STATEMENTS OF CASH FLOWS 23

OBJECTIVES **After studying this chapter you should be able to:**

- **identify the need for a statement of cash flows**
- **describe the difference between funds flow and cash flow**
- **explain why the IASB found it necessary to require cash flow rather than funds flow statements**
- **describe the requirements of IAS 7, *Statements of Cash Flow***
- **prepare a statement of cash flows**
- **identify any problems in relation to a statement of cash flows**
- **compare different GAAPs for statements of cash flow.**

INTRODUCTION

A statement of cash flows, as we will see later, provides additional useful information to users; additional, that is, to the statement of comprehensive income and statement of financial position of an entity. The statement of cash flows emphasizes cash and liquidity rather than revenue, expenses and profit. IAS 7, which was first issued in 1977,

originally required a funds flow statement, not a statement of cash flows. IAS 7 was revised in 1992 and now requires a statement of cash flows. Also note that IAS 7's title, before it was changed in 2007 as a result of changes in terminology introduced by IAS 1, was *Cash Flow Statements*. We will also discuss the difference between funds flow and cash flow within this chapter.

PROFIT VERSUS CASH

The traditional accounting process is an uncertain and complex process. Not only is profit determination complex, it is potentially misleading. In any accounting year there will be a mixture of complete and incomplete transactions. Transactions are complete when they have led to a final cash settlement and these cause no profit measurement difficulties. Considerable problems arise, however, in dealing with incomplete transactions, where the profit or loss figure can only be estimated by means of the accruals concept, whereby revenue and costs are matched with one another so far as their relationship can be established or justifiably assumed and dealt with in the profit and loss account of the period to which they relate.

Thus, the profit for the past year is dependent on the validity of many assumptions about the future. For example, the future life of assets is estimated in order to calculate the depreciation charge for the past year.

The greater the volume of incomplete transactions, the greater the degree of estimation and, accordingly, the greater the risk that investors could turn out to have been misled if actual outcomes deviated from estimates.

To explore the differences between cash flow and profit reporting, consider Activity 23.1 below.

ACTIVITY 23.1

Two short statements about the same business in the same year follow. Summarize in words what each statement is telling us, and suggest reasons for the differences between them.

Statement A re: the business	*€000*
Sales	410
less Cost of sales	329
	81
less Other expenses	36
	45
less Depreciation	13
	32
less Taxation provided	13
	19
less Dividend provided	8
Retained	11

Statement B re: the business	*€000*
Sales received	387
less Payments for goods for sale	333
	54
less Other expenses paid	32
	22
less Capital expenditure	20
	2
less Taxation paid	14
	(12)
less Dividend paid	7
Increase in borrowing	(19)

Activity feedback

Clearly, statement *A* is an income statement. It shows the revenues and expenses, calculated on the traditional bases, the taxation charges relating to the year, and the dividends which, it has been decided, should be paid

(*Continued*)

ACTIVITY 23.1 (*Continued*)

out to shareholders in relation to that year. It shows a profit and implies (although we do not know the size of the business) a successful year.

Statement *B* is a statement of cash movement in the year – a summary of the cash book but analyzed into the various reasons the cash has moved. The individual differences between the two statements will be due to changes in accruals, prepayments and the like. Overall, statement *B* shows a reduction in the cash resources of the business before the payment of the dividend, and obviously shows an even bigger contraction in the cash resources of the business after the dividend payout in the year. Statement *B* surely implies an unsuccessful year.

CASH FLOW REPORTING

People often talk about 'cash flows' or claim to be in favour of 'cash flow statements' or 'cash flow reporting' without being too precise about what they mean. In fact, different people are likely to mean significantly different things, and it is very important that we are able to separate out the various situations and arguments from one another.

At one level, it can be suggested that cash flow reporting – actual and budgeted – should completely replace both the statement of comprehensive income (on whatever basis) and the statement of financial position. The argument for this (ignoring barter situations) is that only cash represents and demonstrates an increase or decrease in the business resources and that this suggests both that only cash should be reported and that only cash need be reported. This argument is surely untenable. Users need information about changes in the command of a business organization over resources, over goods and services, or the power to obtain goods and services.

At a second level, it can be suggested that some form of statement of cash flows on the lines of statement *B* in Activity 23.1 – since it obviously gives information which is potentially useful and which is additional to, and different from, the information in the income statement – should be required as an additional statement in the final reporting package. This is surely logical. Indeed, it is arguable precisely because an income statement for the year is not a good indicator of the cash flow position for the year, and because a statement of cash flows for the year is not a good indicator of the profit and loss position for the year that the argument for including both is so powerful.

However, a weakness of a statement of cash flows, like that in Activity 23.1, is that it is an historical statement, as is a statement of financial position and a statement of comprehensive income. It gives no indication of future cash flows and whether an entity will be able to meet its debts in the future. A forecast statement of cash flows would be required for this.

FUNDS FLOW OR CASH FLOW?

The funds flow statement, as traditionally prepared for many years, was (conceptually speaking) an extremely odd animal. It tried to adjust away some, but not all, of the accrual adjustments used in the creation of the income statement to start with. Historically, the reason for much of this obscurity was that the funds flow statement, being an additional statement not required by the law, was deliberately designed not to give

additional information, but merely to rearrange information already available in a different form. Basically, the funds flow statement concentrated on changes in net current assets rather than cash.

So what is funds flow? Activity 23.2 should illustrate this for you.

ACTIVITY 23.2

An extract from the balance sheet of *A* entity as at 31 December 20X9:

	€000 31.12.X9	*€000* 31.12.X8
Inventory	4 300	4 600
Accounts receivable	2 600	1 300
Cash and bank	1 200	2 500
	8 100	8 400
Accounts payable	6 500	7 900
Working capital	1 600	500

Activity feedback

If we look solely at cash, we could state that *A* had experienced a decrease in cash of €1 300 000 over the year. Contrariwise, looking at working capital/net current assets provides a much better position; an increase of €1 100 000 over the year. But which figure should users of accounts have regard to when taking decisions?

Advantages of cash flow over funds flow

These can be summarized as follows:

- Funds flow data based on movements in working capital can obscure movements relevant to the liquidity and viability of an entity. For example, a significant decrease in cash available may be masked by an increase in inventory or accounts receivable. Entities may, therefore, run out of cash while reporting increases in working capital. Similarly, a decrease in working capital does not necessarily indicate a cash shortage and a danger of failure.
- As cash flow monitoring is a normal feature of business life and not a specialized accounting technique, cash flow is a concept which is more widely understood than are changes in working capital.
- Cash flows can be a direct input into a business valuation model and, therefore, historical cash flows may be relevant in a way not possible for funds flow data.
- A funds flow statement is based largely on the difference between two balance sheets. It reorganizes such data, but does not provide new data. The statement of cash flows may include data not disclosed in a funds flow statement.

So does a statement of cash flows have the relevant characteristics of useful information? Let us see if you can answer the question in Activity 23.3.

ACTIVITY 23.3

State whether you believe, given your knowledge so far, that cash flow is understandable, relevant, reliable and complete.

Activity feedback

1 *Understandable*. Certainly, cash is a concept that most people understand, whereas accrual accounting takes us a few years to learn and even more years to understand the need for!

2 *Relevant*. Cash certainly is relevant as without it a business cannot operate. Entities may be able to show a healthy profit but have a very poor cash position as they are relying on borrowed funds.

(*Continued*)

ACTIVITY 23.3 (*Continued*)

3 *Reliable.* Cash is the end product of a transaction. It is realized! Whereas funds based on profit require us to estimate a point of realization of revenue prior to receipt of cash and the ultimate realization of cash can be in doubt. Cash is certainly free from bias.

4 *Complete.* Is anything that is historical information providing a complete picture? A statement of cash flows shows information about the reporting entity's cash flows in the reporting period, but this provides incomplete information for assessing future cash flows. Some cash flows result from transactions that took place in an earlier period and some are expected to result in further cash flows in a future period.

