IAS 7 – Statement of Cash Flows

Presentation by:

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The cash flow statement

Introduction

The "black sheep of the financial statement family…

But why is it important to users?

The success, growth and survival of every reporting entity depends on its ability to generate or otherwise obtain cash.

Reported profit is important to users of financial statements, but so too is the cash flow generating potential of an entity.

What enables an entity to survive is the tangible resource of cash not profit, which is merely one indicator of financial performance.

Statement of cash flows	KShs'000
Cash flows from operating activities	
Cash generated from operations	
Dividends and interest paid	
Net cash flow from operating activities	
Cash flows from investing activities	
Net cash movements in current accounts with associates	
Acquisition of subsidiaries	
Disposal of subsidiaries	
Net cash used in investing activities	
Cash flows from financing activities	
Non-controlling interests acquired	
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Net increase in cash and cash equivalents	
Cash and cash equivalents at the beginning of the period	
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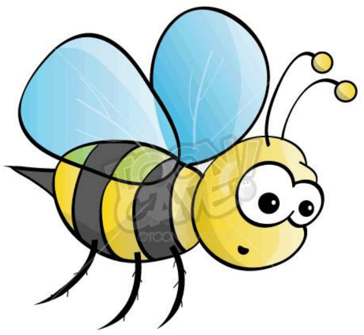
IAS 7 – Statement of cash flows

Why is the statement of cash flows important?

What are the common issues?



Regulator and financial analyst comments

Diversity in items classified as cash equivalents

Different starting point to determine operating cash flows

Inconsistent classification of cash flows

Netting items in cash flow statements

Material or unusual items not disclosed separately

Inconsistency between the cash flow statement and elsewhere in the report

Temperature test

1. Which of the following is the objective of the cash flow statement?

   (a) understand how the entity generates and uses cash

   (b) evaluate the changes in net assets and financial structure

   (c) enhance comparability of performance of different entities

   (d) indicate the amount, timing and certainty of future cash flows

   (e) all of the above

Answer: e

Temperature test

2. Which criterion is **not** included in the definition of cash equivalents?
   - (a) readily convertible to known amount of cash
   - (b) short-term, highly liquid investments
   - (c) subject to an insignificant change in value
   - (d) investment in high-quality instruments

Answer: d

Definition of cash equivalents

- *Short-term*

  - maturity period: 3 months or less from the date of acquisition

- *Readily convertible*

  - into a known amount of cash without an undue notice period

  - without incurring a significant penalty

- *Subject to an insignificant change in value*

- *Held*– to meet short-term cash commitments

Cash subject to restriction

- withdrawal?
- perfunctory?
- notice period?
- changes in value?

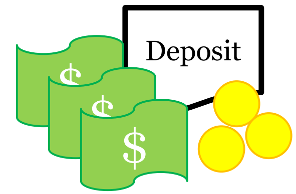
Is this a cash equivalent?

Cash and cash equivalents
Restricted cash

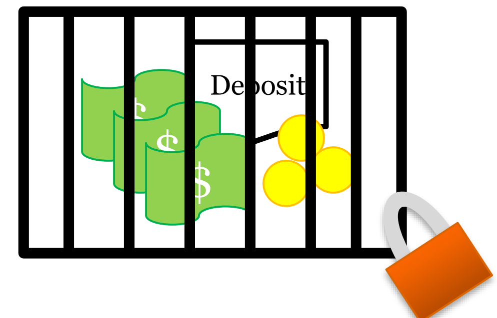
The question arises as to how such restricted funds should be dealt with in the cash flow statement itself.

Restricted cash is classified as cash and cash equivalents if it meets the definition in IAS 7. If, however, the restrictions are so severe such that the instrument no longer meets the definition, then it should be shown separately from cash and cash equivalents.

