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IFRS Foundation: Training Material for the *IFRS® for SMEs*

Module 7 – Statement of Cash Flows

IFRS Foundation: Training Material for the *IFRS® for SMEs*

including the full text of
Section 7 *Statement of Cash Flows*
of the *International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs)*
issued by the International Accounting Standards Board on 9 July 2009

with extensive explanations, self-assessment questions and case studies

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This training material has been prepared by IFRS Foundation education staff. It has not been approved by the International Accounting Standards Board (IASB). The training material is designed to assist those training others to implement and consistently apply the *IFRS for SMEs*. For more information about the IFRS education initiative visit http://www.ifrs.org/Use+around+the+world/Education/Education.htm.

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Module 7 – Statement of Cash Flows

This training material has been prepared by IFRS Foundation education staff and has not been approved by the International Accounting Standards Board (IASB).
The accounting requirements applicable to small and medium-sized entities (SMEs) are set out in the *International Financial Reporting Standard (IFRS) for SMEs*, which was issued by the IASB in July 2009.

INTRODUCTION

This module focuses on the requirements for the presentation of the statement of cash flows in accordance with Section 7 *Statement of Cash Flows* of the *IFRS for SMEs*. Section 3 *Financial Statement Presentation* sets out general presentation requirements and Sections 4–8 focus on the requirements for presenting the individual statements that together comprise a complete set of financial statements. This module introduces the learner to the subject, guides the learner through the official text, develops the learner's understanding of the requirements through the use of examples and indicates significant judgements that are required in presenting a statement of cash flows. Furthermore, the module includes questions designed to test the learner's knowledge of the requirements and case studies to develop the learner's ability to present a statement of cash flows in accordance with the *IFRS for SMEs*.

Learning objectives

Upon successful completion of this module you should know the financial reporting requirements for the statement of cash flows in accordance with the *IFRS for SMEs*. Furthermore, through the completion of case studies that simulate aspects of the real-world application of that knowledge, you should have enhanced your competence to present the statement of cash flows in accordance with the *IFRS for SMEs*. In particular you should, in the context of the *IFRS for SMEs*:

- know the purpose of the statement of cash flows;
- understand the requirements for presenting this statement;
- be able to distinguish cash equivalents from other financial assets;
- be able to distinguish the cash flows from operating, investing and financing activities;
- be able to prepare the statement of cash flows using both the indirect method and the direct method; and
- be able to prepare notes to financial statements and commentary by management in accordance with the requirements of Section 7 of the *IFRS for SMEs*.

Module 7 – Statement of Cash Flows

IFRS for SMEs

The *IFRS for SMEs* is intended to apply to the general purpose financial statements of entities that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The *IFRS for SMEs* includes mandatory requirements and other material (non-mandatory) that is published with it.

The material that is not mandatory includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* and explains its purpose, structure and authority.
- implementation guidance, which includes illustrative financial statements and a disclosure checklist.
- the Basis for Conclusions, which summarises the IASB's main considerations in reaching its conclusions in the *IFRS for SMEs*.
- the dissenting opinion of an IASB member who did not agree with the publication of the *IFRS for SMEs*.

In the *IFRS for SMEs* the Glossary is part of the mandatory requirements.

In the *IFRS for SMEs* there are appendices in Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue.* Those appendices are non-mandatory guidance.

Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity's financial position, performance and cash flows that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Section 3 prescribes general requirements for the presentation of financial statements and specifies that a statement of cash flows is required in a complete set of financial statements. Section 7 specifies requirements for presenting a statement of cash flows.

Presentation of a statement of cash flows is required because users of SMEs' financial statements—particularly lenders and short-term creditors—find that information useful (see paragraph BC139 of the Basis for Conclusions on the *IFRS for SMEs*). Information about the historical cash flows of an entity provides users of financial statements with a basis on which to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise cash and cash equivalents. Economic decisions about the entity require an evaluation of an entity's ability to generate cash and cash equivalents and the timing and certainty of their generation.

Historical cash flow information is also useful in examining the relationship between profitability and net cash flow.

When used in conjunction with the rest of the financial statements, the statement of cash flows provides information that enables users to evaluate the changes in net assets of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities.

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

In accordance with Section 7 an entity must present separately cash flows from its operating, investing and financing activities. It must also choose an accounting policy for presenting operating cash flows—either the indirect or the direct method. It also prescribes the requirements for presenting information about specified cash flows.

What is the difference between presenting operating cash flows using the direct and the indirect methods?

The direct method presents operating cash flows by major classes of gross cash receipts (for example receipts from customers) and gross payments (for example payments to suppliers or employees). In contrast, the indirect method calculates operating cash flows by adjusting profit or loss for the effects of income and expenses 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 choice of method relates only to the presentation of operating cash flows. The amounts presented for *net cash from (or used in) operating activities* is unaffected by the accounting policy elected. The presentation of cash flows from investing and financing activities is unaffected by the manner in which operating cash flows are presented.

For many SMEs, preparing a statement of cash flows using the direct method is not difficult, time-consuming or costly. A statement of cash flows prepared using the direct method categorises and summarises the amounts deposited in the entity's bank account (the gross cash inflows) and categorises and summarises the amounts withdrawn from the entity's bank account (the gross cash outflows). The indirect method can be more complicated because the entity arrives at its net operating cash flow for the year, not by presenting the gross operating cash flows, but instead by adjusting from its profit or loss for the year all non-cash items of income and expenses and those items of income or expenses that are classified as investing and financing activities.

Non-cash transactions

Transactions that do not involve a flow of cash and cash equivalents (non-cash transactions) are excluded from the statement of cash flows even when non-cash transactions are financing or investing activities (eg when an entity acquires machinery on credit or the entity issues shares to its owner in exchange for a building contributed by the owner). However, disclosure is required, in order to provide relevant information about non-cash investing and financing transactions.

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REQUIREMENTS AND EXAMPLES

The contents of Section 7 *Statement of Cash Flows* of the *IFRS for SMEs* are set out below and shaded grey. Terms defined in the Glossary of the *IFRS for SMEs* are also part of the requirements. Those terms are in **bold type** the first time they appear in the text of Section 7. The notes and examples inserted by the IFRS Foundation education staff are not shaded. Other annotations inserted by the IFRS Foundation staff are presented within square brackets in ***bold italics***. The insertions made by the staff do not form part of the *IFRS for SMEs* and have not been approved by the IASB.

Scope of this section

7.1 This section sets out the information that is to be presented in a **statement of cash flows** and how to present it. The statement of cash flows provides information about the changes in **cash** and **cash equivalents** *[Refer: Paragraph 7.2]* of an entity for a **reporting period**, showing separately changes from **operating activities** *[Refer: Paragraph 7.4]*, **investing activities** *[Refer: Paragraph 7.5]* and **financing activities** *[Refer: Paragraph 7.6]*.

Notes

To assess an entity's prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources (see paragraph OB4 of the *Conceptual Framework for Financial Reporting*).

The statement of cash flows, when used in conjunction with the rest of the financial statements, provides information that enables users to evaluate the changes in the net assets of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities. Cash flow information is useful in assessing the ability of the entity to generate cash and cash equivalents and enables users to develop models to asses and compare the present value of the future cash flows of different entities. It also enhances the comparability of the reporting of operating performance by different entities because it eliminates the effects of using different accounting treatments for the same transactions and events (see paragraph 4 of IAS 7).

The great majority of users of SMEs' financial statements who communicated with the IASB when it developed the *IFRS for SMEs*—including, in particular lenders, and short-term creditors—indicated that the cash flow statement is very useful to them. Consequently, the IASB requires SMEs to prepare a cash flow statement in accordance with Section 7 (see paragraph BC139 of the Basis for Conclusions).

The statement of cash flows presents the change in cash and cash equivalents balances in the reporting period.

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Cash is defined as cash on hand and demand deposits. Demand deposits include deposits with financial institutions that are payable on demand and available immediately without penalty (eg a typical current account with a commercial bank). Cash includes foreign bank notes on hand and foreign currency-denominated demand deposits. Cash equivalents are described in paragraph 7.2.

If an entity's cash and cash equivalents increase by CU200 in the reporting period, its statement of cash flows would show the cash inflows and outflows that resulted in that cash balance increasing by CU200 in the period. Presenting those cash flows by classifying them as operating, investing and financing activities (see paragraphs 7.3–7.6) improves the relevance of the information provided.

For many SMEs cash and cash equivalents are restricted to cash in the cash register or the balance in the entity's demand deposit bank account. In such cases, the statement of cash flows can be prepared by analysing the entity's bank account or its cash book (which records the amounts that flow through the entity's bank account).

Examples—cash

Ex 1 **An entity has CU1,000[1] and FCU500[2] on hand.**

Both the CU1,000 and the FCU500 amounts are cash.

Ex 2 **An entity's bank current account with a commercial bank has a balance of CU2,000. The balance is payable on demand and is available immediately without penalty.**

The CU2,000 in the current account is cash—it is a demand deposit.

Example—not cash

Ex 3 **An entity has two gold bars on hand.**

Irrespective of the purpose for which gold bars are held they are not cash.

Cash equivalents

7.2 **Cash equivalents** are short-term, highly liquid investments held to meet short-term cash commitments rather than for investment or other purposes. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Bank overdrafts are normally considered financing activities similar to borrowings. However, if they are repayable on demand and form an integral part of an entity's cash management, bank overdrafts are a component of cash and cash equivalents.

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(1) In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units (CU)'.

(2) In this example, and in all other examples in this module, unless another foreign currency is specified, foreign currency monetary amounts are denominated in 'foreign currency units (FCU)'.

Notes

The statement of cash flows presents changes in both cash (ie cash on hand and demand deposits) and cash equivalents in the period. Most SMEs have only easily identifiable items of cash and cash equivalents. Consequently they should experience no difficulty in identifying those items. Other SMEs may have items that are more difficult to identify as cash equivalents using the definition in the *IFRS for SMEs*. Judgement is needed to determine whether some items qualify as cash equivalents. Consequently, an entity develops criteria so that it can exercise that judgement consistently in accordance with the definition of cash equivalents and with the related guidance in paragraph 7.2. Paragraph 8.6 requires an entity to disclose these judgements when they have the most significant effect on the amounts recognised in the financial statements. From the definition of cash equivalents in the Glossary, four criteria for a cash equivalent are identified:

(i) they are short-term;

(ii) they are highly liquid investments;

(iii) they are readily convertible to known amounts of cash; and

(iv) they are subject to an insignificant risk of changes in value.

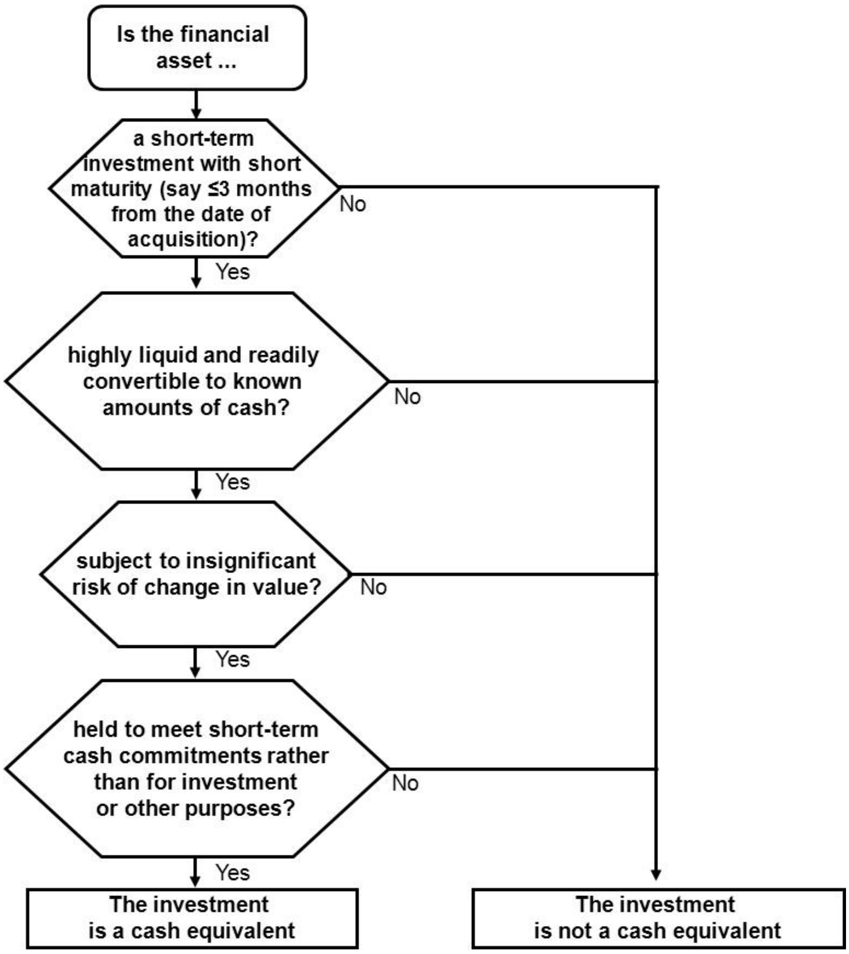
Furthermore, cash equivalents are held to meet short-term cash commitments rather than for investment or other purposes. It follows that cash equivalents may include some investments with financial institutions, some certificates of deposit, some money market instruments, some short-term corporate bonds and some highly liquid investments, provided that they are ‘near to cash’ (ie short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value) and are held to meet short-term cash commitments rather than for investment or other purposes.