Looking back to Activity 23.2, where we noted that a healthy funds flow (working capital) of €1m masked a decrease in cash flow of €1.3m, we can see that the selection of funds or cash flow can have a major impact on a user's interpretation of an entity's financial position. It is also worth noting that cash is the 'life blood' of an entity and without it they cannot operate. Cash is also rather a difficult figure to manipulate.

REQUIREMENTS OF IAS 7

Scope

The IASB viewed cash flow reporting as so important that there are no exemptions for any entities. No matter what an entity's principal revenue-producing activities might be, they need cash to conduct their operation, to pay their obligations, and to provide returns to their investors; their users need this information as they are interested in how the entity uses and generates cash.

Generation of cash flows and definitions

Cash flows within an entity can broadly be generated by three activities:

1 Operating or principal revenue-producing activities, defined by IAS 7 as those activities that are not investing or financing.

2 Investing activities; the acquisition and disposal of long-term assets and investments not included in cash equivalents.

3 Financing activities; activities that result in changes in the size and composition of the equity capital and borrowings of the entity.

Some other definitions from IAS 7, for completeness, are:

- *Cash.* Comprises cash on hand and 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.

Now complete activity 23.4

ACTIVITY 23.4

Provide examples of cash flows, both inflow and outflow, from operating, investing and financing activities. To help we provide an example for each category in Table 23.1. Now extend the table.

TABLE 23.1 Examples of cash flows

Operating activities	*Investing activities*	*Financing activities*
Cash receipts from sale of goods and rendering of services	Cash payments to acquire fixed assets	Cash proceeds from issue of shares and other equity instruments

Activity feedback

You may not have identified all the following but the definitive list, as given by IAS 7, is shown in Table 23.2.

TABLE 23.2 Definitive list of cash flows as given by IAS 7

Operating activities	*Investing activities*	*Financing activities*
Cash receipts from sale goods and rendering services	Cash payments to acquire fixed assets	Cash proceeds from issue of shares and other equity instruments
Cash receipts from royalties, fees, commissions and other revenue	Cash receipts from sale of fixed assets	Cash payments to owners to acquire or redeem the entity's shares
Cash payments to suppliers for goods and services	Cash payments to acquire equity or debt instruments of other entities and interests in joint ventures	Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short- or long-term borrowings
Cash payments to and on behalf of employees	Cash advances and loans made to other parties	Cash repayments of amounts borrowed
Cash payments or refunds of income taxes unless they can be specifically identified with financing or investing activities	Cash receipts from the repayment of advances and loans made to other parties	Cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease
Cash receipts and payments from contracts held for dealing or trading purposes	Cash payments for futures, forward contracts, options and swaps except when the contracts are held for dealing or trading purposes or the payments are classified as financing activities	Cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits

The amount of cash flows from operating activities is highly important for users to assess whether enough cash has been generated from this source for the entity to repay loans, make investments in assets and pay dividends. Cash flows under the heading of operating activities are primarily derived from the principal revenue producing activities of the entity.

Separating out the cash flows from investing activities is also seen as important as this provides users with information on investment made in resources that will potentially generate future income and cash flows. Users require information on cash flows within financing activities so that they can predict claims on future cash flows from providers of capital to the entity.

ACTIVITY 23.5

Identify in which category the following cash flows would be included in.

1. An entity purchases a motor vehicle that it intends to sell on to a customer.
2. An entity purchases a motor vehicle that it intends to use as part of its delivery fleet.
3. An entity purchases a motor vehicle using a finance lease.
4. An entity gains the use of a motor vehicle under an operating lease.
5. An entity holds securities for dealing/trading purposes.
6. Interest paid and received and dividends received by an entity.
7. Dividends paid by an entity.
8. An entity purchases a building which it intends to rent to others.

Activity feedback

1. This is purchase of an inventory item and is therefore shown under operating activities.
2. This is purchase of a fixed asset for the entity and is therefore part of investing activities.
3. The entity has acquired the use of a fixed asset, but the cash flow of principal payments will be shown under financing activities. There will be no cash flow under investing activities.
4. This time the payments under the operating lease will be treated as cash flows under operating activities, as they are viewed as a normal expense payment of the entity. Note that the motor vehicle, depending on the revenue-producing activities of the entity and how the financing of the motor vehicle is arranged, can be regarded as a cash flow of any of the three categories.
5. These are inventory to the dealing house and are therefore part of operating activities as they relate to the principal revenue-producing activities.
6. These are usually classified as operating cash flows for a financial institution, but may also be regarded as operating for other entities as they form part of the net profit calculation – IAS 7, para. 33. This paragraph also allows them to be treated as financing – interest paid, or investing – interest and dividends received. The latter alternative seems more sensible to us.
7. Dividends paid are obviously financing as they are a cost of obtaining finance. However, IAS 7 allows an alternative categorization under operating activities. This is to enable users to judge the ability of the entity to pay dividends out of operating cash flows. We find this lack of consistency over the treatment of interest and dividends received and paid confusing and it will certainly impair comparability of cash flows between entities where different alternatives have been used.
8. This is the purchase of an asset that results in rental income and therefore must be regarded as a cash outflow under operating activities, not investing activities. The rental received will be cash inflow under operating activities.

Cash and cash equivalents

The definitions of these are important as cash flows are defined as inflows and outflows of cash and cash equivalents. It should be apparent to you that an investment, dependent on our view of short term or highly liquid, could be viewed as a cash and cash

equivalent, a cash flow item or an investing activity. Bank borrowings are generally viewed, according to IAS 7, as financing activities, but in certain circumstances bank overdrafts can be viewed as part of cash and cash equivalents. These circumstances are where the overdraft forms an integral part of the entity's cash management. Activity 23.6 demonstrates these definitions so make sure you complete it.

ACTIVITY 23.6

Determine whether the following items are cash, cash equivalents, investing activities, or financing.

1. An account held with a bank where withdrawals require 90 days' notice.
2. An account held with a bank where withdrawals require 95 days' notice.
3. An overdraft with the bank which is seen as short term and part of everyday cash flows of the entity.
4. A loan from the bank for 60 days for a specific purpose.
5. An investment with a bank which has 60 days to maturity, but its final value is subject to significant risk as it is based on the index achievable at that time from a highly fluctuating stock market.

Activity feedback

1. If you view 90 days as short term then this is cash equivalent.
2. If you view 95 days as long term then this would be investing.
3. Cash as part of cash management.
4. Financing as a loan for a specific purpose cannot be viewed as everyday cash management.
5. This investment has a significant risk attached to it in terms of its final value and therefore must be regarded as investing activities.

The decision with regards 1 and 2 in this activity is clarified by IAS 7 (para. 7) as follows:

> An investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from date of acquisition. It must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value.

The decisions required here are quite subjective and it is feasible for one entity to determine an investment as a cash equivalent and for another to determine this as an investing item.

FORMAT OF CASH FLOW STATEMENT

IAS 7 requires entities to report cash flows during a period in a statement identifying cash flows classified by operating, investing and financing activities. This implies a simple statement as follows:

Statement of cash flows

Cash flows from operating activities	A
Cash flows from investing activities	B
Cash flows from financing activities	C
Net change in cash and cash equivalents	X

However, the Standard, in order to provide relevant information to users, requires each of these cash flows to be separated into their constituent parts, i.e.:

1. Gross cash receipts and gross cash payments arising from investing and financing activities. Note here that if a single transaction has cash flows involving financing, investing and operating activities then the transaction will need to be split into its constituent parts. An example of such a transaction is a finance lease payment where the principal repayment will be disclosed as a cash flow under financing and the interest payment can be disclosed under operating or financing.

2 Gross cash receipts and payments from operating activities or net profit adjusted for effects of a non-cash nature.

3 Cash flows under any of the three sections can be reported net where the cash flows reflect the activities of the customer rather than the entity, or where items are large, maturities short and turnover quick.

4 Cash flows relating to extraordinary items should be identified separately under each category.

5 Cash flows relating to taxes, interest and dividends received and paid, acquisitions and disposals of subsidiaries and other business units.