Cash and cash equivalents



Restricted cash- **STILL** cash and cash equivalents



Restrictions too severe- **NOT** cash and cash equivalents

Definition of cash equivalents

	Cash equivalents?
1. A term deposit with a 3 month maturity	✓
2. A term deposit made on 1 Jan 20x1 – at the year end on 31 Dec 20x1, the remaining maturity is 2 months	✗
3. A deposit: • held in an escrow account requiring • a third party's signature to withdraw	✗

Short maturity, ≤ 3 months

Maturity period - from date of acquisition

Restriction is not perfunctory – obtaining third party's signature is not under entity's control

Temperature test

3. What is the principle in IAS 7 for the classification of cash flows?
   (a) Consistent with the classification of the related item in the balance sheet
   (b) According to the nature of the activity in a manner that is most appropriate to the business

Answer: b

Classification of cash flows

- *Key principle:* Nature of activity
- *Operating activities*

  - Principal revenue-producing activities of the entity

  - 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 contributed equity and borrowings

Temperature test

4. Which of the following is a non-cash transaction?

   (a) Acquisition of assets by means of liability or finance lease

   (b) Acquisition of an entity by means of an equity issue

   (c) Conversion of debt to equity

   (d) All of the above

Answer: d

Investing and financing activities with no cash flows

Classifying cash flows

Investing vs. operating vs. financing

The statement of cash flows can be broken up into 3 buckets:

Operating

Investing

Financing

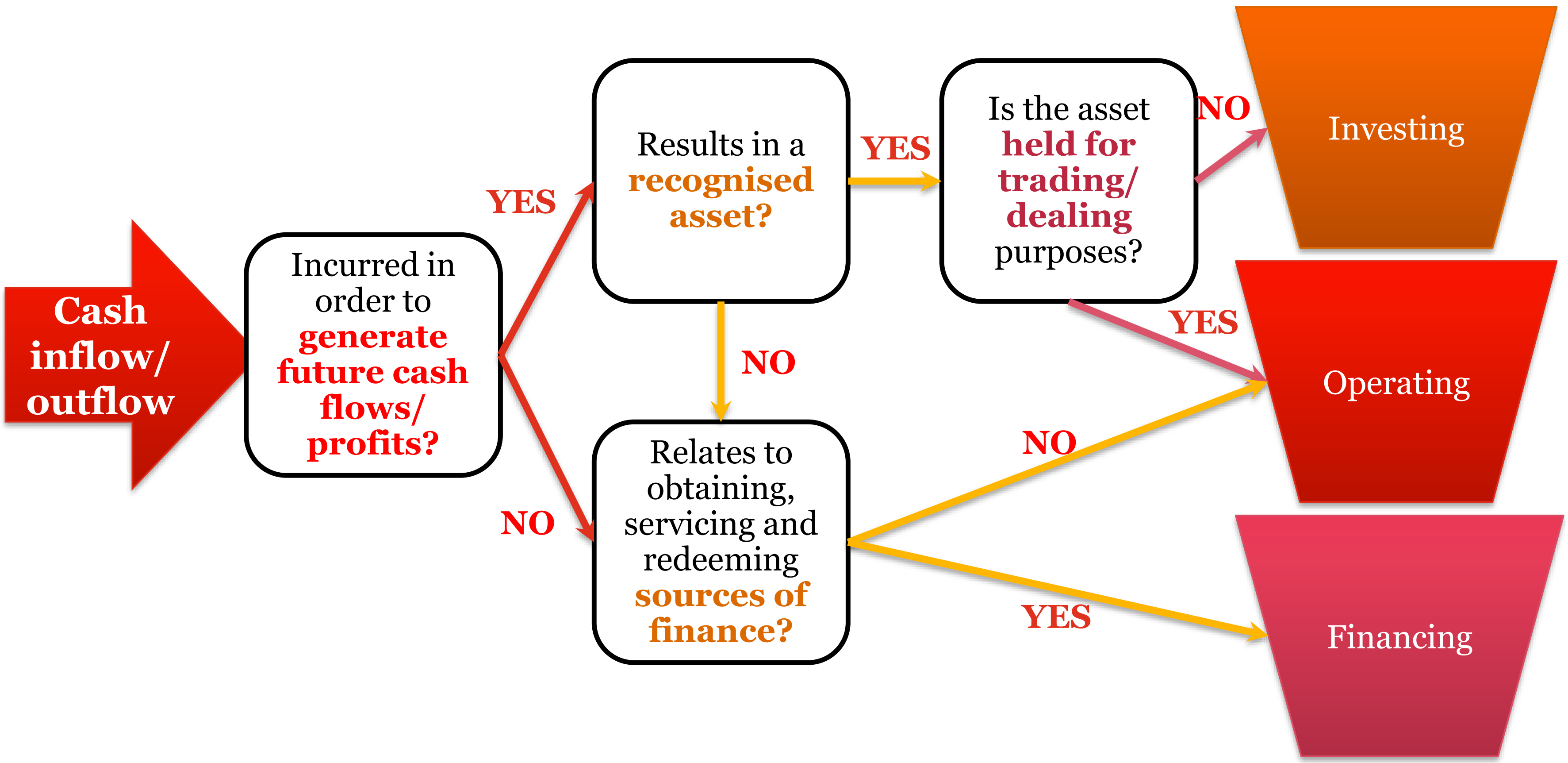
Key concepts behind classifying cash flows:

Business-activity dependent

Discretion in classification

Consistency in application

Classifying cash flows
Decision tree for cash flow classification



Classifying cash flows

Example: Classify the following cash flows

Highrise Ltd is a property developer that is listed on the DSE. During the year they had the following transactions:

Issue of preference shares

We issued a fresh batch of preference shares during the year to fund future projects

FINANCING

Purchase of government land

A number of large plots of land were purchased from the government. The land will be used for a variety of purposes

IT DEPENDS

Listed equity

Highrise added another share to it's ever growing portfolio of investments in other listed entities

INVESTING

The cash flow statement

What's next?

a The 3 cash flow buckets

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Cash flows

Interest and dividends

Generally…

Most entities would categorise interest paid in **operating** and dividends paid to parent and non-controlling shareholders in **financing**

EXERCISE!

Are the following statements true or false?

Interest incurred on a loan taken out to fund the construction of admin offices can be classified as investing activities

TRUE

Dividends received and interest paid or received in respect of the cash flows of a financial institution are investing activities

FALSE

Dividends paid can also be shown as part of operating activities

TRUE

The cash flow statement

What's next?

- The 3 cash flow buckets
- Interest and dividends

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Presenting cash flows

Gross vs. net

The general rule

Major classes of receipts and payments should be reported **gross** in the cash flow statement

The exceptions

Cash receipts and payments on **behalf of customers**

Cash flows where **turnover is quick, the amounts large and the maturities short.**