For example, in setting its accounting policy, an entity might determine that the short maturity threshold is for a period of 90 days or less from the date of acquisition of an instrument. Nevertheless, such instruments cannot be classified as cash equivalents unless they are highly liquid investments that are readily convertible to known amounts of cash and are subject to only an insignificant risk of change in value in response to market risks (eg changes in interest rates). Furthermore, instruments acquired by the entity to meet short-term cash commitments with a remaining maturity period of more than 90 days do not become cash equivalents when their remaining maturity period, measured from a subsequent reporting date, becomes 90 days or less.

Cash equivalents include foreign currency-denominated short-term, highly liquid investments, held to meet short-term cash commitments rather than for investment or other purposes.

Chart 1 on the next page summarises the judgements required to classify a financial asset as a cash equivalent.

Chart 1—Decision tree: cash equivalent classification



Cash flows exclude transfers between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of its operating, investing or financing activities. Cash management includes the investment of excess cash in, for example, a bank account, which is considered a cash equivalent.

Examples—cash equivalents

Ex 4 **An entity has cash on a two-month fixed rate (5 per cent per year) fixed deposit with a commercial bank. If the entity withdraws the capital before it matures it forgoes an insignificant portion of the interest. On maturity the entity expects to use the proceeds to settle with its trade creditors.**

The fixed deposit is a cash equivalent—it is short-term (two months from inception), highly liquid (can be withdrawn at any time), readily convertible into a known amount of cash (capital plus specified accrued interest) and subject to an insignificant risk of change in value (a fixed-interest-rate instrument with a two-month maturity is unlikely to change significantly in value in response to changes in market interest rates and the penalty for early redemption is insignificant). It is also intended to be used to meet short-term cash commitments.

Ex 5 **An entity acquires a three-year fixed rate (5 per cent per year) government bond in an active market, two months before the bond's maturity date. On maturity the entity expects to use the proceeds to settle with its trade creditors. The government debt is AAA credit-rated.**

The investment in the AAA-rated government bond is a cash equivalent—it is short-term (it was acquired two months before its maturity date), highly liquid (it can be traded in an active market) and is readily convertible into a known amount of cash (capital plus specified accrued interest on maturity in two months or before due date at the market price—because the instrument has fixed contractual cash flows that are close to maturity and the government debt is AAA-rated. The variability in the fair value of the instrument is likely to be insignificant and to be subject to an insignificant risk of change in value (a fixed-interest-rate instrument with a two-month maturity is unlikely to change significantly in value in response to changes in market interest rates and the penalty for early redemption is usually insignificant). It is also intended to be used to meet short-term cash commitments.)

Ex 6 **An entity's cheque account with a commercial bank fluctuates between having a positive balance and being in overdraft in accordance with the entity's cash receipts and payments cycle. The overdraft is repayable on demand.**

The bank overdraft is a cash equivalent—it is repayable on demand and forms an integral part of the entity's cash management.

Examples—neither cash nor cash equivalents

Ex 7 **An entity has a pre-approved credit line (overdraft) with a bank of up to CU10,000. Because the entity has never used the overdraft the account balance is nil.**

Because the bank overdraft facility has never been used by the entity, it does not appear to form an integral part of the entity's cash management, even though it is available. It is neither cash nor a cash equivalent.

Ex 8 **An entity acquires a three-year fixed rate (5 per cent per year) government bond in an active market, two months before the bond's maturity date. The entity holds the instrument to speculate on changes in market interest rates.**

Because the investment is held for speculative purposes (rather than to meet short-term cash commitments) it is neither cash nor a cash equivalent.

Ex 9 **An entity has cash on a five-year fixed rate (5 per cent per year) fixed deposit with a commercial bank. At the reporting date the fixed-rate deposit is two months from maturity. If the entity withdraws the capital before maturity it forgoes all interest. On maturity the entity expects to use the proceeds to settle with its trade creditors.**

The investment is neither cash nor a cash equivalent because it is nearly five years since the entity made the deposit (ie it is not short-term).

Note: it is irrelevant that at the reporting date the deposit is only two months from maturity.

Information to be presented in the statement of cash flows

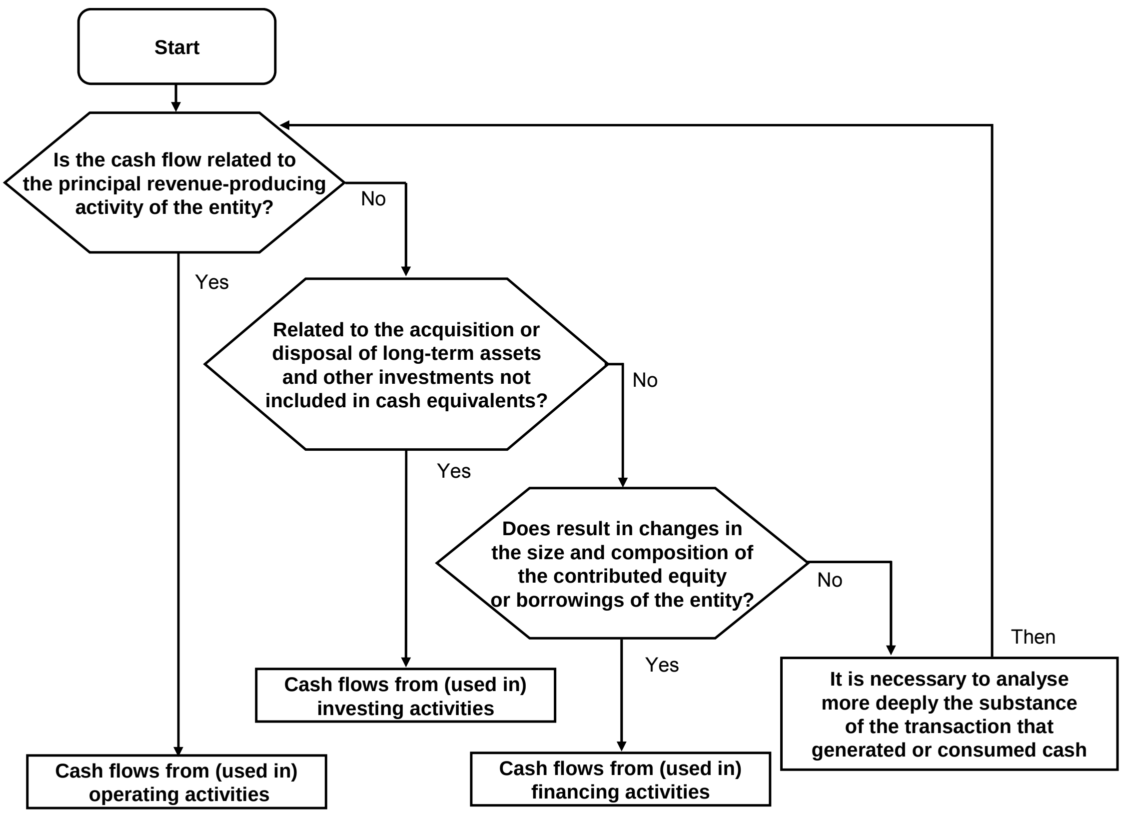
7.3 An entity shall present a statement of cash flows *[Refer: Paragraphs 3.2 and 3.17]* that presents **cash flows** for a reporting period classified by operating activities *[Refer: Paragraph 7.4]*, investing activities *[Refer: Paragraph 7.5]* and financing activities *[Refer: Paragraph 7.6]*.

Notes

Classification by activity (operating, investing or financing) provides more detailed information to help users to assess the ability of the entity to generate cash flows in a particular accounting period and in the future. This information is also useful in evaluating the relationships between those activities when predicting future cash flows. Judgement is required to classify some cash flows as operating, investing or financing. The substance of the transaction that underlies the cash flow (rather than its legal form), judged in the entity's particular circumstances, is applied in classifying cash flows. Because these judgements also apply to classifications in the statement of financial position and the statement of comprehensive income, there should be consistency of treatment across the statements. Furthermore, the concept of consistency of presentation results in consistent presentation by an entity over time.

Chart 2 presents the general guidance for classifying cash flows among operating, investing and financing activities in accordance with the *IFRS for SMEs*.

Chart 2—Decision tree: classification of cash flows among activities



Operating activities

7.4 Operating activities are the principal **revenue**-producing activities of the entity. Therefore, cash flows from operating activities generally result from the transactions and other events and conditions that enter into the determination of **profit or loss**. Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services.

(b) cash receipts from royalties, fees, commissions and other revenue.

(c) cash payments to suppliers for goods and services.

(d) cash payments to and on behalf of employees.

(e) cash payments or refunds of income tax, unless they can be specifically identified with financing and investing activities.

(f) cash receipts and payments from investments, loans and other contracts held for dealing or trading purposes, which are similar to inventory acquired specifically for resale.

Some transactions, such as the sale of an item of plant by a manufacturing entity, may give rise to a gain or loss that is included in profit or loss. However, the cash flows relating to such transactions are cash flows from investing activities.

Notes

Operating activities are the principal revenue-producing activities of the entity. Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity that result in increases in equity, other than increases relating to contributions from equity participants.

The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity have generated sufficient cash flows to repay loans, maintain the operating capability of the entity, pay dividends and make new investments without recourse to external sources of financing.

Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows. That benefit is maximised when operating cash flows are presented using the direct method (see paragraphs 7.7 and 7.9) because of the detailed nature of the information provided.

Examples—cash flow from operating activities

Ex 10 **A school charges its students an annual registration fee plus a monthly tuition fee. Students must wear the school's uniform, which is available to purchase either from the school's uniform store or at independent stores located in the neighbourhood. At lunchtime, students are not allowed to leave the school's building. Consequently, students either bring lunch from home or buy it in the school's cafeteria.**

In the current year the school sold a printer that had been used by its administration staff.

In the statement of cash flows of the school the items shall be classified as follows:

The cash flows from the annual registration fee, the monthly tuition fee, the uniforms sold and the lunches sold are classified as operating activities.

Note: although the profit or loss on the sale of the printer (an item of property, plant and equipment) is included in profit or loss, the proceeds from the sale of the printer are classified as a cash flow from investing activities.

Ex 11 **An entity that manufactures textiles expands its operations by leasing a machine from a machine manufacture under an operating lease agreement in exchange for monthly payments of CU500.**

Because, in accordance with Section 20 *Leases*, the entity does not recognise an asset for its right to use the machine under an operating lease, it presents the lease payment cash outflows of CU500 per month in the operating activities section of its statement of cash flows.

Ex 12 **An entity that rents cars to customers under operating leases renews its rental fleet within 18 months from the date of acquisition. Its ordinary activities also include the selling of used cars (ie its old rental fleet). Consequently, in its statement of comprehensive income the entity recognises rental income and income from the sale of used vehicles as revenue.**

In the current year the entity collected money from the following sources:

- **Car rentals = CU130,000**
- **Sale of used rental cars = CU100,000**
- **Sale of computer equipment that was used to capture information about its customers at the point of rental/sale = CU8,000**

Consistently with the ordinary activity classification in the statement of comprehensive income, the cash flows from car rentals and the sale of used rental cars are classified as cash flows from operating activities.

Notes

Consistently with the recognition of the gain on the sale of the computer equipment outside of revenue in the statement of comprehensive income, the proceeds from the sale of the computer equipment is classified as a cash flow from investing activities (because the entity's ordinary activities do not include the sale of computer equipment).

These classifications (operating and investing) provide relevant information about the entity's cash flows—unlike the irregular (perhaps one-off) investing activity cash inflow from the sale of the computer equipment, the operating cash inflows (proceeds from car rentals and the sale of the used car fleet) are more likely to recur in comparable amounts in future periods.

Ex 13 An entity that trades securities bought securities for trading purposes for CU75,000 and sold them for CU110,000.

A principal revenue-producing activity of the entity is trading securities. Consequently, cash flows from the purchase and sale of those securities are classified as operating activities (ie CU110,000 cash inflow from customers and the CU75,000 cash outflow to suppliers are presented in operating activities in the entity's statement of cash flows).

Investing activities

7.5 Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Examples of cash flows arising from investing activities are:

(a) cash payments to acquire property, plant and equipment (including self-constructed property, plant and equipment), intangible assets and other long-term assets.

(b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets.

(c) cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments classified as cash equivalents or held for dealing or trading).

(d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments classified as cash equivalents or held for dealing or trading).

(e) cash advances and loans made to other parties.

(f) cash receipts from the repayment of advances and loans made to other parties.

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the payments are classified as financing activities.

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge (see Section 12 *Other Financial Instruments Issues*), an entity shall classify the cash flows of the contract in the same manner as the cash flows of the item being hedged.