In addition, the components of cash and cash equivalents are required together with a reconciliation of the amounts in the statement of cash flows, with the equivalent items reported in the statements of financial position.

Direct or indirect method of determining cash flows

Item 2 in the list above indicates that there are two methods for determining cash flows from operating activities, from cash receipts and payments known as the *direct method*, or from adjusting net profit for non-cash receipts and payments known as the *indirect method*. The Standard prefers the direct method as it 'provides information which may be useful in estimating future cash flows which is not available under the indirect method'. Strangely, the UK ASB requires the indirect method as it does not believe that the benefits to the users of the direct method outweigh the costs of preparing it.

ACTIVITY 23.7

1 What information would the direct method provide to users that the indirect method would not ?

2 Why might the direct method be more costly to prepare than the indirect?

3 How should a non-cash transaction be dealt with in a statement of cash flows?

Activity feedback

1 The direct method would identify cash receipts from customers and cash payments to suppliers and employees, whereas the indirect method would only show net profit with its adjustments for depreciation, profit on disposal and changes in working capital, and so on. The actual disclosure of cash receipts and payments enables users to evaluate future cash flows more easily.

2 Entities operate an accounting system that is geared towards accrual accounting. The direct method would require a company to use either an accounting system: a) which directly records and analyses the cash flow in relation to each transaction, thus operating two accounting systems, or b) to adjust sales, costs of sales and other items in the income statement for non-cash items, changes in working capital and other items which relate to investing or financing activities – a time-consuming and costly business. If we take the view that information should be provided that is useful to users – the view of the Framework – then we must support the direct method for the disclosure of operating cash flows.

3 Quite obviously it shouldn't be dealt with as it does not involve a cash flow!

Examples of non-cash transactions given in the Standard are:

- acquisition of assets either by assuming directly related liabilities or by means of a finance lease
- acquisition of an entity by means of an equity issue
- conversion of debt to equity.

All these involve the exchange of a non-cash asset for a non-cash liability, or conversion from one asset or liability to another. These types of transaction will be reported elsewhere in the financial statements.

ACTIVITY 23.8

From the following information relating to Zen entity, calculate the cash flows from operating activities using both the direct and indirect method.

Consolidated statement of comprehensive income for the period ended 31 December 20X2

	€000
Sales	30 650
Cost of sales	26 000
Gross profit	4 650
Depreciation	(450)
Administration and selling expenses	(730)
Interest expense	(400)
Investment income	500
Foreign exchange loss	(40)
Net profit before taxation	3530
Taxes on income	(300)
Net profit	3 230

Consolidated statement of financial position as at 31 December 20X2

	20X2		*20X1*	
	€000	*€000*	*€000*	*€000*
Assets				
Cash and cash equivalents		410		160
Account receivable		1 900		1 200
Inventory		1 000		1 950
Portfolio investments		2 500		2 500
Property, plant and equipment at cost	3 730		1 910	
Accumulated depreciation	(1 450)	2 280	(1060)	850
Total assets		8 090		6 660
Liabilities				
Trade payables		250		1 890
Interest payable		230		100
Income taxes payable		400		1 000
Long-term debt		2 300		1 040
Total liabilities		3 180		4 030
Shareholders' equity				
Share capital		1 500		1 250
Retained earnings		3 410		1 380
Total shareholders' equity		4 910		2 630
Total liabilities and shareholders' equity		8 090		6 660

Other information is available as follows:

(a) All the shares of a subsidiary were acquired for €590 000. The fair values of assets acquired and liabilities assumed were as follows:

	€000
Inventories	100
Accounts receivable	100
Cash	40
Property, plant and equipment	650
Trade payables	100
Long-term debt	200

(b) €250 000 was raised from the issue of shares and €250 000 from long-term borrowings.

(c) Interest expense was €400 000, of which €170 000 was paid during the period. €100 000 relating to interest expense of the prior period was also paid during the period.

(d) Dividends paid were €1 200 000.

(e) The liability for tax at the beginning and end of the period was €1 000 000 and €400 000 respectively. During the period, a further €200 000 tax was provided for. Withholding tax on dividends received during the period of €200 000 amounted to €100 000.

(f) During the period, the group acquired property, plant and equipment with an aggregate cost of €1 250 000, of which €900 000 was acquired by means of finance leases. Cash payments of €350 000 were made to purchase property, plant and equipment.

(g) Plant, with original cost of €80 000 and accumulated depreciation of €60 000, was sold for €20 000.

(h) Accounts receivable as at end 31 December 20X2 include €100 000 of interest receivable.

(adapted from example in Appendix A to IAS 7)

Activity feedback

Direct method

Cash flow from operations:	
Cash receipts from customers (working 1)	30 150
Cash paid to suppliers and employees (working 2)	(27 420)
Cash generated from operations	2 730
Interest paid (170 + 100 note c)	(270)
Income taxes paid (1000 + 200 + 100 − 400)	(900)
Cash flow	1560

(*Continued*)

ACTIVITY 23.8 (*Continued*)

Working 1

Sales – income statement	30 650	
add Opening accounts receivable	1 200	
less Closing accounts receivable	(1 800)	(1 900 – 100 note h)
add Subsidiary accounts receivable	100	
	30 150	

Working 2

Cost of sales – income statement		26 000
less Opening stock		(1 950)
add Closing stock		1 000
Purchases		25 050
less Closing trade payables		(250)
add Opening trade payables		1 890
		26 690
Admin and selling expenses		730
		27 420
Subsidiary trade payables note a		100
less Subsidiary inventories note a		(100)
		27 420

(Note interest and income taxes paid are treated as part of operating activities, dividends paid are not.)

Indirect method

Net profit before tax and dividends	3 530	
add Back interest	(100)	
Foreign exchange loss	40	
Depreciation	450	
	3 920	
Increase in trade and other receivables	(500)	(700 – 100 subsidiary – 100 interest receivable)
Decrease in inventories	1050	(950 + 100 subsidiary)
Decrease in trade payables	(1 740)	(1 640 + 100 subsidiary)
Cash generated from operations	2 730	
Interest paid	(270)	
Income taxes paid	(900)	
Net cash flow from operating activities	1 560	

Cash flows from investing activities

Complete the following activities.

ACTIVITY 23.9

Now calculate the cash flow from investing activities from the data given in Activity 23.8.

Activity feedback

Investing activities cover cash flows in respect of fixed assets, investments in equity or debt, advances and loans to other parties. The balance sheet changes identify any increases/decreases in portfolio investments and property, plant and equipment, and we were also informed about an acquisition of a subsidiary.

Therefore:

Cash flow from investing activities		
Acquisition of subsidiary less cash acquired	(550)	(590 – 40)
Purchase of property, plant and equipment	(350)	(note f) or (working 1)
Proceeds from sale of equipment	20	(note g)
Dividends received	200	(note c)
Interest received (investment income – dividends)	200	
Net cash used in investing activities	(480)	

Working 1

Opening balance sheet of property, etc., at cost	1 910
add Subsidiary bought	650
less Sale	(80)
	2 480
Closing balance sheet at cost	3 730
	1 250
Leased assets so no cash flow	(900)
Therefore, assets bought for cash	350

Cash flows from financing activities

ACTIVITY 23.10

Now identify the cash flows from financing activities from the data in Activity 23.8.

Activity feedback

Cash flow from financing activities covers proceeds from the issue of shares, loans, etc., and repayments of amounts borrowed.

Cash flow from financing activities		
Proceeds from issuing shares	250	(note b)
Proceeds from long-term borrowings	250	(note b)
Payments of finance lease (working 1)	(90)	
Dividends paid	(1 200)	(note d)
	(790)	

Working 1

Opening balance sheet long-term debt	1 040
add Finance lease principal	900
	1 940
add Subsidiary long-term loan	200
	2 140
New loans	250
	2 390
Closing balance sheet long-term debt	2 300
Therefore, lease principal repaid	90

Statement of cash flows

If you put the answers of Activities 23.8, 9, and 10 together and add on cash and cash equivalent changes, you have a full statement of cash flows for the data in Activity 23.8 as follows.

