STATEMENT OF CASH FLOWS

Presentation by:

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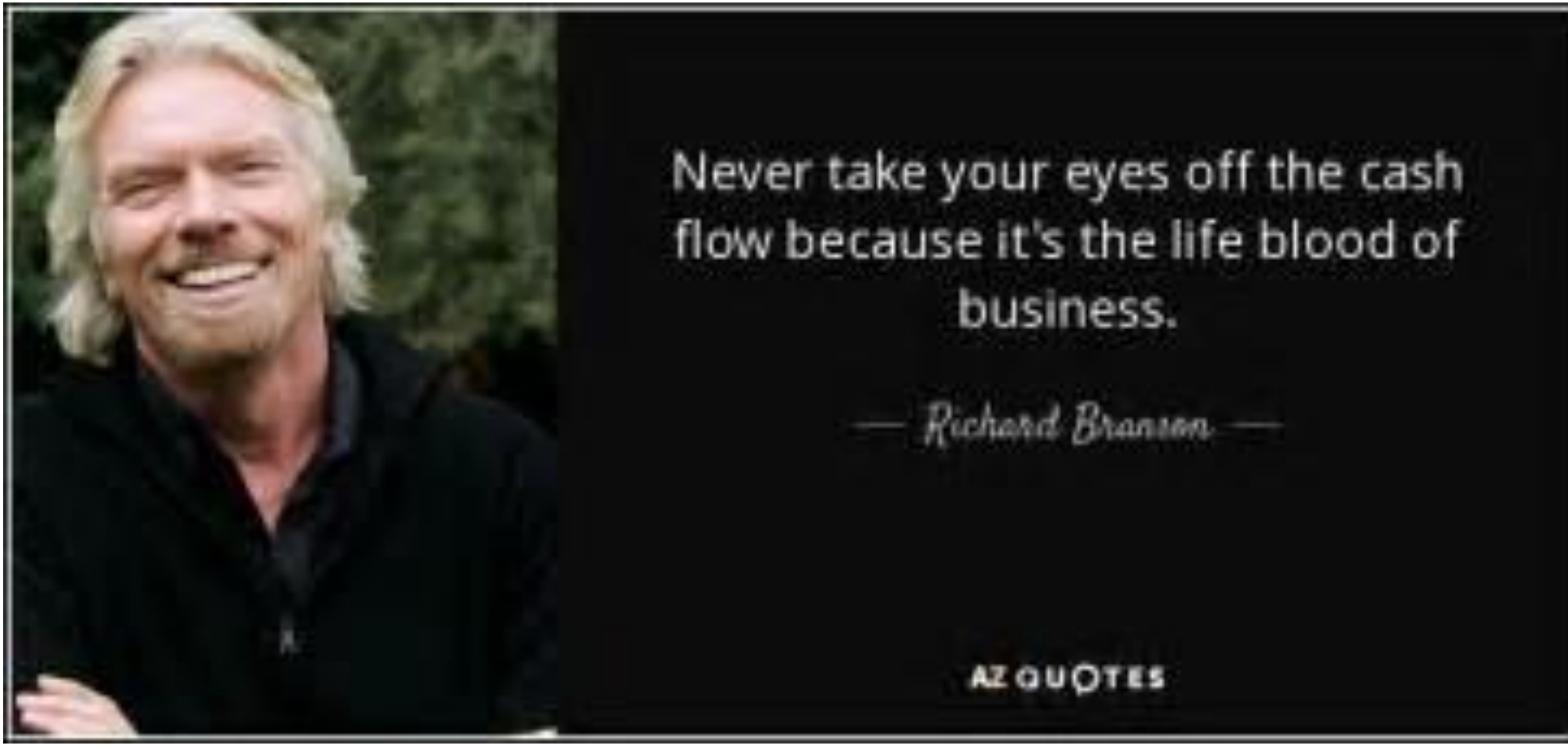

Never take your eyes off the cash flow because it's the life blood of business.
— Richard Branson —
AZ QUOTES

Presentation Agenda

- Overview of the requirements of the standards
- Focus on Direct Method
- Concepts in the Consolidated Statement of Cash Flows
- Making meaning of a Statement of Cash Flows

Overview

An entity **shall** prepare a statement of cash flows in accordance with the requirements of the Standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented.

The Statement of Cash Flows shall report cash flows during the period classified by ***operating, investing and financing activities***.

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

Investing activities are the ***acquisition and disposal of long-term assets*** and other investments not included in cash equivalents.

Financing activities are activities that result in ***changes in the size and composition of the contributed equity and borrowings of the entity***.

Operating Activities

Principal revenue-producing activities include:

- cash receipts from the sale of goods and the rendering of services;
- cash receipts from royalties, fees, commissions and other revenue;
- cash payments to suppliers for goods and services;
- cash payments to and on behalf of employees;
- cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;
- cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and
- cash receipts and payments from contracts held for dealing or trading purposes.