Notes

In some circumstances it may not be clear whether a cash flow is from operating or investing activities. In such cases the entity uses its judgement to develop and apply consistently an accounting policy for classifying those cash flows.

In the absence of explicit guidance in the *IFRS for SMEs* an entity can, in accordance with paragraph 10.6, consider the requirements and guidance in full IFRSs. IAS 7 *Statement of Cash Flows*, on which section 7 is based, provides application guidance that only an expenditure that results in a recognised asset can be classified as a cash flow from investing activity (see IAS 7 paragraph 16). That principle could be extended to SMEs (see example 14).

Example—cash flow from investing activities

Ex 14 **A pharmaceutical producer started its operations in 20X0. In 20X0 the entity's cash outflows included:**

- **start-up costs (CU10,000);**
- **machinery acquisition (CU30,000);**
- **machinery installation (CU2,200);**
- **training of staff (CU4,000);**
- **advertising and promotional activities (CU18,450);**
- **internally generated brands (CU6,900); and**
- **internally generated customer lists (CU870).**

In the statement of cash flows of the pharmaceutical producer for the year ended 31 December 20X0 the items shall be classified as follows:

The entity recognises the CU32,200 cash outflow from the acquisition of property, plant and equipment (CU30,000 machinery acquisition + CU2,200 machinery installation) as investing activities because it is for the acquisition of a long-term asset (property, plant and equipment cost (see paragraph 17.10(b)).

Note: because the other cash flows are not for the acquisition of a recognised long-term asset they are not classified as cash flows from investing activities. The entity would recognise as operating activities the cash outflows for start-up costs, training of staff, advertising and promotional activities, internally generated brands and internally generated customer lists. Those items are not recognised as long-term assets in the entity's statement of financial position. Instead they are recognised as expenses in profit or loss in the period in which they are incurred (see paragraphs 17.11, 18.14 and 18.15).

Examples—not cash flow from investing activities

Ex 15 **A seasonal fruit juice producer invests cash collected from its customers, which is in excess of its immediate cash payments, in short-term highly liquid investments. The invested cash is expected to be used to meet short-term cash commitments as they fall due.**

The short-term highly liquid investments are cash equivalents. They are not classified as investing activities.

Note

Suppose that the entity's opening cash and cash equivalent balance is CU100,000. The entity then invests CU85,000 in short-term highly liquid investments that are classified as cash equivalents. The closing balance of cash and cash equivalent is unchanged (ie it is still CU100,000). Consequently, no cash flow is recognised in the statement of cash flows for the CU85,000 investment because it is a transfer within cash and cash equivalent balances.

Financing activities

7.6 Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of an entity. Examples of cash flows arising from financing activities are:

(a) cash proceeds from issuing shares or other equity instruments.

(b) cash payments to owners to acquire or redeem the entity's shares.

(c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings.

(d) cash repayments of amounts borrowed.

(e) cash payments by a lessee for the reduction of the outstanding liability relating to a **finance lease**.

Example—cash flow from financing activities

Ex 16 **An entity that manufactures textiles decided to increase its equity by CU1,000 by issuing shares to its owner-managers. It also borrowed CU2,000 from a commercial bank. The loan is repayable on demand. The entity repaid CU500 of long-term debt and paid a cash dividend of CU300.**

The entity expanded its operations by obtaining a new machine by entering into a finance lease agreement that specifies monthly payments of CU10.

Share issue

The cash inflow from the share issue is a cash flow from financing activities—it increased the size of the entity's contributed equity.

Short-term loan

The proceeds of the short-term borrowing (loan repayable on demand) is a cash flow from financing activities—it increased the size of the entity's borrowings.

Repayment of long-term debt

The settlement of the long-term borrowing is a cash outflow from financing activities—it decreased the size of the entity's borrowings.

Dividends

The entity may classify dividends paid as (see paragraph 7.16):

- financing activities, because they are a cost of obtaining financial resources (ie it decreased the size of the entity's contributed equity); or
- operating activities, because they are paid out of operating cash flows.

Lease payments

Section 20 *Leases* requires a lessee to apportion the lease payments between a finance charge and the reduction of the outstanding liability (paragraph 20.11).

The entity presents the part of the lease payments that is accounted for as a reduction of the liability as a cash outflow from financing activities—it decreased the size of the entity's borrowings.

Paragraph 7.15 allows an entity an accounting policy choice for interest paid, so the entity presents the part of the lease payment that, in accordance with Section 20, is accounted for as a finance cost as either:

- financing activities—because the entity views the interest as financing the asset; or
- operating activities—because borrowing costs are recognised as expenses in profit or loss in the period in which they are incurred (see paragraph 25.2).

Reporting cash flows from operating activities

7.7 An entity shall present cash flows from operating activities using either:

(a) the indirect method, whereby profit or loss is adjusted for the effects of non-cash transactions, 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, or

(b) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed.

Notes

The direct method presents the entity's cash flows directly (basically as a summary of the operating cash flows that flowed in and out of the entity's bank account in the reporting period). The indirect method determines the net cash flow from operating activities indirectly by adjusting from profit or loss all accruals, adjustments that affect the working capital and all cash flows that are presented outside of operating activities (ie investing or financing activities).

The direct method is easy to understand—it displays the entity's main operating cash flows and thereby provides more detailed information for projecting the entity's future operating cash flows.

The indirect method presents a reconciliation of profit or loss and cash flow from operating activities.

Indirect method

7.8 Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:

(a) changes during the period in inventories and operating receivables and payables;

(b) non-cash items such as **depreciation**, **provisions**, **deferred tax**, accrued income (expenses) not yet received (paid) in cash, unrealised foreign currency gains and losses, undistributed profits of **associates**, and **non-controlling interests**; and

(c) all other items for which the cash effects relate to investing or financing.

Example—the indirect method

Ex 17 **An entity that presents its statement of cash flows using the indirect method recognised CU7,000 profit for the year ended 31 December 20X8. Income in 20X8 comprises CU100,000 revenue from the sale of goods, a gain of CU750 on the sale of an item of property, plant and equipment and an increase of CU250 in the fair value of its investment property. Expenses in 20X8 comprise CU50,000 in cost of goods sold, CU42,600 in staff costs, CU800 in depreciation of its office equipment, CU100 amortisation of its intangible assets and a decrease of CU500 in the fair value of its investment in the publicly traded shares of another entity.**

The entity's statement of financial position at 31 December 20X8 includes CU1,700 trade receivables (20X7: CU1,000), CU1,200 inventories (20X7: CU2,200) and CU2,000 trade payables (20X7: CU2,400).

Extract from the entity's statement of cash flows for the year ended 31 December 20X8

	CU
Cash flows from operating activities	
Profit for the year	7,000
Adjustments for non-cash income and expenses:	
Increase in the fair value of investment property	(250)
Decrease in the fair value of investment in traded securities	500
Depreciation expense	800
Amortisation expense	100
Adjustment for cash flow presented in investing activities:	
Profit on sale of property, plant and equipment	(750)
Changes in working capital:	
Increase in trade receivables	(700)
Decrease in inventories	1,000
Decrease in trade payables	(400)
Net cash flow from operating activities	7,300

…

Direct method

7.9 Under the direct method, net cash flow from operating activities is presented by disclosing information about major classes of gross cash receipts and gross cash payments. Such information may be obtained either:

(a) from the accounting records of the entity; or

(b) by adjusting sales, cost of sales and other items in the statement of comprehensive income (or the income statement, if presented) for:

(i) changes during the period in inventories and operating receivables and payables;

(ii) other non-cash items; and

(iii) other items for which the cash effects are investing or financing cash flows.

Examples—cash flows from operating activities using the direct method

Ex 18 **The facts are the same as in example 17. However, in this example, the entity presents the statement of cash flows using the direct method.**

Extract from the entity's statement of cash flows for the year ended 31 December 20X8

	CU
Cash flows from operating activities	
Cash receipts from customers	99,300 [(a)]
Cash paid to suppliers and employees	(92,000) [(b)]
Net cash flow from operating activities	7,300 [(c)]
…	

Notes that do not form part of the entity's statement of cash flows:

(a) Extracted directly from the entity's cash book (analysis of its cash receipts in 20X8) or indirectly as follows: CU1,000 trade receivable that arose in 20X7 and was paid in 20X8 + CU100,000 revenue from the sale of goods in 20X8 less the CU1,700 receivable at 31 December 20X8 that is expected to be paid in 20X9 = CU99,300.

(b) Extracted directly from the entity's cash book (analysis of its cash payments in 20X8) or indirectly as follows: CU2,400 trade payable that arose in 20X7 and was paid in 20X8 + CU50,000 cost of goods sold less CU1,000 decrease in inventories in 20X8 less CU2,000 trade payables at 31 December 20X8 that are expected to be paid in 20X9 plus CU42,600 staff costs paid in 20X8 = CU92,000.

(c) The cash received from the sale of the entity's item of property, plant and equipment is not included in the entity's cash flows from operating activities because it is presented as a cash flow from investing activities.

Ex 19 An entity elects to presents the statement of cash flows using the direct method.

Selected financial information for 20X4 and 20X3 is as follows:

Income and expenses for the year ended 31 December 20X4

• revenue	CU35,960,000
• cost of goods sold	CU15,789,500
• wages and salaries expense	CU10,220,000
• other expenses (services received)	CU4,956,500
• finance costs (interest expense)	CU456,452
• income tax expense	CU1,360,000

Statement of financial position accounts	*Account balance at 31.12.20X3*	*Account balance at 31.12.20X4*	*Change in account balances from 20X3 to 20X4*
• accounts receivables	CU1,752,000	CU2,150,000	CU398,000
• accounts payables	CU2,125,000	CU3,050,000	CU925,000
• prepayments (services received)	CU345,000		(CU345,000)
• other expenses payable (services received)		CU496,000	CU496,000
• wages and salaries payable			CU535,000
• accrued interest (interest expense)			CU7,800
• current tax payable			(CU235,000)
• deferred tax asset			CU380,000

Extract from the entity's statement of cash flows for the year ended 31 December 20X4 (in thousands of currency units)

	20X4	
Cash flows from operating activities		
Cash receipts from customers	35,562	(a)
Cash paid to suppliers and employees	(28,665)	(b)
Payments to suppliers of goods	(14,865)	(c)
Payments to suppliers of services	(4,116)	(d)
Payments to employees	(9,685)	(e)
Cash generated from operations	6,897	
Interest paid	(449)	(f)
Income taxes paid	(1,975)	(g)
Net cash from operating activities	4,473	
…		

Notes that do not form part of the entity's statement of cash flows:

(a) *Receipts from customers* = CU35,960,000 sales revenue + CU1,752,000 beginning balance of accounts receivable less CU2,150,000 ending balance of accounts receivable = CU35,562,000.

(b) *Cash paid to suppliers and employees* = CU14,864,500[c] payments to suppliers + CU4,115,500[d] payments to suppliers of services + CU9,685,000[e] payments to employees = CU28,665,000.

(c) *Payments to suppliers of goods* = CU15,789,500 cost of goods sold + CU2,125,000 beginning balance of accounts payable less CU3,050,000 ending balance of accounts payable = CU14,864,500. (Note: at the beginning and at the end of the year the entity has no inventory.)

(d) *Payments to suppliers of services* = CU4,956,500 other expenses less CU345,000 decrease in prepayments less CU496,000 increase in other expenses payable = CU4,115,500.

(e) *Payments to employees* = CU10,220,000 wages and salaries expense less CU535,000 increase in wages and salaries payable = CU9,685,000.

(f) *Interest paid* = CU456,452 interest expense less CU7,800 increase in accrued interest = CU448,652.

(g) *Income taxes paid* = CU1,360,000 income tax expense + CU380,000 deferred tax income = CU1,740,000 current tax expense. CU1,740,000 current tax expense + CU235,000 decrease in current tax payable = CU1,975,000.

Reporting cash flows from investing and financing activities

7.10 An entity shall present separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities. The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units shall be presented separately and classified as investing activities.

Example—cash flows from investing and financing activities

Ex 20 **A group (parent and its subsidiaries) presents cash flows from investing and financing activities in its consolidated statement of cash flows as follows:**

Extract from the consolidated statement of cash flows of a group for the year ended 31 December 20X4 (in thousands of currency units)

	20X4
…	
Cash flows from investing activities	
Amount paid for the acquisition of subsidiary X (net of cash acquired)	(875)
Amount paid for purchase of property, plant and equipment	(560)
Proceeds from sale of equipment	20
Proceeds from sale of interests in associate Y	1,200
Interest received[a]	150
Dividends received[a]	400
Net cash from investing activities	**335**
Cash flows from financing activities	
Proceeds from issue of share capital	500
Proceeds from preference shares	250
Proceeds from long-term borrowings	300
Payment of treasury shares	(110)
Payment of finance lease liabilities	(190)
Dividends paid[b]	(1,200)
Net cash used in financing activities	**(450)**
…	

Notes that do not form part of the group's statement of cash flows:

[a] Alternatively, these amounts could be presented as operating cash flows (see paragraph 7.15)

[b] Alternatively, dividends paid could be presented as an operating cash flow (see paragraph 7.16)

Foreign currency cash flows

7.11 An entity shall record cash flows arising from transactions in a foreign currency in the 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 *[Refer: Paragraph 30.7]*.