Direct Method Cash Flow Statement			
Cash flow from operating activities			
Cash receipts from customers (working 1)	30 150		
Cash paid to suppliers and employees (working 2)	(27 420)		
Cash generated from operations	2 730		
Interest paid (170 + 100 note c)	(270)		
Income taxes paid (1 000 + 200 + 100 – 400)	(900)		
Net cash flow from operating activities			**1 560**
Cash flow from investing activities			
Acquisition of subsidiary less cash acquired	(550)	(590 – 40)	
Purchase of property, plant and equipment	(350)	(note f) or (working 1)	
Proceeds from sale of equipment	20	(note g)	
Dividends received	200	(note c)	
Interest received (investment income – dividends)	200		
Net cash used in investing activities			(480)

Cash flow from financing activities		
Proceeds from issuing shares	250	(note b)
Proceeds from long-term borrowings	250	(note b)
Payments of finance lease (working 1)	(90)	
Dividends paid	(1 200)	(note d)
Net cash used in financing activities		**(790)**
Net increase in cash and cash equivalents		**290**
Cash and cash equivalents at beginning of period (160–40 f. e. l.)		120
Cash and cash equivalents at and period		410

Notes to statement of cash flows

Notes to this cash flow are required in respect of:

- the fair value of assets and liabilities of the subsidiary acquired
- the amount of property, plant and equipment acquired by finance lease
- detailed analysis of the cash equivalents
- segmental cash flows.

IAS 7, Appendix A illustrates these notes.

PREPARATION OF STATEMENT OF CASH FLOWS

The next activity requires you to prepare a rather more complicated statement of cash flows.

ACTIVITY 23.11

The balance sheet of Axbrit entity for the year ended 31 March 20X2 is as follows:

	20X2	*20X1*
Assets		
Cash and cash equivalents	27	21
Accounts receivable	15	18
Inventory	25	20
Property, plant and equipment at cost	230	160
Accumulated depreciation	(60)	(44)
Total assets	237	175
Liabilities		
Trade payables	47	39
Income taxes payable	16	12
Long-term debt	32	30
Total liabilities	95	81
Shareholders' equity		
Share capital	33	27
Capital reserves	30	24
Retained earnings	79	43
Total shareholders' equity	142	94
Total liabilities and shareholders' equity	237	175

Prepare the statement of cash flows for the year ended 31 March 20X2 given that no property, plant and equipment was sold during the period and that the increase in long-term debt took place on 1 April 20X2 and carried a 10% rate of interest and that dividends paid during the year were €18.

(*Continued*)

ACTIVITY 23.11 (*Continued*)

Activity feedback

As we are not given the statement of comprehensive income or any other information to enable us to derive net cash flow from operating activities using the direct method we have to use the indirect method in this example.

Indirect method net cash flow from operating activities		
Net profit (change in retained earnings + dividends)		54
Add interest on long-term loans	3.2	
Add taxation charge (assume liability at end is charge for period)	16	
		19.2
Net profit before taxation		73.2
add Depreciation	16	
Increase in inventories	(5)	
Decrease in accounts receivable	3	
Increase in trade payables	8	22
Cash generated from operations		95.2
Interest paid		(3.2)
Income taxes paid		(12)
Net cash flow investing activities		80
Cash flow from investing activities		
Purchase of property, plant and equipment	70	
Net cash used in investing activities		(70)
Cash flow from financing activities		
Proceeds from issues of shares	12	
Proceeds from long-term borrowings	2	
Dividends paid	(18)	
Net cash used in financing activities		(4)
Net increase in cash and cash equivalents		6
Cash and cash equivalents at beginning of period		21
Cash and cash equivalents at end of period		27

The following activity is a good test of your understanding so far, so complete it before reading the feedback.

ACTIVITY 23.12

From the statement of comprehensive income and statements of financial position of Thomas Manufacturing entity prepare the statement of cash flows for the year ended 31 December 20X5.

Thomas Manufacturing Statement of Comprehensive Income for the year ended 31.12.X5.

	€ 000	*€ 000*
Sales		5 000
Change in inventories		500
Own work capitalized		150
Other operating income		50
Raw materials and consumables	(2 000)	
Other external charges	(770)	(2 770)
Employee costs		(1 500)
Depreciation and amortization		(400)
Other operating charges		(100)
		930
Income from investments – dividends		20
Other interest receivable		5
		955
Interest payable		(160)
Income before income taxes		795
Income taxes		(317)
Income for period		478

Dividends paid for the period were €250 000

(*Continued*)

ACTIVITY 23.12 (*Continued*)

Statements of financial position as at 31

12.X4			12.X5		
Cost €000	*Net* €000		*Cost* €000	*Deprec.* €000	*Net* €000
		Non-current assets			
200	100	Intangible	350	200	150
1 500	800	Property, plant and equip.	2 500	775	1 725
100	100	Investments	200		200
1 800	1 000		3 050	975	2 075
		Current assets			
	1 000	Inventories		1 600	
	1 000	Accounts receivable		1 200	
	50	Investments			
	250	Cash		30	2 830
	2 300	Shareholders' equity			4 905
	3 300				
	1 000	Ordinary shares			1 500
	200	Capital reserves			800
	177	Retained earnings			405
	1 377				2 705
		Liabilities			
		Long term			
	980	Loans			790
		Short term			
600		Accounts payable		750	
		Loans		257	
243		Taxation		274	
	843				1 281
	100	Deferred taxes			129
	1 923				1 200
	3 300				4 905

Further information is available as follows:

- As at 1 January X5, freehold land was revalued from €500 000 to €1 000 000.
- During the year ended 31 December X5 plant and equipment costing €300 000, written down to €50 000 at 31 December X4, was sold for €75 000.These book gains and losses were adjusted in to the depreciation charge in the income statement.
- Own work capitalized refers to development work carried forward as an intangible asset.
- Loans with a nominal value of €190 000 were redeemed at par during the year.
- Shares were issued for cash during the year; there were no purchases of the company's own shares.
- The investments shown as current assets at 31 December X4 and not regarded as cash equivalent were sold during the year for €50 000.

Activity feedback

Indirect statement of cash flows for Thomas Manufacturing:

Cash flow from operating activities

	€ 000	*€ 000*
Net profit before tax		795
Adjustments for:		
Depreciation (400 + 25 gain adj. on sale into dep.)	425	
Profit on sale of plant and equipment	(25)	
Investment income	(25)	

(*Continued*)

ACTIVITY 23.12 (*Continued*)

	€ 000	€ 000
Interest expense	160	535
Operating profit before working capital changes		1330
Increase in trade and other receivables	(200)	
Increase in inventories	(600)	
Increase in trade payables	150	(650)
Cash generated from operations		680
Interest paid		(160)
Income taxes paid (see note 1)		(257)
Net cash from operating activities		263
Cash flow from investing activities		
Purchase of intangible fixed assets	(150)	
Purchase of property, plant and equipment (note 2)	(800)	
Purchase of investments	(100)	
Proceeds from sale of investments	50	
Proceeds from sale of equipment	75	
Interest received	5	
Dividends received	20	
Net cash used in investing activities		(900)
Cash flow from financing activities		
Proceeds from issues of shares	600	
Proceeds from long-term borrowings	257	
Redemption of loans	(190)	
Dividends paid	(250)	
Net cash from financing activities		417

Net decrease in cash and cash equivalents

	€000s
Cash and cash equivalents at beginning of period	(220)
Cash and cash equivalents at end of period	250
	30

Note 1

Opening balance of taxes (243 +100)	343
Add income statement charge (325 – 8)	317
	660
Closing balance of taxes (274 +129)	403
Therefore taxes paid during the year	257

Note 2

Opening balance of assets at cost	1 500
add Revaluation during the year	500
less Sale at cost	(300)
	1 700
Closing balance at cost	2 500
Therefore purchase of assets	800

Disclosure Requirements of Ias 7

As an example of disclosure required in respect of statements of cash flows by IAS 7 we present that relating to the Bayer Group for the year ended 31 December 2007.