Investing Activities

The acquisition and disposal of long-term assets

- cash receipts/payments from/to sales/acquisition of equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
- cash advances and loans made to other parties (other than advances and loans made by a financial institution);
- cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);
- cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
- cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

Financing Activities

Activities related to ***changes in the size and composition of the contributed equity and borrowings of the entity***

- cash proceeds from issuing shares or other equity instruments;
- cash payments to owners to acquire or redeem the entity's shares;
- cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;
- cash repayments of amounts borrowed; and
- cash payments by a lessee for the reduction of the outstanding liability relating to a lease.

Foreign Currency Cash Flows

- Cash flows arising from transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

- The cash flows of a foreign subsidiary shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

Unrealised gains and losses

- Unrealised gains and losses arising from changes in foreign currency exchange rates **are not cash flows.**
- However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period.
- This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

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.
- These may include:

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

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

  (c) the conversion of debt to equity.

  - Such transactions shall be disclosed

Components of Cash and Cash Equivalents

- An entity discloses the policy which it adopts in determining the composition of cash and cash equivalents.

- The effect of any change in the policy for determining components of cash and cash equivalents, is reported in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Discontinued Operations

An entity shall disclose:

- the net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented either in the notes or in the financial statements.

We were always focused on our profit and loss statement. But cash flow was not a regularly discussed topic. It was as if we were driving along, watching only the speedometer, when in fact we were running out of gas.

Michael Dell

The Direct Method

- An entity shall report cash flows from operating activities using either:
  (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.

The Direct Method

- Entities are encouraged to report cash flows from operating activities using the direct method.
- The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method.

	2011	2010
Cash flows from operating activities		
Cash receipts from customers	xx	xx
Cash paid to suppliers and employees	(xx)	(xx)
Cash generated from operations	xx	xx
Interest received	x	x
Interest paid	(x)	(x)
Income taxes paid	(x)	(x)
Net cash provided by operating activities	xx	xx

The Direct Method

Cash receipts from customers=

+ Net sales
+ Beginning Accounts Receivable
- Ending Account Receivables

Cash payments to Suppliers =

+ Purchases
+ Ending Inventory
- Beginning Inventory
+ Beginning Accounts Payable
- Ending Accounts Payable

Cash payments to employees =

+ Beginning salaries payable
- Ending salaries payable
+ Salaries expense

Cash payments for purchase of prepaid assets=

+ Ending Prepaid rent, Prepaid insurance, etc
+ Expired Rent, Expired Insurance, etc
- Beginning Prepaid rent, Prepaid insurance, etc

Interest payments =

+ Beginning interest payable
- Ending interest payable
+ Interest expense

Income tax payments =

+ Beginning Income Tax Payable
- Ending Income Tax Payable
+ Income tax Expense

The Direct Method

- According to research published in The Accounting Review, the direct method ***provides a more accurate picture for investors of a company's cash flow situation than the indirect method.***

- After comparing financial statements of different companies using either the direct or the indirect methods, researchers Steven Orpurt and Yoonseok Zang found that the direct method provided the best basis for investors to predict future cash flows and earnings potential.

- This is because some cash flow items, such as collections from customers, are difficult to estimate in the indirect method.

ICPAK

Uphold Public Interest

Group Consolidated Statement of Cash flows

- The Group Statement of Cash Flows is prepared from the consolidated financial statements and as such reflects the cash flows of the group.

- The principles underpinning the Group Statement of Cash Flows are essentially the same as preparing a Statement of Cash Flows at individual company level.

Consolidation Process

Obtain Consolidated Financial Statements - SOFP, SOPL, etc → Calculate changes in assets, liabilities, equity → Incorporate each change into the statement of cash flows → Make non-cash and other adjustments → Eliminate intragroup cash flows and transactions

NB: Only when the parent and subsidiaries use the same functional currency

Consolidation Process

Foreign subsidiary

Prepare individual statements of cash flows for both parent and subsidiary (s) → Translate subsidiary's statement of cashflows to the presentation currency → Aggregate parent's and subsidiary's statement of cash flows → Eliminate intragroup cash flows and transactions

Remember: The cash flows of a foreign subsidiary shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