Notes—transactions in foreign currencies

An entity is required to measure its results and financial position in its functional currency—the currency of the primary economic environment in which the entity operates. An entity's functional currency is determined in accordance with the guidance provided in paragraphs 30.3–30.5.

A foreign currency is a currency other than the functional currency of the entity. When an entity enters directly into foreign currency transactions, it is exposed to changes in the value of the foreign currency in relation to the functional currency.

An entity converts a foreign currency item into its functional currency when the item is first recognised in accordance with the *IFRS for SMEs* by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction. At the end of each reporting period, an entity:

- translates foreign currency monetary items using the closing rate;
- translates non-monetary items that are measured in terms of historical cost in a foreign currency using the exchange rate at the date of the transaction; and
- translates non-monetary items that are measured at fair value in a foreign currency using the exchange rates at the date when the fair value was determined.

When the direct method of presenting operating cash flows is used, there are few complications arising from transacting in foreign currencies because the cash flows are determined directly and consequently adjustments are not made for unrealised foreign exchange gains and losses. When the indirect method is used, the unrealised foreign exchange gains and losses are separately disclosed in the reconciliation of profit for the year and net cash flow from operating activities (see example 21) unless the unrealised foreign exchange gains are also included in changes in operating assets and liabilities (see example 25).

Examples—transactions in foreign currencies

Facts used in examples 21 to 26:

- the functional currency of the entity is the currency unit 'CU'. Consequently, from the entity's perspective, the local currency of country B (LCB) and local currency of country R (LCR) are foreign currencies.
- the reporting date of the entity is 31 December
- the following exchange rates apply:

  1 January 20X0: LCB1 = CU2

  10 December 20X0: LCB1 = CU2

14 December 20X0: LCB1 = CU2.05

20 December 20X0: LCB1 = CU2.08

28 December 20X0: LCR1 = CU1.4

Weighted average for the year ended 31 December 20X0: LCB1 = CU2.04

31 December 20X0: LCB1 = CU2.10; LCR1 = CU1.3 and CU1 = LCG2

Ex 21 **On 1 January 20X0 the entity received LCB100,000 from a bank in exchange for a promise to pay the bank LCB110,000 on 1 January 20X1. The LCB100,000 was converted to CU200,000 at the time of receipt.**

The following exchange rates apply:

- **1 January 20X0: LCB1 = CU2**
- **Weighted average for the year ended 31 December 20X0: LCB1 = CU2.04**
- **31 December 20X0: LCB1 = CU2.10**

The entity presents the CU200,000 cash inflow as ‘proceeds of loan’ in the financing section of its statement of cash flows for the year ended 31 December 20X0 (ie LCB100,000 foreign currency amount × 2 (the exchange rate on the date of the cash flow) = CU200,000).

The entity would record the resulting transactions in its functional currency as follows:

1 January 20X0

Dr	Cash (asset)	CU200,000[a]	
	Cr Bank loan (liability)		CU200,000

To recognise the proceeds of the foreign currency-denominated bank loan.

31 December 20X0

Dr	Profit or loss (finance cost)	CU20,400[b]	
	Cr Bank loan (liability)		CU20,400

To recognise the interest for 20X0.

Dr	Profit or loss (unrealised foreign exchange loss)	CU10,600[c]	
	Cr Bank loan (liability)		CU10,600

To recognise the exchange difference at 31 December 20X0.

[a] LCB100,000 foreign currency amount × 2 (the exchange rate on the date of the cash flow) = CU200,000.

[b] LCB10,000 finance cost (see Section 11) × 2.04 (the weighted average exchange rate for the year ended 31 December 20X0) = CU20,400 finance cost accrued.

[c] CU231,000 foreign bank loan at 31 December 20X0 (ie LCB110,000 × 2.1 (the exchange rate on 31 December)) less CU200,000 foreign bank loan received on 1 January (ie LCB100,000 × 2 (the exchange rate on 1 January)) less CU20,400 finance cost accrued = CU10,600 unrealised foreign exchange loss.

Presentation

If the entity presents cash flows using the direct method, it could present the transactions in example 21 in its statement of cash flows for the year ended 31 December 20X0 as follows:

	20X0	
There are no cash flows from operating activities and investing activities		
Cash flows from financing activities		
Proceeds of loan	200,000	[a]
Net cash from financing activities	200,000	
Net increase in cash and cash equivalents	200,000	
Cash and cash equivalents at the beginning of the year	–	
Cash and cash equivalents at the end of the year	200,000	

[a] LCB100,000 foreign currency amount × 2 (the exchange rate on the date of the cash flow) = CU200,000

If the entity presents cash flows using the indirect method, it could present the transaction in example 21 in its statement of cash flows for the year ended 31 December 20X0 as follows:

	20X0	
Cash flows from operating activities		
Loss for the year	(31,000)	[a]
Adjustment for non-cash expense		
Accrued finance cost	20,400	[b]
Unrealised foreign exchange loss	10,600	[c]
Net cash from operating activities	–	
Cash flows from financing activities		
Proceeds of loan	200,000	[d]
Net cash from financing activities	200,000	
Net increase in cash and cash equivalents	200,000	
Cash and cash equivalents at the beginning of the year	–	
Cash and cash equivalents at the end of the year	200,000	

[a] CU20,400[b] finance cost + CU10,600[c] unrealised foreign exchange loss = CU31,000.

[b] LCB10,000 finance cost (see Section 11) × 2.04 (the weighted average exchange rate

for the year ended 31 December 20X0) = CU20,400 finance cost accrued.

(c) CU231,000 foreign bank loan at 31 December 20X0 (ie LCB110,000 × 2.1 (the exchange rate on 31 December)) less CU200,000 foreign bank loan received on 1 January (ie LCB100,000 × 2 (the exchange rate on 1 January)) less CU20,400[(b)] finance cost accrued = CU10,600 unrealised foreign exchange loss.

(d) LCB100,000 foreign currency amount × 2 (the exchange rate on the date of the cash flow) = CU200,000.

Ex 22 **On 10 December 20X0 the entity entered into a contract for the import of inventory for LCB100,000. The transaction is denominated in the supplier's functional currency 'LCB'.**

On 20 December 20X0 the risk and rewards of ownership of the goods transferred from the supplier to the entity when the entity received the goods in good order.

The following exchange rates apply:

- **10 December 20X0: LCB1 = CU2**
- **20 December 20X0: LCB1 = CU2.08**

The entity records the cash outflow 'cash paid to supplier' at CU208,000 (ie LCB100,000 foreign currency amount × 2.08 (the exchange rate on the date of the cash flow) = CU208,000.

Note: the entity would record the transactions as follows:

20 December 20X0

Dr	Inventory (asset)	CU208,000[(a)]	
	Cr Cash		CU208,000

To recognise the purchase of inventory and the payment to the supplier.

(a) LCB100,000 × 2.08 = CU208,000

Ex 23 **The facts are the same as in example 22. On 28 December 20X0 the entity sold 80 per cent of the imported goods to a customer for LCR300,000. The transaction is denominated in the customer's functional currency 'LCR'. On 28 December 20X0 (the time of receipt) the entity converted the LCR300,000 received from its customer to CU420,000 (ie LCR300,000 × CU1.4 (the exchange rate) = CU420,000).**

In accordance with paragraph 7.11, the entity records the cash flow arising from the foreign currency-denominated sale of goods as a cash inflow 'cash receipt from customer' at CU420,000 (ie LCR300,000 foreign currency amount × 1.4 (the exchange rate on the date of the cash flow) = CU420,000).

The entity would record the sale of 80 per cent of the inventory for LCR300,000 and the receipt of LCR300,000 in settlement of the sale transaction as follows:

28 December 20X0

Dr	Cash	CU420,000[a]	
	Cr Revenue (profit or loss)		CU420,000[b]

To recognise the sale of goods.

Dr	Cost of goods sold (profit or loss)	CU166,400[c]	
	Cr Inventory		CU166,400

To recognise the cost of goods sold.

[a] In accordance with paragraph 7.11: LCR300,000 cash received × 1.4 (the exchange rate at the date of the cash flow) = CU420,000.

[b] In accordance with paragraph 30.7: LCR300,000 revenue from the sale of goods × 1.4 (the spot exchange rate at the date of the sale) = CU420,000.

[c] CU208,000 × 80% = CU166,400

At 28 December 20X0 the remaining inventory held by the entity (a non-monetary asset) continues to be measured at cost, CU41,600 (ie CU208,000 × 20 per cent).

Ex 24 **The facts are the same as in examples 22 and 23. Furthermore, on 31 December 20X0 the entity declared and paid a dividend of CU58,000. Half of the entity's shareholders are citizens of country R with LCR-denominated bank accounts. All dividends are deposited by the entity into its shareholders' bank accounts.**

Because the dividend is denominated in CU the cash flow is CU58,000 cash outflow. From the entity's perspective there are no currency translation issues for the dividend distribution.

Presentation

If the entity presents cash flows using the direct method, it could present the transactions in examples 22–24 in its statement of cash flows for the year ended 31 December 20X0 as follows:

	20X0
Cash flows from operating activities	
Cash received from customers	420,000 [a]
Cash paid to suppliers	(208,000) [b]
Net cash from operating activities	212,000
Cash flows from financing activities	
Dividends paid	(58,000)
Net cash used in financing activities	(58,000)
Net increase in cash and cash equivalents	154,000
Cash and cash equivalents at beginning of period	–
Cash and cash equivalents at end of period	154,000

[a] LCR300,000 × 1.4 = CU420,000

[b] LCB100,000 × 2.08 = CU208,000

If the entity presents cash flows using the indirect method, it could present the transactions in examples 22–24 in its statement of cash flows for the year ended 31 December 20X0 as follows:

	20X0
Cash flows from operating activities	
Profit for the year	253,600 [(a)]
Changes in working capital:	
Increase in inventories	(41,600) [(b)]
Net cash from operating activities	212,000
Cash flows from financing activities	
Dividends paid	(58,000)
Net cash used in financing activities	(58,000)
Net increase in cash and cash equivalents	154,000
Cash and cash equivalents at beginning of period	–
Cash and cash equivalents at end of period	154,000

(a) CU420,000 revenue from the sale of goods less CU166,400 cost of goods sold = CU253,600

(b) CU41,600 inventory at the end of the period less CU0 inventories at the beginning of the period = CU41,600 (ie 20% × CU208,000)

Ex 25 **The facts are the same as in examples 22–24. However, in this example the purchase from the supplier and the sale to the customer were both on credit. At 31 December 20X0 the full amount of both the foreign debtor's debt and the foreign creditor's credit was outstanding.**

The entity's only cash flow for the year ended 31 December 20X0 is the CU-denominated dividend paid.

The following rates apply:

- **31 December 20X0: LCB1 = CU2.10**
- **31 December 20X0: LCR1 = CU1.30**

Presentation

If the entity presents cash flows using the direct method, it could present the transactions in example 25 in its statement of cash flows for the year ended 31 December 20X0 as follows:

	20X0
There are no cash flows from operating and investing activities	
Cash flows from financing activities	
Dividends paid	(58,000)
Net cash used in financing activities	(58,000)

...continued

...continued

Net decrease in cash and cash equivalents	(58,000)
Cash and cash equivalents at beginning of period	–
Cash and cash equivalents at end of period	(58,000) [a]

[a] Assuming that the bank overdraft qualifies for classification as a component of cash and cash equivalents (see paragraph 7.2)

If the entity presents cash flows using the indirect method, it could present the transactions in example 25 in its statement of cash flows for the year ended 31 December 20X0 as follows:

	20X0
Cash flows from operating activities	
Profit for the year	221,600 [a]
Changes in working capital:	
Increase in inventories	(41,600) [b]
Increase in trade payables	210,000 [c]
Increase in trade receivables	(390,000) [d]
Net cash from operating activities	–
Cash flows from financing activities	
Dividends paid	(58,000)
Net cash used in financing activities	(58,000)
Net decrease in cash and cash equivalents	(58,000)
Cash and cash equivalents at beginning of period	–
Cash and cash equivalents at end of period	(58,000) [e]

[a] CU420,000 revenue from the sale of goods less CU166,400 cost of goods sold less CU2,000 unrealised foreign exchange loss on foreign creditor less CU30,000 unrealised foreign exchange loss on foreign debtor = CU221,600

[b] CU41,600 inventory at the end of the period less CU0 inventories at the beginning of the period = CU41,600 (ie 20% × CU208,000) increase in inventories

[c] CU210,000 trade payables at 31 December 20X0 (ie LCB100,000 × 2.1 (the exchange rate on 31 December)) less CU0 trade payables at the beginning of the period = CU210,000 increase in trade payables

[d] CU390,000 foreign debtor at 31 December 20X0 (ie LCR300,000 × 1.3 (the exchange rate on 31 December)) less CU0 foreign debtor at the beginning of the period = CU390,000 increase in trade receivables.