ANNUAL REPORT

Bayer Group Statement of Cash Flows

	Note	*2006*	*2007*
€ million			
Income from continuing operations after taxes		1,526	2,306
Income taxes		454	(72)
Non-operating result		782	920

	Note	*2006*	*2007*
Income taxes paid		(763)	(915)
Depreciation and amortization		1,913	2,712
Change in pension provisions		(295)	(369)
(Gains) losses on retirements of noncurrent assets		(133)	(13)
Non-cash effects of the remeasurement of acquired assets (inventory work-down)		429	215
Gross cash flow		3,913	4,784
Decrease (increase) in inventories		(155)	(347)
Decrease (increase) in trade accounts receivable		(201)	(183)
(Decrease) increase in trade accounts payable		130	189
Changes in other working capital, other non-cash items		241	(162)
Net cash provided by (used in) operating activities(net cash flow), continuing operations	[33]	**3,928**	**4,281**
Net cash provided by (used in) operating activities(net cash flow), discontinued operations	[6.3]	275	2
Net cash provided by (used in) operating activities(net cash flow) (total)		**4,203**	**4,283**
Cash outflows for additions to property, plant, equipment and intangible assets		(1,876)	(1,860)
Cash inflows from sales of property, plant, equipment and other assets		185	165
Cash inflows from divestitures		489	4,648
Cash inflows from noncurrent financial assets		850	70
Cash outflows for acquisitions less acquired cash		(15,351)	(491)
Interest and dividends received		686	636
Cash inflows (outflows) from current financial assets		287	18
Net cash provided by (used in) investing activities (total)	**[34]**	**(14,730)**	**3,186**
Capital contributions		1,174	0
Bayer AG dividend, dividend payments to minority stockholders, reimbursements of advance capital gains tax payments		(535)	(773)
Issuances of debt		13,931	2,155
Retirements of debt		(3,216)	**(7,768)**
Interest paid		(1,155)	(1,344)

	Note	2006	2007
Net cash provided by (used in) financing activities (total)	**[35]**	**10,199**	**(7,730)**
Change in cash and cash equivalents due to business activities (total)		**(328)**	**(261)**
Cash and cash equivalents at beginning of year		**3,290**	**(2,915)**
Change in cash and cash equivalents due to changes in scope of consolidation		(2)	(4)
Change in cash and cash equivalents due to exchange rate movements		(45)	(119)
Cash and cash equivalents at end of year	**[36]**	**2,915**	**2,531**

Notes to the Statements of Cash Flows

The cash flow statement shows how the liquidity of the Bayer Group was affected by the inflow and outflow of cash and cash equivalents during the year. The effects of changes in the scope of consolidation are eliminated. Cash flows are classified by operating, investing and financing activities in accordance with IAS 7 (Cash Flow Statements). The cash and cash equivalents shown in the balance sheet comprise cash, checks, balances with banks and securities with original maturities of up to three months.

The amounts reported by consolidated companies outside the euro zone are translated at average exchange rates for the year, with the exception of cash and cash equivalents, which are translated at closing rates as in the balance sheet. The effect of changes in exchange rates on cash and cash equivalents is shown separately.

Cash and cash equivalents contain both the proceeds from divestitures of discontinued operations and the cash inflows from these operations prior to the divestitures. In principle, therefore, the statement of cash flows must account for all cash inflows and outflows from continuing and discontinued operations. However, IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations) specifies that cash flows from operating, investing and financing activities be classified by continuing and discontinued operations. The discontinued operations' shares of the cash flows from operating, investing and financing activities are stated separately in Note [6.3].

In both the balance sheet and the income statement, however, the amounts corresponding to the components of the net operating cash flow are shown for continuing operations only. This is the case, for example, with the amounts of inventories, receivables and payables recognised in the balance sheet that determine the changes in working capital shown in the cash flow statement. The income from continuing operations after taxes that is recognised in the income statement forms the starting point for the cash flow statement. To ensure that the operating activities are consistently presented in the cash now statement, income statement and balance sheet, the net operating cash flow from continuing operations is stated first on the face of the cash flow statement. The total net operating cash flow from discontinued operations is shown in the next line, by analogy with the presentation of the income statement. The cash flows from continuing and discontinued operations are added together to give the net operating cash flow (total) for the entire business.

33. Net cash provided by (used in) operating activities

The gross cash flow for 2007 of €4 784 million (2006: €3 913 million) is the cash surplus from operating activities before any changes in working capital. The cash flows by segment are shown in the table in Note [1].

The net operating cash flow from continuing operations of €4 281 million (2006: €3 928 million) takes into account the changes in working capital and other non cash-relevant transaction, The €2 million (2006: €275 million) net cash flow from the discontinued operations comprises operating income from the H.C. Starck and Wolff Walsrode business units and the diagnostics business. The total net cash flow for 2007 is €4 283 million (2006: €4 203 million).

The line 'Non-cash effects of the remeasurement of acquired assets (inventory work-down)' has been inserted in the cash flow statement in order to eliminate the effects of the Schering purchase price allocation from gross cash flow. Thus, the non-cash effect of the work-down of the step-up from the remeasurement of Schering inventories to fair value as of June 23, 2006, the date of acquisition, on the gross cash flow is reversed. In 2007 €215 million (2006: €429 million) was transferred to this line from 'Decrease/Increase in inventories.' These non-cash effects do not impact net cash flow.

34. Net cash provided by (used in) investing activities

In 2007, there was a net cash inflow of €3 186 million (2006: net cash out flow of €14 730 million), consisting principally of the proceeds from the divestitures of the Diagnostics Division, H.C. Starck and Wolff Walsrode. The principal acquisitions were those of the U.S. cotton seed producer Stoneville Pedigreed Seed Company, the Ure-Tech group of Taiwan, and a biologics manufacturing facility from Novartis. Further details of acquisitions and divestitures are given in Notes [6.2/6.3].

Cash outflows fur additions to property, plant and equipment and intangible assets in 2007 came to €1 860 million (2006: €1 876 million). Disbursements for property, plant and equipment and intangible assets included those for the acquisition of Zymo Genetics and the expansion of the production site for polymer products in Caojing, near Shanghai, China.

Inflows from sales of property, plant and equipment and other assets amounted to €165 million (2006: €185 million). An initial payment of €395 million on the divestiture of the diagnostics business, which was completed at the start of 2007, was received at the end of 2006.

Cash inflows from noncurrent financial assets amounted to €70 million (2006: €850 million).

35. Net cash provided by (used in) financing activities

In fiscal 2007 there was a net cash outflow of €7 730 million (2006: net cash in flow of €10 199 million) from financing activities. These disbursements served primarily to reduce debt by €5 613 million (2006: net borrowing of €10.7 billion to finance the acquisition of Schering).

Cash outflows for dividend payments amounted to €773 million (2006: €535 million – including the €176 million refund of advance capital gains tax payments made on intragroup dividends in 2004). Interest expense increased to €1 344 million (2006: €1 155 million).

36. Cash and cash equivalents

Cash and cash equivalents comprise cash, checks and balances with banks. In accordance with IAS 7 (Cash Flow Statements) this item also includes securities with original maturities of up to three months, reflecting their high liquidity. Cash and cash equivalents amounted to €2 531 million as of December 31, 2007 (2006: €2 915 million). Cash of €755 million (2006: €799 million) has been deposited in escrow accounts. This amount comprises €695 million (2006: €710 million) transferred to a guarantee account in light of the resolved squeeze-out of the remaining minority stockholders of Schering, and €60 million (2006: €89 million) to be used exclusively for payments relating to antitrust fines and civil law settlements.

