net increase in cash and cash equivalents		X
Cash and cash equivalents at beginning of period		X
Cash and cash equivalents at end of period		X

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Reporting cash flows from investing and financing activities

Reported on a net basis

Reporting cash flows on a net basis

Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

(a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity;

- the acceptance and repayment of demand deposits of a bank;
- funds held for customers by an investment entity; and
- rents collected on behalf of, and paid over to, the owners of properties.

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(b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short. advances made for, and the repayment of:

- principal amounts relating to credit card customers;
- the purchase and sale of investments; and
- other short-term borrowings, for example, those which have a maturity period of three months or less.

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Cash flows arising from each of the following activities of a financial institution may be reported on a net basis

(a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;

(b) the placement of deposits with and withdrawal of deposits from other financial institutions; and cash advances and loans made to customers and the repayment of those advances and loans.

Interest and dividends

Transaction	IFRS Classification
Interest Received	Operating or Investing
Dividends Received	Operating or Investing
Interest Paid	Financing or Operating
Dividends Paid	Financing or Operating
Income Taxes	Operating unless specifically associated with financing or investing activity

Taxes on income

Disclosed : Separately disclosed

Classified : Operating activities unless they can be specifically identified with financing and investing activities.

Non-cash transactions

Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows.

Such transactions shall be disclosed elsewhere in the financial statements.

Examples of non-cash transactions are:

(a) the acquisition of assets either by assuming directly related liabilities or by means of a lease;

(b) the acquisition of an entity by means of an equity issue; and

Components of cash and cash equivalents

Disclose the components of cash and cash equivalents

Present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the statement of financial position.