[e] A qualifying bank overdraft (see paragraph 7.2)

Ex 26 **The facts are the same as in example 25. On 15 February 20X1 the entity paid CU200,000 to settle the amount owed to the foreign creditor. On 28 February 20X1 the entity received CU400,000 from the foreign debtor as settlement of the amount outstanding.**

The entity records the cash outflow ‘cash payment to supplier’ at CU200,000, ie at the exchange rate on 15 February 20X1 (the date of the cash flow).

The entity records the cash inflow ‘cash receipt from customer’ at CU400,000, ie at the exchange rate on 28 February 20X1 (the date of the cash flow).

Presentation

If the entity presents cash flows using the direct method, it could present the transactions in example 26 in its statement of cash flows for the year ended 31 December 20X1 as follows:

	20X1	
Cash flows from operating activities		
Cash received from customers	400,000	
Cash paid to suppliers	(200,000)	
Net cash from operating activities	200,000	
There are no cash flows from financing and investing activities		
Net increase in cash and cash equivalents	200,000	
Cash and cash equivalents at beginning of period	(58,000)	(a)
Cash and cash equivalents at end of period	142,000	

(a) A qualifying bank overdraft (see paragraph 7.2)

If the entity presents cash flows using the indirect method, it could present the transactions in example 26 in its statement of cash flows for the year ended 31 December 20X1 as follows:

	20X1	
Cash flows from operating activities		
Profit for the year	20,000	(a)
Changes in working capital:		
Decrease in trade payables	(210,000)	(b)
Decrease in trade receivables	390,000	(c)
Net cash from operating activities	200,000	
There are no cash flows from financing activities		
Net increase in cash and cash equivalents	200,000	
Cash and cash equivalents at beginning of period	(58,000)	(d)
Cash and cash equivalents at end of period	142,000	

(a) CU10,000[e] realised foreign exchange gain on foreign creditor + CU10,000[f] realised foreign exchange gain on foreign debtor = CU20,000 profit for the year

(b) CU0 trade payables at the end of the period less CU210,000 trade payables at 31 December 20X0 (ie LCB100,000 × 2.1 (the exchange rate on 31 December 20X0)) = CU210,000 decrease in trade payables

(c) CU0 foreign debtor at the end of the period less CU390,000 foreign debtor at 31 December 20X0 (ie LCR300,000 × 1.3 (the exchange rate on 31 December))

= CU390,000 decrease in trade receivables.

(d) A qualifying bank overdraft (see paragraph 7.2)

(e) CU200,000 paid in settlement less CU210,000 foreign creditor at 31 December 20X0 (ie LCB100,000 × 2.1 exchange rate on 31 December) = CU10,000 realised foreign exchange gain

(f) CU400,000 received as settlement less CU390,000 foreign debtor at 31 December 20X0 (ie LCR300,000 × 1.3 exchange rate on 31 December) = CU10,000 realised foreign exchange gain

7.12 The entity shall translate cash flows of a foreign subsidiary at the exchange rates between the entity's functional currency and the foreign currency at the dates of the cash flows *[Refer: Paragraph 30.18(b)]*.

Ex 27 **On 1 December 20X0 an entity whose functional currency is the currency unit (CU) acquired a foreign subsidiary (whose functional currency is the foreign currency unit (FCU)). At the date of acquisition the foreign subsidiary's only asset was FCU1,000 inventory (its share capital at the date of acquisition was also FCU1,000). The subsidiary entered into the following transactions in December 20X0:**

- **on 10 December the subsidiary sold half of its inventory for FCU700 cash.**
- **on 20 December the subsidiary paid FCU100 rent.**

Notes

- **the reporting date of the parent entity is 31 December**
- **the parent's functional currency and its presentation currency is the CU**
- **the following exchange rates apply:**

  1 December 20X0: FCU1 = CU2

  10 December 20X0: FCU1 = CU2.1

  20 December 20X0: FCU1 = CU2.2

  31 December 20X0: FCU1 = CU2.15

To prepare the group's direct method consolidated statement of cash flows for the year ended 31 December 20X0 the subsidiary's cash flows would first be translated into the group's presentation currency as follows:

	FCU	*Rate*	*CU*
Cash flows from operating activities			
Cash received from customers	700	2.1	1,470
Cash paid to suppliers	(100)	2.2	(220)
Net cash from operating activities	600		1,250

...continued

...continued

Net increase in cash and cash equivalents	600		1,250
Cash and cash equivalents at beginning of period	–		–
Unrealised foreign exchange loss in cash and cash equivalents			40[(a)]
Cash and cash equivalents at end of period	600	2.15	1,290

[(a)] balancing figure (for further explanation see Module 30)

Note: *From the subsidiary's perspective there are no cash flows from investing and financing activities*

7.13 Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, to reconcile cash and cash equivalents at the beginning and the end of the period, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency must be presented in the statement of cash flows. Therefore, the entity shall remeasure cash and cash equivalents held during the reporting period (such as amounts of foreign currency held and foreign currency bank accounts) at period-end exchange rates. The entity shall present the resulting unrealised gain or loss separately from cash flows from operating, investing and financing activities.

[Refer: Paragraph 7.20 for cash and cash equivalents reconciliation]

[Refer: Paragraph 30.18(a)]

Example—Gain and losses on translating foreign cash and cash equivalents

In example 28:

- the functional currency and the presentation currency of the entity is the currency unit 'CU'
- the reporting date of the entity is 31 December
- the following exchange rates apply:

  10 December 20X0: FCU1 = CU2

  31 December 20X0: FCU1 = CU2.1

Ex 28 On 10 December 20X0 the entity received FCU1,000 from a customer in settlement of a CU2,000 receivable.

The entity held the FCU1,000 in its safe until it deposited it in its CU-denominated bank account on 5 January 20X1.

The entity records the cash inflow 'cash received from customer' at CU2,000, ie at the exchange rate on 10 December 20X0 (the rate on the date of the cash flow—see paragraph 7.11).

Notes

If the entity presents cash flows using the direct method, it could present the transactions in example 28 in its statement of cash flows for the year ended 31 December 20X0 as follows:

	20X0	
Cash flows from operating activities		
Cash received from customers	2,000	
Net cash from operating activities	2,000	
There are no cash flows from investing and financing activities		
Net increase in cash and cash equivalents	2,000	
Cash and cash equivalents at beginning of period	–	
Unrealised foreign exchange gain in cash and cash equivalents	100	[a]
Cash and cash equivalents at end of period	2,100	

[a] CU2,100 value of FCU1,000 at 31 December 20X0 (ie FCU1,000 at 31 December 20X0 × 2.1 (the exchange rate on 31 December)) less CU2,000 received from trade debtor = CU100 unrealised foreign exchange gain

If the entity presents cash flows using the indirect method, it could present the transactions in example 28 in its statement of cash flows for the year ended 31 December 20X0 as follows:

	20X0	
Cash flows from operating activities		
Profit for the year	100	[a]
Adjustment for non-cash income—unrealised foreign exchange gain	(100)	[a]
Changes in working capital—decrease in trade receivables	2,000	
Net cash from operating activities	2,000	
There are no cash flows from investing and financing activities		
Net increase in cash and cash equivalents	2,000	
Cash and cash equivalents at beginning of period	–	
Unrealised foreign exchange gain in cash and cash equivalents	100	[a]
Cash and cash equivalents at end of period	2,100	

[a] CU2,100 value of FCU1,000 at 31 December 20X0 (ie FCU1,000 at 31 December 20X0 × 2.1 (the exchange rate on 31 December)) less CU2,000 received from trade debtor = CU100 unrealised foreign exchange gain

Interest and dividends

7.14 An entity shall present separately cash flows from interest and dividends received and paid. The entity shall classify cash flows consistently from period to period as operating, investing or financing activities.

Notes

An entity would change the presentation or classification of interest and dividends received and paid in its statement of cash flows only if the change provides information that is reliable and more relevant to users of the financial statements and the revised classification is likely to continue, so that comparability over time is not impaired. In accordance with paragraph 3.11 such a change in classification can only be made following a significant change in the entity's operations or a review of its financial statements.

In accordance with paragraph 3.12, when the presentation or classification of dividend or interest cash flows is changed, an entity reclassifies comparative amounts and discloses the nature of the reclassification and the amount of each item or class of items that is reclassified.

7.15 An entity may classify interest paid and interest and dividends received as operating cash flows because they are included in profit or loss. Alternatively, the entity may classify interest paid and interest and dividends received as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

Notes

The classification of interest and dividend receipts and payments is determined by the entity on the basis appropriate to the business. Presenting interest and dividends received as investing cash flows relates those cash flows directly to investing activities from which they arise. Presenting interest payments as financing cash flows relates those cash flows directly to the capital provided.

Examples—classification of interest paid, interest and dividends received

In examples 29–32, the entity prepares the statement of cash flows using the direct method.

Ex 29 **In the year ended 31 December 20X0 an entity received interest from its interest-bearing investments of CU650, paid CU1,400 interest on long-term debt and received dividends from its other investments (ie not controlled, associated or jointly controlled entities) of CU230.**

The entity classifies interest paid and interest and dividends received as operating cash flows.

Extract from statement of cash flow for the year ended 31 December 20X0

	CU
Cash flows from operating activities	
Cash receipts from customers	X
Payments to suppliers and employees	(X)
Interest received	650
Interest paid	(1,400)
Dividends received	230
Net cash from operating activities	**X**
Cash flows from investing activities	
Proceeds on sale of equipment	X
Purchases of equipment	(X)
Net cash used in investing activities	**X**
Cash flow from financing activities	
Payment of finance lease liabilities	(X)
Repayment of borrowings	(X)
Net cash used in financing activities	**(X)**
Net increase in cash and cash equivalents	**X**
Cash and cash equivalents at beginning of year	X
Cash and cash equivalents at end of year	**X**

Ex 30 **The facts are the same as in example 29. However, in this example, the entity chooses to classify interest paid as financing cash flows and interest and dividends received as investing cash flows.**

Extract from statement of cash flow for the year ended 31 December 20X0

	CU
Cash flows from operating activities	
Cash receipts from customers	X
Payments to suppliers and employees	(X)
Net cash from operating activities	**X**
Cash flows from investing activities	
Proceeds on sale of equipment	X
Purchases of equipment	(X)
Interest received	650
Dividends received	230
Net cash used in investing activities	**X**

Cash flow from financing activities	
Payment of finance lease liabilities	(X)
Repayment of borrowings	(X)
Interest paid	(1,400)
Net cash used in financing activities	**(X)**
Net increase in cash and cash equivalents	**X**
Cash and cash equivalents at beginning of year	X
Cash and cash equivalents at end of year	**X**

7.16 An entity may classify dividends paid as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, the entity may classify dividends paid as a component of cash flows from operating activities because they are paid out of operating cash flows.

Notes

The classification of dividends paid is also a matter of preference. Dividends paid may be classified as operating or financing activities, as long as the presentation choice is applied consistently from one period to the next (see paragraph 3.11).

Presenting dividend payments in operating activities displays the extent to which dividends are paid out of operating cash flows. For example, in some cases dividends are distributed to the owners in proportion to the volume of their transactions with the entity during the reporting period rather than in proportion to the relative interests that they hold in the entity's contributed capital. This is the case for some rural co-operatives in some jurisdictions. Hence, classifying dividends paid as cash flows used in operating activities may be more appropriate in this particular case.

Examples—classification of dividends paid

Ex 31 **The facts are the same as in example 29. However in this example the entity paid dividends of CU2,000 to its shareholders and chooses to classify dividends paid as cash flows from financing activities.**

Extract from statement of cash flow for the year ended 31 December 20X0

	CU
Cash flows from operating activities	
Cash receipts from customers	X
Payments to suppliers and employees	(X)
Interest received	650
Interest paid	(1,400)
Dividends received	230
Net cash from operating activities	**X**

Cash flows from investing activities	
Proceeds on sale of equipment	X
Purchases of equipment	(X)
Net cash used in investing activities	**X**
Cash flow from financing activities	
Payment of finance lease liabilities	(X)
Repayment of borrowings	(X)
Dividends paid	(2,000)
Net cash used in financing activities	**(X)**
Net increase in cash and cash equivalents	**X**
Cash and cash equivalents at beginning of year	X
Cash and cash equivalents at end of year	X

Ex 32 **The facts are the same as in example 29. However, in this example, the entity chooses to classify dividends paid as operating cash flows.**

Extract from statement of cash flows for the year ended 31 December 20X0

	CU
Cash flows from operating activities	
Cash receipts from customers	X
Payments to suppliers and employees	(X)
Interest received	650
Interest paid	(1,400)
Dividends received	230
Dividends paid	(2,000)
Net cash from operating activities	**X**
Cash flows from investing activities	
Proceeds on sale of equipment	X
Purchases of equipment	(X)
Net cash used in investing activities	**X**
Cash flow from financing activities	
Payment of finance lease liabilities	(X)
Repayment of borrowings	(X)
Net cash used in financing activities	**(X)**

...continued

...continued

Net increase in cash and cash equivalents	**X**
Cash and cash equivalents at beginning of year	X
Cash and cash equivalents at end of year	**X**

Income tax

7.17 An entity shall present separately cash flows arising from income tax and shall classify them as cash flows from operating activities unless they can be specifically identified with financing and investing activities. When tax cash flows are allocated over more than one class of activity, the entity shall disclose the total amount of taxes paid.