GAAP COMPARISONS

UK versus IAS

The UK standard FRS 1 (revised 1996), *Cash Flow Statements*, defines cash flow as increases or decreases in cash. Thus those items that would be regarded as cash equivalents under IAS 7 are presented in accordance with FRS 1 under a heading of 'management of liquid resources'. FRS 1 also has many more headings than the IAS as can be seen in Table 23.3.

A note of the reconciliation of the movement in net debt is required by FRS 1 but not by IAS 7. There is also a difference in the treatment of cash flows from a foreign subsidiary. IAS 7 requires translation using exchange rates prevailing on dates of cash flows whereas FRS 1 requires the same rate as that used in the income statement, which will be the average or closing rate.

TABLE 23.3 FRS 1 and IAS 7 compared

FRS1	*IAS 7*
Operating	Operating
Dividends from joint ventures and associates	Operating or investing
Returns on investments and servicing of finance	Operating or financing for interest paid, investing for interest and dividends received
Taxation	Operating
Capital expenditure and financial investment	Investing
Acquisition and disposals	Investing
Equity dividends paid	Financing or operating
Management of liquid resources	Investing or cash equivalent
Financing	Financing

US versus IAS

US cash flow statements (SFAS 95 as amended by 102, 104 and 117) use the three headings of IAS 7 but there are some minor differences arising from permitted alternatives within the IAS.

THE FUTURE

The statement of cash flows is set to be reviewed under the joint project of the IASB/FASB on presentation of financial information in individual statements.

Initial discussions are focusing on:

- the need to specify the direct method of calculating cash flows from operations as a requirement
- the need to specify a reconciliation schedule of statements of cash flows to the statement of comprehensive income

- the notion that cash equivalents should not be retained in financial statement presentation
- the need to ensure cohesiveness of financial statements.

Direct method

As we stated earlier, the IASB prefer the use of the direct method but did not require it in IAS 7 due to the concerns about the cost of preparing a direct method statement of cash flows. It now emerges that there are two approaches to preparing the direct method of cash flows:

- The 'bottom-up' or 'cash ledger' approach (referred to as the 'direct-direct method'). Under this approach, cash receipts and payments are determined by aggregating cash flow amounts from cash ledgers. This is a costly approach.
- The 'top-down' or 'financial statement' approach (referred to as the 'indirect-direct method'). Under this approach, cash receipts and payments are determined by adjusting revenues, expenses, and gains and losses for the change in the related accrual over the period. This approach, it is thought, would be cheaper than the direct-direct method.

Reconciliation schedule

This would form a new schedule in the financial statements and would be columnar as follows:

Cash flows	*Cash flows not affecting income*	*Valuation adjustments*	*All other changes*	*Comprehensive income*
A	B	C	D	A – B + C + D

with a line for each item on the cash flow and comprehensive income statement.

Whether such a complicated reconciliation statement will be of use to users remains to be seen.

Cohesiveness of financial statements

Within the joint project the IASB are suggesting that all three statements (i.e. the statement of comprehensive income, the statement of financial position and the statement of cash flows) should use the same section names. The proposed sections are:

Business – operating cash flows and investing cash flows

Financing – financing asset cash flows and financing liability cash flows

Income taxes

Discontinued operations

Equity

An exposure draft on financial statement presentation is expected in the second quarter of 2010 with a final standard issued in 2011.

SUMMARY

Within this chapter we have attempted to show you how to draw up a statement of cash flows using both the direct and indirect method and we have highlighted some of the problems associated with it. These problems are:

- the arbitrary three-month cut-off for cash equivalents
- the choice of category for interest and dividends
- the difficulty of producing direct cash flows
- the lack of user information in indirect cash flows
- the historical nature of the statement of cash flows.

On the whole, however, the statement of cash flows under IAS 7 is certainly an improvement on the previous funds flow statement and the production of cash flow information provides important information to users. We will deal with the analysis of cash flow statements in Chapter 31

EXERCISES

Suggested answers to exercises marked ✓ are to be found on the Student side of the companion website.

Suggested answers to the remaining exercises are to be found on the Instructor side of the companion website.

1 Comment on the usefulness of both funds flow statements and statements of cash flows to users.

2 Cash is a very difficult figure to fiddle (David Tweedie). Discuss.

3 Compare and contrast the direct and indirect method of preparing a statement of cash flows and identify and comment on the reasons why the IASB prefers the direct method.

4 Using the statement of cash flows provided in respect of the Bayer Group analysis, as far as the information permits, the performance of the group.

✓ **5** Discuss the proposition that a statement of cash flows is more useful to users than an income statement.

6 Differentiate, using illustrative examples where necessary, between cash and cash equivalents.

7 Cash flows should be defined as increases or decreases in cash. Discuss.

8 The following information is available in respect of Barn entity.

Statement of comprehensive income for the year ended 30 September 2007

	£m	£m	£m
Gross profit			280
Depreciation		60	
Interest receivable	(10)		
Interest payable	16	6	
Profit on sale of assets		(16)	
Impairment of intangibles		40	90
Net profit before tax			190
Tax			80
Net profit after tax			110
Dividends paid and proposed			80
Retained earnings			30

Statements of financial position as at:

	30.9.06 £m	*30.9.07* £m
Assets		
Non-current assets		
Intangibles	240	280
Property, plant and equipment	640	778
	880	1 058
Current assets		
Inventory	60	68
Trade receivables	48	44
Cash and bank	128	144
	236	256
Total assets	1 116	1 314
Equity and liabilities		
Equity		
Ordinary share capital	500	600
Share premium	40	60
Retained earnings	192	222
	732	882
Non-current liabilities	200	240
Current liabilities		
Trade payables	64	72
Dividends	30	40
Tax	90	80
	184	192
Total equity and liabilities	1 116	1 314

The sale proceeds from the sale of non-current assets was £72m. All interest due has been received and the interest payable has been paid.

Required:

(a) Prepare the statement of cash flows for Barn entity for the year ended 30 September 2007in accordance with IAS 7, Cash Flow Statements. (Notes to the cash flow statement are not required.)

(b) Identify two limitations of a cash flow statement.

9 The following information is available in respect of Theta entity.

Statement of comprehensive income for the year ended 31 December 2007

	£m	£m	£m
Gross profit			420
Depreciation		90	
Interest receivable	(15)		
Interest payable	24	9	
Profit on sale of assets		(24)	
Impairment of intangibles		60	135
Net profit before tax			285
Tax			120
Net profit after tax			165
Dividends paid and proposed			120
Retained earnings			45

Statements of financial position as at:

	31.12.06	*31.12.07*
Assets	£m	£m
Non-current assets		
Intangibles	360	420
Property, plant and equipment	960	1 167
	1 320	1 587
Current assets		
Inventory	90	102
Trade receivables	72	66
Cash and bank	192	216
	354	384
Total assets	1 674	1 971
Equity and liabilities		
Equity		
Ordinary share capital	750	900
Share premium	60	90
Retained earnings	288	333
	1 098	1 323
Non-current liabilities	300	360
Current liabilities		
Trade payables	96	108
Dividends	45	60

Statements of financial position as at:

	31.12.06	*31.12.07*
Assets	*£m*	*£m*
Tax	135	120
	276	288
Total equity and liabilities	1 674	1 971

The sale proceeds from the sale of non-current assets was £108m. All interest due has been received and the interest payable has been paid.

Required:

(a) Prepare the statement of cash flows for Theta entity for the year ended 31 December 2007in accordance with IAS 7, Cash Flow Statements. (Notes to the statement of cash flows are not required.)

(b) Identify information that is provided by a statement of cash flows to users that is not provided by a statement of comprehensive income and a statement of financial position.