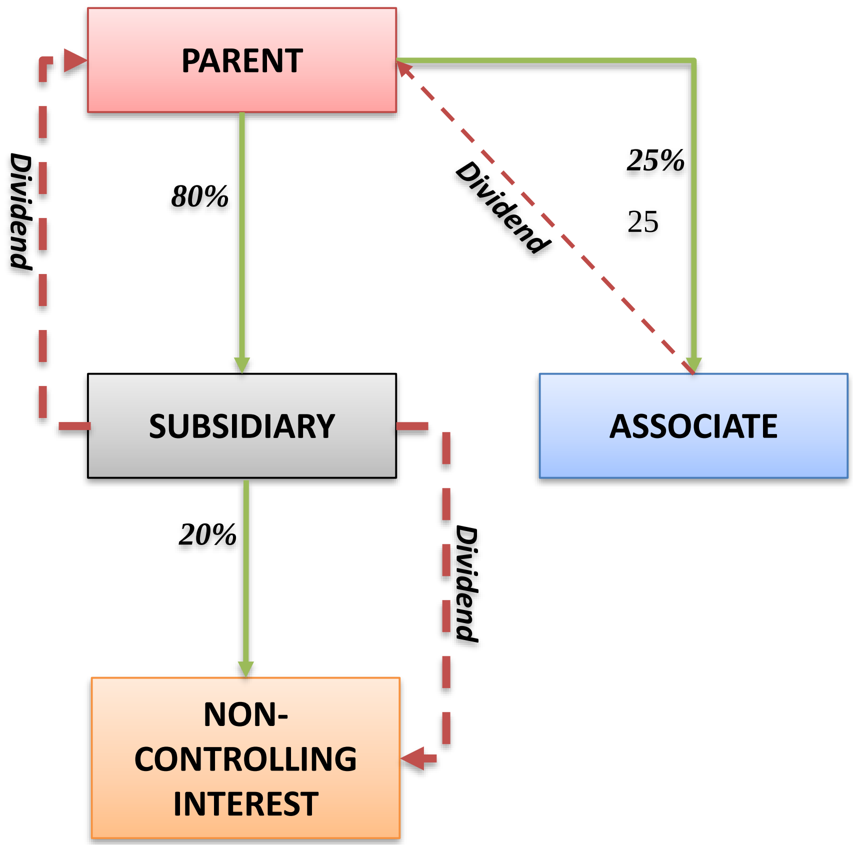
Additional Considerations in Consolidated Statement of Cash flows

When a group statement of cash flows is being prepared, there are additional cash flows to consider, such as:

- Dividends paid out to non-controlling interests
- Dividends received from equity accounted investees, such as associates
- Cash flows arising from the acquisition or disposal of subsidiary companies

STATEMENT OF CASHFLOWS		
	Note	Kes'000
Cash flows from operating activities:		
Profit before tax		**XXX**
Adjustments for:		
Non-cash income and expenses in SPL		XX/(XX)
Impairment of goodwill		XX/(XX)
(Gain)/loss on dissposal of subsidiary		XX/(XX)
Share of profit from associate		XX/(XX)
Operating profit before working capital changes		XXX
Increase / decrease in current assets and liabilities		XX/(XX)
Cash generated from operations		
Interest paid		(XX)
Income tax paid		(XX)
Net cash generated from / utilised in operating activities	**A**	XXX
Cash flows from investing activities:		
Purchase of non-current assets or short term investment (on cash basis)		(XXX)
Disposal of non-current assets or short term investment (on cash basis)		XX
Cash received from associate (dividend)		XX
Cash paid to acquire subsidiary (net of cash acquired)		(XX)
Cash received from disposal of subsidiary (net of cash balance)		XX
Investment income (on cash basis)		XX
Net cash from (utilised in) investing activities	**B**	(XXX)
Cash flows from financing activities:		
Cash preoceeds from share issue, loan issue or borrowings		XXX
Cash paid for share re-purchase, loan and borrowings repayment		(XX)
Cash (Dividend) paid to NCI		(XX)
Net cash from financing activities	**C**	XXX
Net decrease in cash and cash equivalents	**A+B+C**	XXX
Cash and cash equivalents at beginning of the year	**SFP**	XXX
Cash and cash equivalents at end of the year	**SFP**	XXX
Remember to take effect of acquisitions, disposals, and exchange gain or loss.		

Dividends Paid Out to Non-Controlling Interests



Dividends Paid Out to Non-Controlling Interests

The dividends paid to NCI are presented as financing activities' outflows.

Non-controlling interests

NCI decrease - step acquisition	xxx	Balance b/d	xxx
Cash dividend (paid)	xxx	NCI share of profit	xxx
Balance c/d	xxx	NCI increase - partial disposal	xxx
	xxxx		xxxx

Dividends Received From Equity Accounted Investees

Dividends received are presented as investing activities' inflows. Only dividend received represents a cash inflow, dividends receivable but not yet received represent an increase in group receivables.

Investments in Associates

Balance b/d	xxx	Impairment	xxx
Share of profit	xxx	Cash (s/h sold)	xxx
Cash (further investment)	xxx	Cash (dividend rec)	xxx
		Balance c/d	xxx
	xxxx		xxxx

Dividends Received From Equity Accounted Investees

The other cash inflow/outflows that should also be considered include:

- Cash paid to acquire further shareholding
- Cash received from disposing of some shareholding
- Cash loans made to associate
- Loans paid by associate

Cash Flows Arising From the Acquisition or Disposal of Subsidiary Companies

The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.