Notes

Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in a statement of cash flows. While tax expense may be readily identifiable with investing or financing activities, it is often impracticable to identify the related tax cash flows and they may arise in a different period from the cash flows of the underlying transaction. Consequently, taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities, the tax cash flow is classified as an investing or financing activity, as appropriate and to the extent that it can be allocated reliably. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

Examples—classification of income taxes paid

Ex 33 **In its first year of operations (20X1) a service provider incurred CU2,000 income tax expense (CU1,800 current tax and CU200 deferred tax). The entity's reported profit for the year ended 31 December 20X1 is CU4,000 (ie CU6,000 profit before tax less CU2,000 income tax expense). The entity will pay the CU1,800 current tax incurred in 20X2. It expects the temporary difference that gave rise to the deferred tax liability to reverse in 20X5.**

The entity prepares its statement of cash flows using the indirect method.

Extract from the entity's statement of cash flows for the year ended 31 December 20X1

	CU
Cash flows from operating activities	
Profit for the year	4,000
Add back non-cash income and expenses	
Unpaid current income tax expense	1,800
Deferred tax expense	200
Net cash from operating activities	6,000

Ex 34 **The facts are the same as in example 33. However, in this example the entity paid CU1,000 income tax in 20X1.**

Extract from the statement of cash flows of an entity for the reporting period ended 31 December 20X1

	CU
Cash flows from operating activities	
Profit for the year	4,000
Add back	
Unpaid current income tax expense[a]	800
Deferred tax expense	200
Net cash from operating activities	5,000
…	
[a] Income tax paid in cash	1,000

Ex 35 **Cash and cash equivalents of the entity at the beginning of 20X0 were CU500.**

In 20X0 an entity's only cash flows were:

- **CU480 cash received from customers**
- **CU30 cash paid to suppliers and employees**
- **CU400 dividends received**
- **CU450 income tax paid (including CU100 tax in respect of the dividends received).**

The entity chooses to classify dividends received as investing cash flows.

Statement of cash flows of the entity for the year ended 31 December 20X0

Cash flows from operating activities		*CU*
Cash receipts from customers	480	
Cash paid to suppliers and employees	(30)	
Income taxes paid	(350) [a]	
Net cash from operating activities		**100**
Cash flow from investing activities		
Dividends received	400	
Income taxes paid	(100)[a]	
Net cash from investing activities		**300**
Net increase in cash and cash equivalents		**400**
Cash and cash equivalents at the beginning of period		500
Cash and cash equivalents at the end of period		900
[a] Income tax paid in cash	(450)	

Non-cash transactions

7.18 An entity shall exclude from the statement of cash flows investing and financing transactions that do not require the use of cash or cash equivalents. An entity shall disclose such transactions elsewhere in the **financial statements** in a way that provides all the relevant information about those investing and financing activities.

7.19 Many investing and financing activities do not have a direct impact on current cash flows even though they affect the capital and asset structure of an entity. The exclusion of non-cash transactions from the statement of cash flows is consistent with the objective of a statement of cash flows because these items do not involve cash flows in the current period. Examples of non-cash transactions are:

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

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

(c) the conversion of debt to equity.

Notes

An entity must exclude all non-cash investing and financing activities (ie those not having a direct impact on cash flows) from its statement of cash flows. Consequently, the entity presents only transactions having a direct impact on cash and cash equivalents in a reporting period. The list of examples presented in paragraph 7.19 is not exhaustive. Other non-cash activities include:

(a) the reclassification of long-term debt to short-term debt, or vice-versa;

(b) changes in liabilities or assets with no cash inflows or outflows (eg forgiveness of debt);

(c) revenue and expenses that arise from barter transactions; and

(d) non-cash dividends paid or received.

Ex 36 The entity acquired a building on credit which is payable five years later. The fair value of the transaction was CU10,000.

While this transaction does not entail a direct inflow or outflow of cash, the entity shall exclude it from the statement of cash flows. However, the entity must disclose the non-cash investing and financing activity elsewhere in the financial statements (typically in the Notes). The entity could, in accordance with paragraph 7.18, disclose the following information.

Note 10 Non-cash investing and financing activities

Building acquired on credit	CU10,000

Components of cash and cash equivalents

7.20 An entity shall present the components of cash and cash equivalents and shall present a reconciliation of the amounts presented in the statement of cash flows to the equivalent items presented in the statement of financial position. However, an entity is not required to present this reconciliation if the amount of cash and cash equivalents presented in the statement of cash flows is identical to the amount similarly described in the statement of financial position.

Examples—components of cash and cash equivalents

Ex 37 **At the end of the reporting period an entity reports cash and cash equivalents of CU100,000 in its statement of cash flows. In its statement of financial position those cash and cash equivalents are presented as CU150,000 cash (a current asset) and CU50,000 bank overdraft (a current liability).**

In a note to the statement of cash flows, the entity presents the disaggregation of the CU100,000 cash and cash equivalents at the end of the year—CU150,000 cash and CU50,000 bank overdraft, as reported as separate line items in the statement of financial position.

Ex 38 **At 31 December 20X8 an entity reports cash and cash equivalents of CU20,000 in its statement of cash flows. In its statement of financial position the entity presents CU50,000 cash (a current asset) and CU170,000 bank overdrafts (current liabilities). A bank overdraft with a balance of CU30,000 is classified as a component of cash and cash equivalents because it is repayable on demand and forms an integral part of the entity's cash management. The other bank overdraft (balance of CU140,000 at the end of the reporting period) is not a component of cash and cash equivalents.**

The entity could present the disclosures required by paragraph 7.20 in the notes referenced to the statement of cash flows as follows:

Note X. Cash and cash equivalents

	Cash on hand	Bank overdrafts	Total
	CU	*CU*	*CU*
Cash and cash equivalents at 31/12/20X8 (statement of cash flows)	50,000	(30,000)	**20,000**
Included in financing activities in statement of cash flows when the cash flows occur		(140,000)	
Separate line item in statement of financial position at 31/12/20X8	**50,000**	**(170,000)**	

Ex 39 A group prepares its financial statements in accordance with the *IFRS for SMEs*. Extracts from the statement of cash flows, statement of financial position and notes to the financial statements, including accounting policies and explanatory notes, to the financial statements of the group are presented as follows:

Extract from the consolidated statement of cash flows of the group for the year ended 31 December 20X8

	20X8
	CU
…	
Net increase in cash and cash equivalents	**38,532**
Cash and cash equivalents at beginning of period	(93,432)
Cash and cash equivalents at end of period	**(54,900)**

	Notes	*20X8*	*20X7*
Assets		*CU*	*CU*
Current assets			
Cash	24	28,700	22,075
…			

	Notes	*20X8*	*20X7*
Liabilities and Equity		*CU*	*CU*
Current liabilities			
Bank overdraft and loan	16	133,600	265,507

Extract from the notes to the consolidated financial statements of the group, including accounting policies and explanatory notes for the year ended 31 December 20X8:

16. Bank overdraft and loan

	20X8	*20X7*
	CU	*CU*
Bank overdraft	83,600	115,507
Bank loan—due in 20X9, pre-payable without penalty	50,000	150,000
Total	**133,600**	**265,507**

The bank overdraft and loan are secured by a floating lien over land and buildings owned by the Group with a carrying amount of CU266,000 as at 31 December 20X8 (CU412,000 as at 31 December 20X7).

Interest is payable on the bank overdraft at 200 points above the London Interbank Borrowing Rate (LIBOR). Interest is payable on the bank loan over seven years at a fixed rate of 5 per cent of the principal amount.

24. Cash and cash equivalents

	20X8	*20X7*
	CU	*CU*
Cash on hand[a]	28,700	22,075
Overdrafts[b]	(83,600)	(115,507)
Total	(54,900)	(93,432)

[a] Presented as a current asset in the statement of financial position.

[b] Presented as a current liability in the statement of financial position.

Ex 40 **A group prepares its 20X8 financial statements following the *IFRS for SMEs*. The functional currency of the parent and its subsidiaries is the CU. The presentation currency of the group is the CU. This group has cash and cash equivalents in four foreign currencies. There is an unrealised loss, CU120,000, in foreign cash and cash equivalents at the end of the reporting period. The information about cash and cash equivalents as a part of the statement of cash flows of this group is presented as follows:**

Extract from the consolidated statement of financial position of the group for the year ended 31 December 20X8

	20X8	*20X7*
	CU	*CU*
Assets		
Cash on hand and balances with banks	150,000	390,000
Short-term investments	1,700,000	170,000
…		
Liabilities		
Bank overdraft	130,000	50,000
…		

Extract from the consolidated statement of cash flows for the year ended 31 December 20X8

	Notes	*20X8*
		CU
…		
Net increase in cash and cash equivalents		1,330,000
Cash and cash equivalents at beginning of period		510,000
Unrealised foreign exchange loss in cash and cash equivalents		(120,000)
Cash and cash equivalents at end of period	18	**1,720,000**
…		

Extract from the notes of the group for the year ended 31 December 20X8

Note 18 Cash and cash equivalents

Cash and cash equivalents in the statement of cash flows consist of cash on hand and balances with banks, and investments in money market instruments. They are presented as separate line items in the statement of financial position as follows:

	20X8
	CU
Amounts reflected in the statement of financial position	
Cash on hand and balances with banks	150,000
Short-term investments	1,700,000
Bank overdrafts	(130,000)
Total cash and cash equivalents in the statement of cash flows	**1,720,000**

Other disclosures

7.21 An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the entity. Cash and cash equivalents held by an entity may not be available for use by the entity because of, among other reasons, foreign exchange controls or legal restrictions.

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* to transactions and events often requires judgement. Information about significant judgements and key sources of estimation uncertainty are useful in assessing the financial position, performance and cash flows of an entity. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. Furthermore, in accordance with paragraph 8.7, an entity must disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Other sections of the *IFRS for SMEs* require disclosure of information about particular judgements and estimation uncertainties.

Cash and cash equivalents

Cash and cash equivalents are cash on hand, demand deposits and short-term, highly liquid investments held to meet short-term cash commitments, rather than for investment or other purposes. In most cases little difficulty is encountered in determining whether an asset (or even a liability—for example, a bank overdraft) is an item of cash and cash equivalents. However, in some circumstances significant judgement is required to classify some items of cash and cash equivalents. For example, in judging:

- whether some investments in equity instruments or debt instruments meet the classification criteria of cash equivalents items;
- whether some bank overdrafts form an integral part of an entity's cash management; and
- whether some significant cash and cash equivalent balances held by the entity are not available for use by the entity.

Cash flows activities

The statement of cash flows presents cash flows for a reporting period classified by operating, investing and financing activities. In most cases little difficulty is encountered in determining whether a cash flow forms a part of an entity's operating, investing or financing activities. However, significant judgement is required to classify some cash flows among these activities. For example, judging whether:

- the cash outflows related to interest on loans payable are classified either as operating activities or financing activities
- the cash inflows related to interest on investments not forming part of cash or cash equivalent items are classified either as operating activities or investing activities.

Direct method

Under the direct method cash flows from operating activities is presented by disclosing information about major classes of gross cash receipts and gross cash payments. In most cases little difficulty is encountered in determining what constitutes major classes of gross cash flows.

COMPARISON WITH FULL IFRSS

Full IFRSs (see IAS 7 *Statement of Cash Flows*) and the *IFRS for SMEs* (see Section 7 *Statement of Cash Flows*) issued at 9 July 2009 share the same principles for the presentation of the statement of cash flows.

A high level overview of differences between these two requirements includes:

- The *IFRS for SMEs* is drafted in simple language and includes significantly less guidance on how to apply the principles.
- *IFRS for SMEs* does not explicitly:
    - encourage entities to report cash flows from operating activities using the direct method (see IAS 7 *Statement of Cash Flows*, paragraph 19).
    - require the reporting of particular cash flows on a net basis (see IAS 7 *Statement of Cash Flows*, paragraph 22).

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for the presentation of the statement of cash flows in accordance with the *IFRS for SMEs* by answering the questions below.

Once you have completed the test check your answers against those set out below this test.

Assume all amounts are material.

Mark the box next to the most correct statement.