10 The following information has been extracted from the draft financial statements of TEX, a manufacturing entity:

TEX - Income statement for the year ended 30 September 2003

	$000
Revenue	15 000
Cost of sales	(9 000)
Gross profit	6 000
Other operating expenses	(2 300)
	3 700
Finance cost	(124)
Profit before tax	3 576
Income tax expense	(1 040)
Dividends	(1 100)
	(1 436)

TEX – Balance sheets at 30 September

		2003		*2002*
	$000	*$000*	*$000*	*$000*
Assets				
Non-current assets		18 160		14 500
Current assets:				
Inventories	1 600		1 100	
Trade receivables	1 500		800	
Bank	150		1 200	
		3 250		3 100
Total assets		21 410		17 600

TEX – Balance sheets at 30 September

		2003		*2002*
	$000	*$000*	*$000*	*$000*
Assets				
Equity and liabilities:				
Capital and reserves:				
Issued capital		10 834		7 815
Accumulated profits		5 836		4 400
		16 670		12 215
Non-current liabilities:				
Interest-bearing borrowings		1 700		2 900
Deferred tax		600		400
		2 300		3 300
Current liabilities:				
Trade payables	700		800	
Proposed dividend	700		600	
Tax	1 040		685	
		2 440		2 085
		21 410		17 600

Notes

Non-current assets:

	Property	*Plant*	*Total*
	$000	*$000*	*$000*
At 30 September 2002			
Cost	8 400	10 800	19 200
Depreciation	1 3400	3 400	4 700
Net book value	7 100	7 400	14 500
At 30 September 2003			
Cost	11 200	13 4600	24 600
Depreciation	1 540	4 900	6 440
Net book value	9 660	8 500	18 160

(i) Plant disposed of during the year had an original cost of $2 600 000 and accumulated depreciation of $900 000; cash received on disposal was $730 000.

(ii) All additions to non-current assets were purchased for cash,

(iii) Dividends were declared before the balance sheet dates.

Required:

Prepare TEX's statement of cash flows and associated notes for the year ended 30 September 2003, in accordance with IAS 7, *Statements of Cash Flows*.

(CIMA paper, Financial Accounting and Tax Principles – May 2005)

11 The financial statements of AG are given below:

Balance sheets as at:	*31 March 2005*		*31 March 2004*	
	$000	*$000*	*$000*	*$000*
Non-current assets:				
Plant, property and equipment	4 500		4 800	
Development expenditure	370	4 870	400	5 200
Current assets:				
Inventories	685		575	
Trade receivables	515		420	
Cash and cash equivalents	552	1 752	232	1 227
Total assets		6 622		6 427
Equity and liabilities Equity:				
Share capital	2 600		1 900	
Share premium account	750		400	
Revaluation reserve	425		300	
Retained earning	1 430		1 415	
Total equity		5 205		4 015
Non-current liabilities:				
10% loan notes	0		1 000	
5% loan notes	500		500	
Deferred tax	250		200	
Total non-current liabilities:		750		1 700
Current liabilities:				
Trade payables	480		350	
Income tax	80		190	
Accrued expenses	107		172	
Total current liabilities:		667		712
Total equity and liabilities		6 622		6 427

Income statement for the year ended 31 March 2005	*$000*	*$000*
Revenue		7 500
Cost of sales		4 000
Gross profit		3 500
Distribution costs	900	
Administrative expenses	2 300	3 200
Profit from operations		300
Finance costs		45
Profit before tax		255
Income tax expense		140
Profit for the period		115

Additional information:

(i) On 1 April 2004, AG issued 1 400 000 $0.50 ordinary shares at a premium of 50%.

(ii) On 1 May 2004, AG purchased and cancelled all its 10% loan notes at par.

(iii) Non-current tangible assets include properties which were revalued upwards by $125 000 during the year.

(iv) Non-current tangible assets disposed of in the year had a net book value of $75 000; cash received on disposal was $98 000. Any gain or loss on disposal has been included under cost of sales.

(v) Cost of sales includes $80 000 for development expenditure amortized during the year.

(vi) Depreciation charged for the year was $720 000.

(vii) The accrued expenses balance includes interest payable of $87 000 at 31 March 2004 and $12 000 at 31 March 2005.

(viii) The income tax expenses for the year to 31 March 2005 is made up as follows:

	$000
Corporate income tax	90
Deferred tax	50
	140

(ix) Dividends paid during the year $100 000.

Required:

Prepare a statement of cash flows, using the indirect method, for AG for the year ended 31 March 2005, in accordance with IAS 7, *Statements of Cash Flows*

(CIMA paper, Financial Accounting and Tax Principles – May 2005)

12 The financial statements of CJ for the year to 31 March 2006 were as follows:

Balance sheets at:	*31 March 2006*		*31 March 2005*	
	$000	*$000*	*$000*	*$000*
Non-current tangible assets:				
Property	19 160		18 000	
Plant and equipment	8 500		10 000	
Available for sale investments	1 500		2 100	
		29 160		30 100
Current assets:				
Inventory	2 714		2 500	
Trade receivables	2 106		1 800	
Cash at bank	6 553		0	
Cash in hand	409		320	
		11 782		4 620
Total assets		40 942		34 720
Equity and liabilities				
Equity:				
Ordinary share $0.50 each	12 000			7 000
Share premium	10 000			5 000

Balance sheets at:	*31 March 2006*		*31 March 2005*	
	$000	*$000*	*$000*	*$000*
Revaluation reserve	4 200			2 700
Retained profit	3 009			1 510
		29 209		16 210
Non-current liabilities:				
Interest bearing borrowings	7 000		13 000	
Provision for deferred tax	999	7 999	800	13 800
Current liabilities:				
Bank overdraft	0		1 200	
Trade and other payables	1 820		1 700	
Corporate income tax payable	1 914		1 810	
		3 734		4710
		40 942		34 720

Income statement for the year to 31 March 2006

	$000
Revenue	31 000
Cost of sales	(19 000)
Gross profit	12 000
Other income	200
Administrative expenses	(3 900)
Distribution costs	(2 600)
	5 700
Finance cost	(1 302)
Profit before tax	4 398
Income tax expense	(2 099)
Profit for the period	2 299

Additional information:

(i) On 1 April 2005, CJ issued 10 000 000 $0.50 ordinary shares at a premium of 100%.

(ii) No additional available for sale investments were acquired during the year.

(iii) On 1 July 2005, CJ repaid $6 000 000 of its interest bearing borrowings.

(iv) Properties were revalued by $1 500 000 during the year.

(v) Plant disposed of in the year had a net book value of $95 000; cash received on disposal was $118 000.

(vi) Depreciation charged for the year was properties $2 070 000 and plant and equipment $1 985 000.

(vii) The trade and other payables balance includes interest payable of $650 000 at 31 March 2005 and $350 000 at 31 March 2006.

(viii) Dividends paid during the year, $800 000 comprised last year's final dividend plus the current year's interim dividend. CJ's accounting policy is not to accrue proposed dividends.

(ix) Other income comprises:

	$
Dividends received	180 000
Gain on disposal of available for sales investments	20 000
	200 000

Dividends receivable are not accrued.

(x) Income tax expense comprises:

	$
Corporate income tax	1 900 000
Deferred tax	199 000
	2 099 000

Required:

Prepare CJ's statement of cash flow for the year ended 31 March 2006, in accordance with IAS 7, *Statements of Cash Flows*.

(CIMA paper, Financial Accounting and Tax Principles – May 2006)

13 (a) Casino is a publicly listed company. Details of its balance sheets as at 31 March 2005 and 2004 are shown below together with other relevant information:

Balance Sheet as at	*31 March 2005*		*31 March 2004*	
	$m	*$m*	*$m*	*$m*
Non-current assets (note (i)):		880		760
Property, plant and equipment				
Intangible assets		400		510
		1 280		1 270
Current assets:				
Inventory	350		420	
Trade receivables	808		372	
Interest receivable	5		3	
Short-term deposits	32		120	
Bank	15	1 210	75	990
Total assets		2 490		2 260
Share capital and reserves:				
Ordinary Shares of $1 each		300		200
Reserves				
Share premium	60		nil	
Revaluation reserve	112		45	
Retained earnings	1 098	1 270	1 165	1 210
		1 570		1 410
Non-current liabilities:				
12% loan note	nil		150	
8% variable rate loan note	160		nil	
Deferred tax	90	250	75	225

Balance Sheet as at	*31 March 2005*		*31 March 2004*	
	$m	*$m*	*$m*	*$m*
Current liabilities:				
Trade payables	530		515	
Bank overdraft	125		nil	
Taxation	15		110	
		670		625
Total equity and liabilities		2 490		2 260

The following supporting information is available:

(i) Details relating to the non-current assets are: Property, plant and equipment at:

	31 March 2005			*31 March 2004*		
	Cost/ Valuation	*Depreciation*	*Value Carrying*	*Cost/ Valuation*	*Depreciation*	*Carrying value*
	$m	*$m*	*$m*	*$m*	*$m*	*$m*
Land and buildings	600	12	588	500	80	420
Plant	440	148	292	445	105	340
			880			760

Casino revalued the carrying value of its land and buildings by an increase of $70 million on 1 April 2004. On 31 March 2005 Casino transferred $3 million from the revaluation reserve to retained earnings representing the realisation of the revaluation reserve due to the depreciation of buildings.

