

Chapter 14

STATEMENTS OF CASH FLOWS

1. Introduction

Companies are required by IAS 7 Statements of Cash Flows to include a Statement of Cash Flows in their financial statements.

In this chapter we will look at the required format and explain how to prepare a Statement of Cash Flows.

2. Description

A Statement of Cash Flows is simply a summary of the cash receipts and payments. The purpose is to provide users of the financial statements with more information than is provided just by the Statement of Profit or Loss and Statement of Financial Position.

For example, the company may have issued shares during the year, but the cash balance at the end of the year may be lower than at the end of the previous year. An ordinary shareholder may be puzzled by this, but maybe the explanation is that the company had very large expenditure on non-current assets. To you as an accountant, this may be obvious from inspection of the Statement of Financial Position, but a Statement of Cash Flows will make it more obvious to the shareholder.

3. The indirect method

There are two approaches allowed in preparing a Statement of Cash Flows – the direct method and the indirect method. We will look at the indirect method first which is more common in practice.



Statement of Cash Flows - PROFORMA

- X plc Statement of Cash Flows for the year ended 31 December 2008

	\$	\$
<i>Cash flows from operating activities</i>		
Net profit before taxation	x	
Adjustments for:		
Depreciation	x	
Profit on sale of non-current assets	(x)	
Interest expense	<u>x</u>	
Op. profit before working cap. changes	x	
Increase in accounts receivable	(x)	
Increase in inventories	(x)	
Increase in accounts payable	<u>x</u>	
Cash generated from operations	x	
Interest paid	(x)	
Dividends paid	(x)	
Taxation paid	<u>(x)</u>	
Net cash from operating activities		x
<i>Cash flows from investing activities</i>		
Purchase of non-current assets	(x)	
Sale proceeds of non-current assets	x	
Interest received	x	
Dividends received	<u>x</u>	
Net cash from investing activities		x
<i>Cash flows from financing activities</i>		
Proceeds from issue of shares	x	
Repayment of debenture loan	<u>(x)</u>	
Net cash from financing activities		<u>x</u>
Net increase in cash & cash equivalents		x
Cash and cash equivalents b/f		<u>x</u>
Cash and cash equivalents c/f		<u>x</u>



Example 1

Blair Limited -Statement of Financial Position as at 31 December 2008

	2008		2007	
	\$	\$	\$	\$
ASSETS				
Non-current assets		545,000		410,000
Current assets:				
Inventories	90,000		81,000	
Receivables	83,000		75,000	
Cash	45,000		64,000	
		218,000		220,000
		<u>763,000</u>		<u>630,000</u>
EQUITY AND LIABILITIES				
Capital and reserves:				
\$1 ordinary shares		150,000		100,000
Share Premium Account		20,000		
Accumulated profits		476,000		431,000
		<u>646,000</u>		<u>531,000</u>
Current liabilities:				
Trade payables	97,000		69,000	
Corporation tax payable	20,000		30,000	
		117,000		99,000
		<u>763,000</u>		<u>630,000</u>

Statement of Profit or Loss for the year ended 31 December 2008

	\$
Turnover	1,000,000
Cost of sales	<u>700,000</u>
Gross profit	300,000
Administrative expenses	<u>199,000</u>
Operating profit	101,000
Interest	<u>1,000</u>
Profit before tax	100,000
Tax	<u>39,000</u>
Profit after tax	<u>\$61,000</u>

The following information is relevant:

- (1) Administrative expenses include depreciation of \$40,000
- (2) During the year there had been sales of non-current assets for \$30,000. The assets sold had originally cost \$50,000 and had a net book value of \$20,000.
- (3) Dividends paid during the year were \$16,000

Produce a Statement of Cash Flows for the year ended 31 December 2008

4. The direct method

In the previous paragraph, where we used the indirect method, we established the cash flow from operations by taking the profit from the Statement of Profit or Loss and working backwards – eliminating non-cash items and adjusting for changes in working capital.

The alternative approach is to calculate the cash flow from operations directly by taking the cash receipts from customers and deducting the cash payments. This is known as the direct method. (Note that the rest of the Statement of Cash Flows stays the same as before.)

The layout for arriving at the cash flow from operations is as follows:

Cash received from customers	x
Cash payments to suppliers	(x)
Cash paid to and on behalf of employees	(x)
Other cash payments	<u>(x)</u>
Net cash inflow from operating activities	<u>x</u>



Example 2

Gatis has the following Statement of Profit or Loss for the year ended 31 December 2007:

	\$
Revenue	1,200,000
Cost of sales	(840,000)
Gross profit	360,000
Distribution and administrative expenses	(120,000)
Net profit before tax	240,000

The following are extracts from Gatis's Statements of Financial Position:

	2007 \$	2006 \$
Current assets		
Inventory	160,000	140,000
Trade receivables	259,000	235,000
Current liabilities		
Trade payables	168,000	138,000

You are given the following further information:

- (1) expenses include depreciation of \$36,000, irrecoverable debts written-off of \$14,000 and employment costs of \$42,000
- (2) during the year Gatis disposed of a non-current asset for \$24,000 which had a book value of \$18,000, the profit on which had been netted off expenses.

You are required to show:

- (a) **how the cash generated from operations would be presented on the Statement of Cash Flows using the indirect method.**
- (b) **how the cash generated from operations would be presented on the Statement of Cash Flows under the direct method.**

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE FA MCQ TEST](#)