Question 1

The statement of cash flows presents changes in cash and cash equivalents:

☐ (a) from operating activities

☐ (b) from operating and financing activities

☐ (c) from operating, investing and financing activities

Question 2

The statement of financial position of an airline domiciled in Country A (a developed economy; local currency is CU), presents the following financial assets at 31 December 20X5:

- Bank cheque account = CU58,400.
- Bank savings account (collectible immediately) = CU23,440.
- Cash = CU10,000.
- Common stocks of Entity Z, one of the most traded assets in Country A's stock exchange, purchased by the airline to speculate = CU2,715.
- Oil price derivative entered into by the entity to hedge the commodity price risk of the anticipated future purchase of oil for use in the entity's operating business = CU6,720.
- A gold price derivative entered into by the entity to speculate = CU9,880.
- Treasury bonds issued by the government of Country A = CU8,500. The entity acquired the bonds from the government one week before the entity's reporting date. The bonds mature 2 months after the date of acquisition (ie they are two-month bonds from date of issue).
- Treasury bonds issued by the government of Country A = CU6,300. The entity acquired those bonds from the government in the previous annual reporting period. The bonds mature 15 months after the date of acquisition (ie they are 15-month bonds).

In the absence of evidence to the contrary, the entity's total cash and cash equivalent at 31 December 20X5 is:

☐ (a) CU91,840

☐ (b) CU98,560

☐ (c) CU100,340

☐ (d) CU107,060

- [ ] (e) CU109,775
- [ ] (f) CU113,360

Question 3

Cash receipts from customers for the sale of goods are cash flows from:

- [ ] (a) operating activities
- [ ] (b) investing activities
- [ ] (c) operating or financing activities
- [ ] (d) financing activities

Question 4

Payment of non-refundable purchase taxes on the purchase of property, plant and equipment are allocated as cash flows from:

- [ ] (a) operating activities
- [ ] (b) investing activities
- [ ] (c) financing activities
- [ ] (d) operating or financing activities

Question 5

Cash payments to acquire the entity's own shares (ie treasury shares) are:

- [ ] (a) cash outflows from operating activities
- [ ] (b) cash outflows from investing activities
- [ ] (c) cash outflows from financing activities

Question 6

Cash proceeds from long-term borrowings are:

- [ ] (a) cash inflows from operating activities
- [ ] (b) cash inflows from investing activities
- [ ] (c) cash inflows from financing activities

Question 7

Interest and dividends received:

- [ ] (a) are cash inflows from operating activities
- [ ] (b) are cash inflows from financing activities
- [ ] (c) could be classified as operating or financing cash flows
- [ ] (d) could be classified as operating or investing cash flows

Question 8

Cash receipts from the sale of an owner-operated plant are:

- ☐ (a) cash flows from financing activities
- ☐ (b) cash flows from investing activities
- ☐ (c) cash flows from operating activities

Question 9

Entity A acquired 50 per cent of the equity of entity B on 1 January 20X3 for CU520,000 (cash) when the fair value of entity B's identifiable net assets (total assets less total liabilities and contingent liabilities) was CU1,000,000 (including cash and cash equivalents of CU100,000). With effect from 1 January 20X3 entity A controls entity B. In the group's consolidated statement of cash flows the separate line item 'cash flow on acquiring a subsidiary' is:

- ☐ (a) a cash inflow of CU520,000
- ☐ (b) a cash outflow of CU520,000
- ☐ (c) a cash inflow of CU420,000
- ☐ (d) a cash outflow of CU420,000

Question 10

The facts are the same as in Question 9. However, in this question, with effect from 1 January 20X3 entity A has significant influence (that is neither control nor joint control) over entity B. In its statement of cash flows entity A reports the separate line item 'cash flow on acquiring an associate' as:

- ☐ (a) a cash outflow of CU520,000
- ☐ (b) a cash outflow of CU420,000
- ☐ (c) a cash outflow of CU260,000
- ☐ (d) a cash outflow of CU210,000

Question 11

When presenting operating cash flows using the direct method, the reconciliation of profit or loss to net cash flow from operating activities:

- ☐ (a) is required to be presented in the statement of cash flows
- ☐ (b) is required to be disclosed in the notes to the financial statements
- ☐ (c) is prohibited from being presented or disclosed in any way
- ☐ (d) is permitted (but not required) to be disclosed in the notes to the financial statements

Module 7 – Statement of Cash Flows

Answers

Q1 (c) See paragraph 7.1

Q2 (c) See paragraph 7.2 and the definition of cash equivalents in the Glossary (calculation: CU58,400 bank cheque account + CU23,440 bank saving account + CU10,000 cash + CU8,500 treasury bond acquired 2 months from maturity date). Note: common stocks of entity Z and the gold derivative have a significant risk of change in value and the airline entered into those investments for speculative purposes; the oil commodity price risk derivative is not held for short-term cash management purposes; and the treasury bonds were acquired with a maturity period of more than three months.

Q3 (a) See paragraph 7.4(a)

Q4 (b) See paragraphs 7.4(e), 7.5(a) and 7.17

Q5 (c) See paragraph 7.6(b)

Q6 (c) See paragraph 7.6(c)

Q7 (d) See paragraphs 7.15

Q8 (b) See paragraphs 7.4 (requirement after 7.4(f)) and 7.5(b)

Q9 (d) See paragraph 7.5(c)

Q10 (a) See paragraph 7.5(c)

Q11 (d) See paragraphs 7.9 and 8.2(c)

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for the presentation of the statement of cash flows in accordance with the *IFRS for SMEs* by solving the case studies below.

Once you have completed the case studies check your answers against those set out at the end of this test.

Case study 1

Financial effects of the entity's operations for the year ended 31 December 20X3:

	(Income) or Expense	Cash	Trade receivables	Trade payables	Accrued employee benefits	Inventory	Investment property	Furniture and equipment
Carrying amount at 01/01/20X3		600	200	(150)	(60)	1,000	800	500
Credit sales	(6,000)		6,000					
Credit purchases				(2,200)		2,200		
Cost of goods sold	3,000					(3,000)		
Cash receipts from customers		3,600	(3,600)					
Rental income	(40)	40						
Cash payments to suppliers		(2,000)		2,000				
Cash payments to employees	1,500	(1,560)			60			
Depreciation	50							(50)
Sale of computer	(110)	210						(100)
Change in fair value	(100)						100	
Profit/carrying amount at 31/12/20X3	(1,700)	890	2,600	(350)	–	200	900	350

Part A: Prepare the entity's statement of cash flows for the year ended 31 December 20X3 using the indirect method.

Part B: Prepare the entity's statement of cash flows for the year ended 31 December 20X3 using the direct method.

Note: for simplicity, in this example tax has been ignored.

Answer to case study 1

Part A: indirect method of presenting operating cash flows

Extract from the statement of cash flows of the entity for the year ended 31 December 20X3

	CU	
Cash flows from operating activities		
Profit for the year	1,700	
Adjustments for non-cash income and expenses:		
Depreciation expense	50	
Increase in fair value of investment property	(100)	
Adjustment for item included in investing activities:		
Profit on sale of equipment	(110)	
Changes in working capital:		
Increase in trade and other receivables	(2,400)	(a)
Decrease in inventories	800	(b)
Increase in trade and other payables	140	(c)
Net cash from operating activities	80	
Cash flows from investing activities		
Proceeds on sale of equipment	210	
Net cash from investing activities	210	
Cash and cash equivalents		
Increase in cash for the year ended 31 December 20X3	290	(d)
Cash at 1 January 20X3	600	
Cash at 31 December 20X3	890	

Calculations that do not form part of the statement of cash flows presented above:

(a) CU2,600 closing balance less CU200 opening balance = CU2,400.

(b) CU200 closing balance less CU1,000 opening balance = CU800.

(c) CU350 closing balance less CU210 (ie 150 trade payables + CU60 accrued employee benefits) opening balance = CU140.

(d) CU80 net cash flow from operating activities + CU210 net cash flow from investing activities = CU290.

Answer to case study 1

Part B: direct method of presenting operating cash flows

Entity X statement of cash flows for the year ended 31 December 20X3

	CU
Cash flows from operating activities	
Cash receipts from customers	3,600
Rentals received from tenants	40
Cash paid to suppliers and employees	(3,560)
Net cash from operating activities	80
Cash flows from investing activities	
Proceeds on sale of equipment	210
Net cash from investing activities	210
Cash and cash equivalents	
Increase in cash for the year ended 31 December 20X3	290
Cash at 1 January 20X3	600
Cash at 31 December 20X3	890

Case study 2

Group B prepares its financial statements for the year ended 31 December 20X6 in accordance with the *IFRS for SMEs*. Financial information for 20X6 (in thousands of currency units):

	20X6	*20X5*
Accounts receivable	725	850
Trade payables	310	425
Inventory	625	550
Increase in other expenses payable—services	15	
Increase in wages and salaries payable	65	
Increase in accrued interest	2	
Increase in current tax payable	10	
Decrease in deferred tax—asset	7	
Purchases of inventory	5,425	
Sales revenue from the sale of goods and rendering services	16,540	
Other expenses—services	210	
Wages and salaries expense	4,690	
Interest expense	95	
Income tax expense	205	

The group classifies interest paid in operating activities and interest received in investing activities. In 20X6 the group:

- borrowed (and received) CU590 (long-term loan)
- paid CU90 to settle long-term borrowing
- received interest of CU5
- paid CU265 for property, plant and equipment acquired
- received CU150 from the sale of equipment
- paid CU135 to acquire a software licence custom-made for its production process
- paid CU345 to acquire an investment property
- purchased a second investment property on credit for CU345
- paid CU110 as a reduction of financial lease liability.

The group had CU130 in cash and cash equivalents at beginning of the 20X6 reporting period and CU5,940 in cash and cash equivalents at the end of the 20X6 reporting period.

Prepare the group's consolidated statement of cash flow for the year ended 31 December 20X6 using the direct method of presenting operating cash flows.

Answer to case study 2

The statement of cash flow shall be presented as following on the direct method of presenting the operating activities:

Direct method—consolidated statement of cash flows of Group B for the year ended 31 December 20X6
(in thousands of currency units)

	20X6
Cash flows from operating activities	
Cash receipts from customers	16,665 [(a)]
Cash paid to suppliers and employees	(10,360) [(b)]
Cash generated from operations	6,305
Interest paid	(93) [(f)]
Income taxes paid	(202) [(g)]
Net cash from operating activities	**6,010**
Cash flows from investing activities	
Purchase of property, plant and equipment	(265)
Proceeds from sale of equipment	150
Purchase of intangible assets	(135)
Purchase of investment properties	(345)
Interest received	5
Net cash used in investing activities	**(590)**
Cash flows from financing activities	
Repayment of borrowings	(90)
Proceeds from long-term borrowings	590
Payment of finance lease liabilities	(110)
Net cash from financing activities	**390**
Net increase in cash and cash equivalents	**5,810**
Cash and cash equivalents at beginning of period	130
Cash and cash equivalents at end of period	**5,940**

Workings that do not form a part of the group's consolidated statement of cash flows:

[(a)] *Receipts from customers* = sales revenue + beginning accounts receivable less ending accounts receivable = CU16,540 + CU850 less CU725 = CU16,665.

[(b)] *Cash paid to suppliers and employees* = payments to suppliers + payments to suppliers of services + payments to employees = CU5,540[(c)] + CU195[(d)] + CU4,625[(e)] = CU10,360.

[(c)] *Payments to suppliers of inventory* = purchases of inventory + beginning accounts payable less ending accounts payable = CU5,425 + CU425 less CU310 = CU5,540.

[(d)] *Payments to suppliers of services* = other expenses less increase in other expenses payable = CU210 less CU15 = CU195.

[(e)] *Payments to employees* = Wages and salaries expense less increase in wages and salaries payable = CU4,690 less CU65 = CU4,625.

[f] *Interest paid* = Interest expense less increase in accrued interest = CU95 less CU2 = CU93.

[g] *Income taxes paid* = Income tax expense less increase in current tax payable + decrease in deferred tax asset = CU205 less CU10 + CU7 = CU202.

Note: in accordance with paragraph 7.18 the entity excludes from the statement of cash flows investing and financing transactions that do not require the use of cash or cash equivalents. However, the entity must disclose elsewhere in its financial statements the non-cash investing and financing transaction that occurred in the period (ie the purchase of the investment property on credit for CU345).