Certain cash flows in **financial institutions**

The net cash flows of a **business combination**

The 3 cash flow buckets

Interest and dividends

Gross vs. net presentation

The cash flow statement

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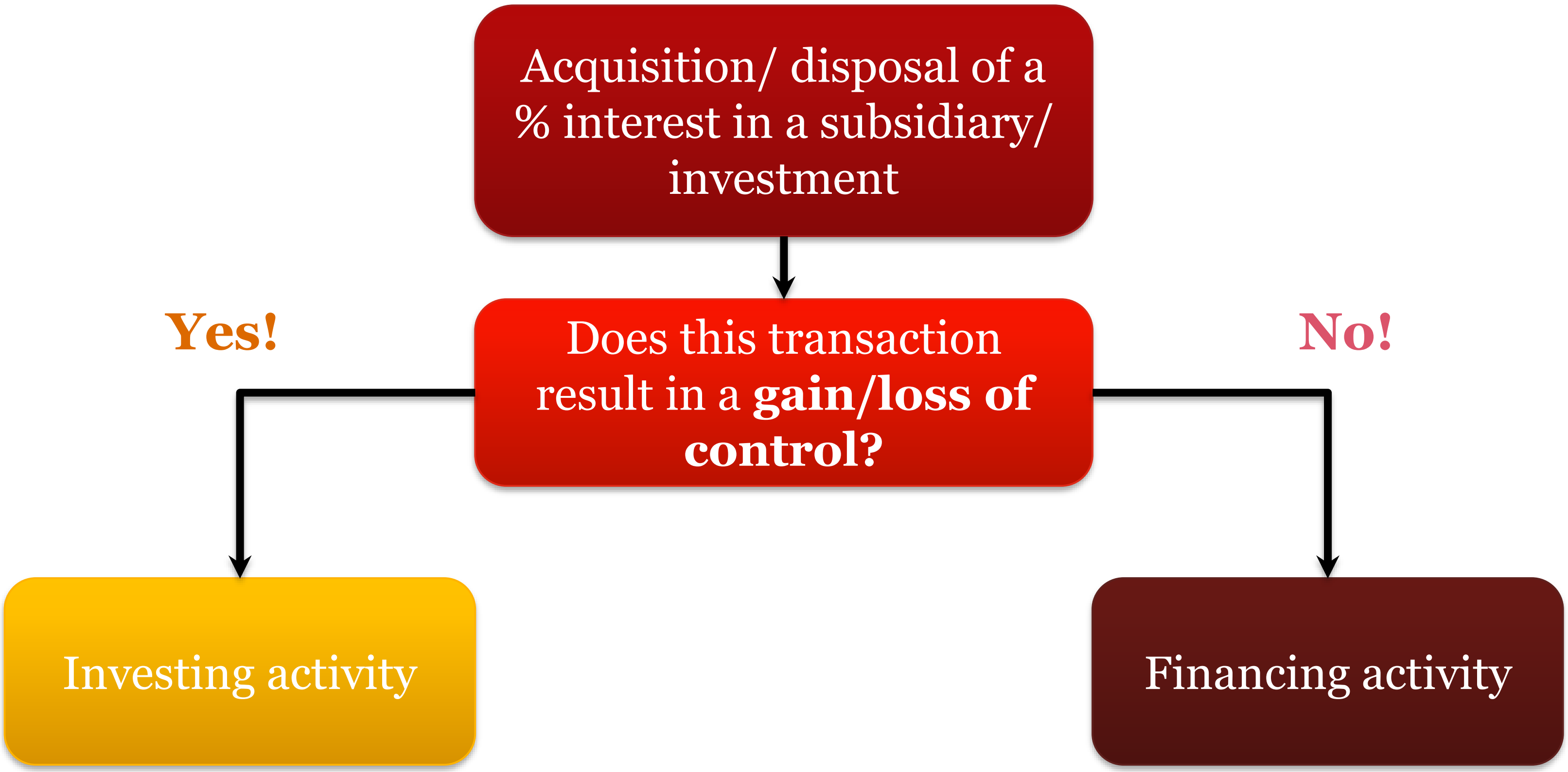
Acquisition and disposal-related cash flows

Disposing of an investment in a subsidiary



Acquisition and disposal-related cash flows
Examples

Rights issue

Scarlett Ltd's 60% subsidiary makes a rights issue of new equity shares pro rata. **Scarlett Ltd** paid KShs 6 million for the additional shares. The other shareholders also paid up for their additional shares.

How should the transaction be shown in the **Scarlett Ltd** consolidated cash flow statement?

Cash flows from financing activities

Rights issue to NCI KShs 4 million

Acquisition of an investment

Life Ltd acquired a 100% stake in **Flash Ltd**. The price was settled by paying KShs 20 million in cash and issuing KShs 80 million in shares. The total net assets acquired were worth KShs 100 million (cash and cash equivalents being KShs 30 million).