During the year Casino acquired new plant at a cost of $60 million and sold some old plant for $15 million at a loss of $12 million.

There were no acquisitions or disposals of intangible assets.

(ii) The following extract is from the draft income statement for the year to 31 March 2005:

	$m	*$m*
Operating loss		(32)
Interest receivable		12
Finance costs		(24)
Loss before tax		(44)
Income tax repayment claim	14	
Deferred tax charge	(15)	(1)
Loss for the period		(45)
The finance costs are made up of:		
Interest expenses		(16)
Penalty cost for early redemption of fixed rate loan		(6)
Issue costs of variable rate loan		(2)
		(24)

(iii) The short-term deposits meet the definition of cash equivalents,

(iv) Dividends of $25 million were paid during the year.

Required:

As far as the information permits, prepare a statement of cash flows for Casino for the year to 31 March 2005 in accordance with IAS 7, *Statements of Cash Flows*

(b) In recent years many analysts have commented on a growing disillusionment with the usefulness and reliability of the information contained in some companies' income statements.

Required:

Discuss the extent to which a company's statement of cash flows may be more useful and reliable than its statement of comprehensive income.

(CIMA paper, Financial Accounting and Tax Principles – June 2005)

14 Extracts from the consolidated financial statements of the EAG Group for the year ended 30 April 2008 are as follows:

EAG Group: Consolidated income statement for the year ended 30 April 2008

$ million	*$ million*
Revenue	30 750.0
Cost of sales	(26 447.5)
Gross profit	4 302.5
Distribution costs	(523.0)
Administrative expenses	(669.4)
Finance cost	(510.9)
Share of profit of associate	1.6
Profit on disposal of associate	3.4
Profit before tax	2 604.2
Income tax	(723.9)
Profit for the period	1 880.3
Attributable to	
Equity holders of the parent	1 652.3
Minority interests	228.0
	1 880.3

EAG Group: Balance sheet at 30 April 2008

	2008 $ million	*2007 $ million*
Assets		
Non-current assets		
Property, plant and equipment	22 225.1	19 332.8
Goodwill	1 662.7	1 865.3
Intangible assets	306.5	372.4
Investment in associate	–	13.8
	24 194.3	21 584.3
Current assets		
Inventories	5 217.0	4 881.0
Trade receivables	4 633.6	4 670.0
Cash	62.5	88.3
	9 913.1	9 639.3
	34 107.4	31 223.6

	2008 *$ million*	*2007* *$ million*
Equity and Liabilities		
Equity		
Share capital	4 300.0	3 600.0
Retained earnings	14 643.7	12 991.4
	18 943.7	16 591.4
Minority interest	2 010.5	1 870.5
Non-current liabilities		
Long-term borrowings	6 133.9	6 013.0
Current liabilities		
Trade payables	5 579.3	5 356.3
Short-term borrowings	662.4	507.7
Income tax	777.6	884.7
	7 019.3	6 748.7
	34 107.4	31 223.6

Notes

1 Depreciation of $2 024.7 million was charged in respect of property, plant and equipment in the year ended 30 April 2008.

2 On 1 January 2008 EAG disposed of the investment in associate for $18 million. The share of profit in the income statement relates to the period from 1 May 2007 to 31 December 2007. A dividend was received from the associate on 1 June 2007. There were no other disposals, and no acquisitions, of investments in the accounting period.

3 Goodwill in one of the group's subsidiaries suffered an impairment during the year. The amount of the impairment was included in cost of sales.

4 The long-term borrowings are measured at amortised cost. The borrowing was taken out on 1 May 2006, and proceeds of $6 000 million less issue costs of $100 000 were received on that date. Interest of 5% of the principal is paid in arrears each year, and the borrowings will be redeemed on 30 April 2011 for $6.55 million. All interest obligations have been met on the due dates. The effective interest rate applicable to the borrowings is 7%. The finance cost in the income statement includes interest in respect of both the long-term and the short-term borrowing. Short-term borrowing comprises overdrafts repayable on demand.

5 Amortization of 25% of the opening balance of intangibles was charged to cost of sales. A manufacturing patent was acquired for a cash payment on 30 April 2008.

6 An issue of share capital at par was made for cash during the year.

7 Dividends were paid to minority interests during the year, but no dividend was paid to the equity holders of the parent entity.

Required:

Prepare the consolidated cash flow statement of the EAG Group for the financial year ended 30 April 2008. The cash flow statement should be presented in accordance with the requirements of IAS 7, *Cash Flow Statements*, and using the indirect method. Notes to the financial statement are NOT required, but full workings should be shown.

(CIMA P8 – May 2008)

15 The consolidated statement of financial position for MIC as at 31 March 2009 and its comparative for 2008 are shown below:

	2009	*2008*
Assets	*$000*	*$000*
Non-current assets		
Property, plant and equipment	16 800	15 600
Goodwill	2 900	2 400
Investment in associate	8 000	7 800
Current assets	27 700	25 800
Inventories	11 600	12 000
Receivables	9 400	8 200
Held for trading investment	2 200	1 800
Cash and cash equivalents	1 400	4 100
	24 600	26 100
Total assets	52 300	51 900
Equity and Liabilities		
Equity attributable to owners of the parent		
Share capital ($1 ordinary shares)	12 000	10 000
Share premium	2 800	—
Other reserves	400	400
Retained earnings	7 300	6 300
	22 500	16 700
Non-controlling interest	6 500	6 100
Total equity	29 000	22 800
Non-current liabilities		
Long term loans	14 000	18 000
Current liabilities		
Payables	8 700	10 200
Income tax	600	900
	9 300	11 100
Total liabilities	23 300	29 100
Total equity and liabilities	52 300	51 900

The consolidated income statement for MIC for the year ended 31 March 2009 is shown below:

	$000
Revenue	12 000
Cost of sales	(8,400)
Gross profit	3 600
Distribution costs	(400)
Administrative expenses	(1 260)
Finance costs	(450)

	$000
Share of profit of associate	500
Profit before tax	1 990
Income tax expense	(600)
PROFIT FOR THE YEAR	1 390
Attributable to:	
Owners of the parent	1 200
Non-controlling interest	190
	1 390

Additional information:

1 There were no disposals of property, plant and equipment in the year. Depreciation charged in arriving at profit totaled $1,800,000.

2 MIC acquired 90% of the ordinary share capital of GH on 1 December 2008 for a cash consideration of $460,000 plus the issue of 1 million $1 ordinary shares in MIC, which had a deemed value of $3.60 per share at the date of acquisition. The fair values of the net assets acquired were as follows:

	$000
Property, plant and equipment	800
Inventories	2 200
Receivables	700
Cash and cash equivalents	200
Payables	(500)
	3 400

MIC made no other purchases or sales of investments in the year. The group policy is to value the non-controlling interest at acquisition at the proportionate share of the fair value of the net assets.

3 Finance costs include interest on loans and any gains or losses on held for trading investments. All interest due was paid in the year.

Required:

Prepare the consolidated statement of cash flows for MIC for the year ended 31 March 2009.

(CIMA F2 – November 2009 Specimen)