Cash Flows Arising From the Acquisition or Disposal of Subsidiary Companies

If a subsidiary is acquired or disposed of during the year, the following must be reported separately under investing activities:

1. Cash payments to acquire subsidiaries (net of cash and cash equivalent acquired); and
2. Cash receipts from disposals of subsidiaries (net of cash and cash equivalent disposed of).

All assets and liabilities acquired (or disposed of) must be included in any workings to calculate the cash movement for an item during the year.

This applies to all assets and liabilities acquired (or disposed of) including the NCI.

Cash Flows Arising From the Acquisition or Disposal of Subsidiary Companies

Working Capital Movements

	Inventory	Receivables	Payables
Opening balance	xx	xx	xx
Acquistion/(disposal)	xx/(xx)	xx/(xx)	xx/(xx)
Expected closing balance	xx	xx	xx
Actual closing balance	xx	xx	xx
Movement	↑or ↓	↑or ↓	↑or ↓

Cash Flows Arising From the Acquisition or Disposal of Subsidiary Companies

PPE Movements

PPE

Bal b/d	xx	Depn	x
Acquisition	x	Disposal	x
Cash	xx	Bal c/d	xx
	xxx		xxx

Cash Flows Arising From the Acquisition or Disposal of Subsidiary Companies

An entity shall disclose, in aggregate, in respect of both obtaining and losing control of subsidiaries or other businesses during the period each of the following:

(a) the total consideration paid or received;

(b) the portion of the consideration consisting of cash and cash equivalents;

(c) the amount of cash and cash equivalents in the subsidiaries or other businesses over which control is obtained or lost; and

(d) the amount of the assets and liabilities other than cash or cash equivalents in the subsidiaries or other businesses over which control is obtained or lost, summarised by each major category.

IPSAS 2

Comparison with IAS 7

IPSAS 2, “Cash Flow Statements,” is drawn primarily from IAS 7, “Cash Flow Statements.” The main differences between IPSAS 2 and IAS 7 are as follows:

- Commentary additional to that in IAS 7 has been included in IPSAS 2 to clarify the applicability of the standards to accounting by public sector entities.

- IPSAS 2 uses **different terminology**, in certain instances, from IAS 7. The most significant examples are the use of the terms entity, revenue, statement of financial performance, statement of financial position and net assets/equity in IPSAS 2. The equivalent terms in IAS 7 are enterprise, income, income statement, balance sheet and equity.

- IPSAS 2 contains a different set of **definitions of technical terms** from IAS 7 (paragraph 8).
- In common with IAS 7, IPSAS 2 allows either the direct or indirect method to be used to present cash flows from operating activities.

- The Appendix to IPSAS 2 does not include an illustration of a Cash Flow Statement for a financial institution.

Making Meaning of a Cash Flow

"THE THREE MOST DREADED WORDS IN THE ENGLISH LANGUAGE ARE 'NEGATIVE CASH FLOW'."

DAVID TANG

Making Meaning of a Cash Flow

So what are we really looking at and what does it mean?

ABC LIMITED

STATEMENT OF CASHFLOWS	**2013** 000	**2014** 000	**2015** 000	**2016** 000	**2017** 000
Net cash generated/ (utilised) in operating activities	1,000	2,000	3,000	4,000	5,000
Net cash generated/(utilised) in investing activities	- 500	- 1,000	- 1,500	- 2,000	- 2,500
Net cash generated/(utilised in financing) activities	- 500	- 800	- 1,000	- 1,500	- 1,500
Net cash	-	200	500	500	1,000

XYZ LIMITED

Net cash generated/ (utilised) in operating activities	2,500	2,000	1,000	500	- 1,000
Net cash generated/(utilised) in investing activities	- 1,000	- 1,000	- 1,500	2,000	- 500
Net cash generated/(utilised in financing) activities	- 1,000	- 800	1,000	500	1,500
Net cash	500	200	500	3,000	-

Making Meaning of a Cash Flow

So what are we really looking at and what does it mean?

- For auditors – Is the entity able to continue as a going concern into the foreseeable future?
- For directors – What is our ability to generate cash and cash equivalents and what are our needs to utilise available cash flows?
- For banks, creditors and financiers – Is the entity solvent? Is it able to repay debts as they fall due?
- For investors and market players –
  - What is the likelihood of us receiving our return on investments?
  - What is the company's investment strategy in the short and long terms? Is the entity putting all its eggs in one basket?
  - The effect of the entity’s activities on the share price.

"No, don't put the cheque in the post - I'll send someone round to pick it up."