How should the transaction be shown in the **Life Ltd** consolidated cash flow statement?

Cash flows from investing activities

Inflow from acquisition of sub.
KShs 10 million

Acquisition and disposal-related cash flows
Examples

Acquisiton costs

Root Ltd acquired a 60% stake of **Vibe Ltd** for KShs 8.5 million. As part of the acquisition, **Root Ltd** incurred KShs 0.5 million in transaction costs, how should these transaction costs be classified in **Vibe Ltd's** stand-alone and group financials?

Root Ltd consolidated cash flow statement

- [a] Operating activity
- [ ] Investing activity
- [ ] Financing activity

Root Ltd separate cash flow statement

- [a] Operating activity
- [a] Investing activity
- [ ] Financing activity

The cash flow statement

What's next?

- The 3 cash flow buckets
- Interest and dividends
- Gross vs. net presentation
- Acquisition and disposal-related cash flows

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Foreign currency in cash flows

Is translation of cash flows foreign to you?

Foreign currency activities

- Business transactions that are denominated in a foreign currency
- Foreign operations conducted through a subsidiary, associate, joint venture or branch

Foreign currency in cash flows

Interaction between IAS 21 and IAS 7

What do the standards say?

Assets and liabilities to be translated at the **closing rate** and income and expense items to be translated at the rate ruling at the date of the transaction or the **average rate** that approximates to the actual rates. Exchange differences are recognised in other comprehensive income (OCI)

IAS 21

IAS 7

Foreign subsidiary's cash flows statement to be translated at the exchange rates at the date of the cash flows or permits use of the **weighted average rate** in line with the income statement treatment

Foreign currency in cash flows

Effect on the cash flow statement

1. Functional currency differs from presentation currency, cash flows of the operation are considered as a whole rather than as a series of single transactions.
2. Exchange differences relating to the translation of opening net assets to the closing rate are recognised in OCI and therefore have no cash flow effect.
3. Where the net assets include foreign currency cash and cash equivalents, the exchange differences arising on their translation are reported in the cash flow statement.

Prepare the cash flow statement in the functional currency of the subsidiaries and then translate into the presentation currency…

The cash flow statement
What's next?

- The 3 cash flow buckets
- Interest and dividends
- Gross vs. net presentation
- Acquisition and disposal-related cash flows
- Translating cash flows

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IAS 7 Amendments *[Para 44A-44E]*

IAS 7 amendments

Net debt reconciliation: Disclose cash flows and non-cash changes in liabilities arising from financing activities

Changes from financing cash flows	Changes arising from obtaining or losing control	Changes from foreign exchange rates	Changes in Fair values	Other changes

How to comply with this requirement?

IAS 7 Amendments

IAS 7 amendments : Net debt réconciliation

see example below

	2017	Cash flows	Non-cash changes		2018
			Acquisition	FX Movements	
Long term borrowings	1,000	(1,004)	7,620	401	8,017
Short term borrowings	1,047	(592)	1,830	83	2,368
Total liabilities from financing activities	2,047	(1,596)	9,450	484	10,385

- Effective from **1 January 2017**, early application permitted
- No requirement for comparatives in first year of application

Comparison- IAS 7 and IPSAS 2

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 income, income statement, balance sheet and equity.
- IPSAS 2 contains a different set of definitions of technical terms from IAS 7
- In common with IAS 7, IPSAS 2 allows either the direct or indirect method to be used to present cash flows from operating activities. Where the direct method is used to present cash flows from operating activities, IPSAS 2 encourages disclosure of a reconciliation of surplus or deficit to operating cash flows in the notes to the financial statements.

Key message

The cash flow statement can reveal a lot about the business

- Going concern risk? Liquidity risk?

Common pitfalls

- Are they cash equivalents?
- Proper and consistent cash flows classification?
- Consistency with other parts of the report?
- Material non-cash transactions?

Any questions?

Thank you