Case study 3

Entity A prepares its financial statements in accordance with *IFRS for SMEs*. Its statement of comprehensive income, statement of changes in equity and statement of financial position are as follows:

Entity A's statement of comprehensive income for the year ended 31 December

	20X9	*20X8*
	CU	*CU*
Revenue	848,000	630,000
Cost of goods sold	(450,000)	(320,000)
Distribution costs	(108,640)	(77,675)
General and administrative expenses	(109,027)	(90,375)
Change in provisions	3,450	(12,600)
Loss on disposal of property, plant and equipment	(12,083)	–
Finance income	1,884	720
Finance expenses	(7,460)	(3,135)
Profit before tax	**166,124**	**126,935**
Income tax	(41,531)	(31,734)
Profit for the year	**124,593**	**95,201**

Statement of changes in equity for the year ended 31 December

	Share capital	Retained Earnings	Total Equity *CU*
Balance at 31 December 20X7	**60,000**	**6,500**	**66,500**
Shares issued in exchange for cash	15,000	–	15,000
Shares issued in exchange for property, plant and equipment	25,000	–	25,000
Profit for the year	–	**95,201**	**95,201**
Dividends distributed and paid in cash during the reporting period	–	(80,000)	(80,000)
Balance at 31 December 20X8	**100,000**	**21,701**	**121,701**
Profit for the year	–	**124,593**	**124,593**
Dividends distributed and paid in cash and cash equivalent	–	(85,000)	(85,000)
Dividends distributed and paid in shares	15,000	(15,000)	–
Balance at 31 December 20X9	**115,000**	**46,294**	**161,294**

Entity A
Statement of financial position as at 31 December

	20X9	*20X8*	*20X7*
	CU	*CU*	*CU*
Assets			
Current assets			
Cash and cash equivalent	12,894	101,071	25,900
Short-term investments (non-cash equivalents)	14,700	6,700	6,000
Accrued interest	254	120	–
Trade receivables	235,200	176,400	49,600
Inventories	29,200	15,200	30,200
Prepaid expenses	2,000	1,800	1,200
Total current assets	**294,248**	**301,291**	**112,900**
Non-current assets			
Long-term investments	117,000	20,000	26,000
Accrued interest	1,970	520	–
Intangible assets	7,100	–	–
Property, plant and equipment	78,000	23,750	–
Total non-current assets	**204,070**	**44,270**	**26,000**
Total assets	**498,318**	**345,561**	**138,900**
Liabilities			
Current liabilities			
Short-term loans	25,000	25,000	6,700
Accrued interest	985	35	–
Current portion of finance lease liabilities	10,000	–	–
Accounts and trade payables	69,600	7,625	19,800
Wages and salaries payables	8,400	6,300	3,500
Income taxes payable	30,000	20,000	800
Other operating payables	5,979	7,500	1,600
Unearned revenue	–	8,000	–
Total current liabilities	**149,964**	**74,460**	**32,400**
Non-current liabilities			
Long-term loans	110,000	135,000	40,000
Accrued interest	6,910	1,800	–
Finance lease	61,000	–	–
Provisions	9,150	12,600	–
Total non-current liabilities	**187,060**	**149,400**	**40,000**
Equity			
Share capital	115,000	100,000	60,000
Retained earnings	46,294	21,701	6,500
Total equity	**161,294**	**121,701**	**66,500**
Total liabilities and equity	**498,318**	**345,561**	**138,900**

Additional information (amounts in CU):

	20X9	20X8
	CU	CU
Depreciation expense	3,667	1,250
Amortisation expense	6,400	–
Impairment loss on intangible assets	2,500	–
Carrying amount of property, plant and equipment sold, at the date of disposal	22,083	–
Property, plant and equipment acquired in the period under finance lease	80,000	–
New loans advanced to the entity in 20X8	–	120,000

Composition of cash and cash equivalents at 31 December:

	20X9	20X8	20X7
	CU	CU	CU
Cash	1,400	950	1,000
Bank deposits	11,494	32,000	20,000
Short-term investments – cash equivalent	–	68,121	4,900
Total cash and cash equivalents	**12,894**	**101,071**	**25,900**

Prepare the entity's statement of cash flows in accordance with the *IFRS for SMEs* for the year ended 31 December 20X9 (including comparative amounts) using the indirect method. Present interest paid and interest received as cash flows from operating activities and dividends paid classified as cash flows from financing activities.

Notes:

1. The IFRS for SMEs does not require a statement of financial position at the beginning of the earliest comparative period (see paragraph 3.14). The statement of financial position provided by Entity A in this example includes a column for the statement of financial position at 31 December 20X7 to enable the calculation of the amounts in the statement of cash flows for the year ended 31 December 20X8.
2. Entity A does not have any deferred tax.

Answer to case study 3

Statement of cash flows for the years ended 31 December	*20X9*		*20X8*	
	CU		*CU*	
Cash flow from operating activities				
Profit for the year	124,593		95,201	
Adjustments for non-cash income and expenses:				
Non-cash finance cost[*]	4,476	(a)	1,195	(b)
Non-cash income tax expense[**]	10,000	(c)	19,200	(d)
Depreciation and amortisation	10,067	(e)	1,250	
Impairment	2,500		–	
Change in provisions	(3,450)	(f)	12,600	(g)
Loss on disposal of property, plant and equipment	12,083		–	
Changes in working capital:				
Accounts and trade receivables	(58,800)	(h)	(126,800)	(i)
Inventories	(14,000)	(j)	15,000	(k)
Prepaid expenses	(200)	(l)	(600)	(m)
Accounts and trade payables	61,975	(n)	(12,175)	(o)
Wages and salaries payables	2,100	(p)	2,800	(q)
Other operating payables	(1,521)	(x)	5,900	(y)
Unearned revenue	(8,000)	(z)	8,000	(aa)
Net cash from operating activities	**141,823**		**21,571**	
Cash flow from investing activities[(bb), (cc)]				
Purchase of intangible assets	(16,000)	(dd)	–	
Proceeds from the disposal of property, plant and equipment	10,000	(ee)	–	
Investment in (withdraw from) non-cash equivalent financial	(105,000)	(ff)	5,300	(gg)
Net cash from (used in) investing activities	**(111,000)**		**5,300**	
Cash flow from financing activities				
Proceeds from issue of share capital	–		15,000	
Proceeds from loan borrowings	–		120,000	
Payment of finance lease	(9,000)	(hh)	–	
Repayment of loans	(25,000)	(ii)	(6,700)	(jj)
Dividends paid	(85,000)		(80,000)	
Net cash from (used in) financing activities	**(119,000)**		**48,300**	
Net increase (decrease) in cash and cash equivalents	**(88,177)**		**75,171**	
Cash and cash equivalents as at the beginning of the year	101,071		25,900	
Cash and cash equivalents as at the year-end	**12,894**		**101,071**	

[*] **Interest received in cash**	**300**	**80**
[*] **Interest paid in cash**	**1,400**	**1,300**
[**] **Income tax paid in cash**	**31,531**	**12,534**

The calculations and explanatory notes below do not form part of the answer to this case study:

(a) CU4,476 = interest expense (CU7,460) less interest income (CU1,884) + interest received (CU300) less interest paid (CU1,400).

CU300 (interest received) = current asset accrued interest as at 31 December 20X8 (CU120) + non-current asset accrued interest as at 31 December 20X8 (CU520) + finance income (CU1,884) less current asset accrued interest as at 31 December 20X9 (CU254) less non-current asset accrued interest as at 31 December 20X9 (CU1,970).

CU1,400 (interest paid) = current liability accrued interest as at 31 December 20X8 (CU35) + non-current liability accrued interest as at 31 December 20X8 (CU1,800) + finance expense (CU7,460) less current liability accrued interest as at 31 December 20X9 (CU985) less non-current liability accrued interest as at 31 December 20X9 (CU6,910).

(b) CU1,195 = interest expense (CU3,135) less interest income (CU720) + interest received (CU80) less interest paid (CU1,300).

CU80 (interest received) = current asset accrued interest as at 31 December 20X7 (zero) + non-current asset accrued interest as at 31 December 20X7 (zero) + finance income (CU720) less current asset accrued interest as at 31 December 20X8 (CU520) less non-current asset accrued interest as at 31 December 20X8 (CU120).

CU1,300 (interest paid) = current liability accrued interest as at 31 December 20X7 (zero) + non-current liability accrued interest as at 31 December 20X7 (zero) + finance expense (CU3,135) less current liability accrued interest as at 31 December 20X8 (CU35) less non-current liability accrued interest as at 31 December 20X8 (CU1,800).

(c) CU10,000 = tax accrued (CU41,531) less tax paid (CU31,531).

CU31,531 (tax paid) = income taxes payable as at 31 December 20X8 (CU20,000) + income tax expense (CU41,531) less income taxes payable as at 31 December 20X9 (CU30,000).

(d) CU19,200 = tax accrued (CU31,734) less tax paid (CU12,534).

CU12,534 (tax paid) = income taxes payable as at 31 December 20X7 (CU800) + income tax expense (CU31,734) less income taxes payable as at 31 December 20X8 (CU20,000).

(e) CU10,067 = depreciation of PPE (CU3,667) + amortisation of intangible assets (CU6,400).

(f) CU3,450 = provisions as at 31 December 20X9 (CU9,150) less provisions and contingent liabilities as at 31 December 20X8 (CU12,600).

(g) CU12,600 = provisions as at 31 December 20X8 (CU12,600) less provisions and contingent liabilities as at 31 December 20X7 (zero).

(h) CU58,800 = trade receivables as at 31 December 20X9 (CU235,200) less accounts and trade receivables as at 31 December 20X8 (CU176,400).

(i) CU126,800 = trade receivables as at 31 December 20X8 (CU176,400) less accounts and trade receivables as at 31 December 20X7 (CU49,600).

(j) CU14,000 = inventories as at 31 December 20X9 (CU29,200) less inventories as at 31 December 20X8 (CU15,200).

(k) CU15,000 = inventories as at 31 December 20X8 (CU15,200) less inventories as at 31 December 20X7 (CU30,200).

(l) CU200 = prepaid expenses as at 31 December 20X9 (CU2,000) less prepaid expenses as at 31 December 20X8 (CU1,800).

(m) CU600 = prepaid expenses as at 31 December 20X8 (CU1,800) less prepaid expenses as at 31 December 20X7 (CU1,200).

(n) CU61,975 = accounts and trade payables as at 31 December 20X9 (CU69,600) less accounts and trade payables as at 31 December 20X8 (CU7,625).

(o) CU12,175 = accounts and trade payables as at 31 December 20X8 (CU7,625) less accounts and trade payables as at 31 December 20X7 (CU19,800).

(p) CU2,100 = wages and salaries payables as at 31 December 20X9 (CU8,400) less wages and salaries payables as at 31 December 20X8 (CU6,300).

(q) CU2,800 = wages and salaries payables as at 31 December 20X8 (CU6,300) less wages and salaries payables as at 31 December 20X7 (CU3,500).

(x) CU1,521 = other operating payables as at 31 December 20X9 (CU5,979) less other operating payables as at 31 December 20X8 (CU7,500).

(y) CU5,900 = other operating payables as at 31 December 20X8 (CU7,500) less other operating payables as at 31 December 20X7 (CU1,600).

(z) CU8,000 = unearned revenue as at 31 December 20X9 (zero) less unearned revenue as at 31 December 20X8 (CU8,000).

(aa) CU8,000 = unearned revenue as at 31 December 20X8 (CU8,000) less unearned revenue as at 31 December 20X7 (zero).

(bb) Note: in this example a separate line item 'purchase of property, plant and equipment' is not presented in the statement of cash flows because the amount in both 20X9 and 20X8 is zero. Calculation: PPE as at 31 December 20X9 (CU78,000) less PPE as at 31 December 20X8 (CU23,750) + depreciation expense of PPE (CU3,667) + write-off carrying amount of PPE sold (CU22,083) less PPE acquired under finance lease (CU80,000). The finance lease entered into in the period is a non-cash investing and financing activity.

(cc) Zero = PPE as at 31 December 20X8 (CU23,750) less PPE as at 31 December 20X7 (zero) + depreciation expense of PPE (CU1,250) less contributed capital in PPE (CU25,000). The issue of shares in exchange for property, plant and equipment in the year is a non-cash investing and financing activity.

(dd) CU16,000 = intangible assets as at 31 December 20X9 (CU7,100) less intangible assets as at 31 December 20X7 (zero) + amortisation expense of intangible assets (CU6,400) + impairment expense of intangible assets (CU2,500).

(ee) CU10,000 = carrying amount of PPE sold (CU22,083) less gain (loss) on disposal of PPE (CU12,083).

(ff) CU105,000 = current asset investments as at 31 December 20X9 (CU14,700) + non-current asset investments as at 31 December 20X9 (CU117,000) less current asset investments as at 31 December 20X8 (CU6,700) less non-current asset investments as at 31 December 20X8 (CU20,000).

(gg) CU5,300 = current asset investments as at 31 December 20X8 (CU6,700) + non-current asset investments as at 31 December 20X8 (CU20,000) less current asset investments as at 31 December 20X7 (CU6,000) less non-current asset investments as at 31 December 20X7 (CU26,000).

(hh) CU9,000 = short-term maturity of finance lease as at 31 December 20X9 (CU10,000) + non-current liability finance lease as at 31 December 20X9 (CU61,000) less PPE acquired under finance lease (CU80,000) less short-term maturity of finance lease as at 31 December 20X8 (zero) less non-current liability finance lease as at 31 December 20X8 (zero).

(ii) CU25,000 = short-term loans as at 31 December 20X8 (CU25,000) + long-term loans as at 31 December 20X8 (CU135,000) + loans borrowed (zero) less short-term loans as at 31 December 20X9 (CU25,000) less long-term loans as at 31 December 20X9 (CU110,000).

(jj) CU6,700 = short-term loans as at 31 December 20X7 (CU6,700) + long-term loans as at 31 December 20X7 (CU40,000) + loans borrowed (CU120,000) less short-term loans as at 31 December 20X8 (CU25,000) less long-term loans as at 31 December 20X8 (CU135,000).

Case study 4

Group XYZ prepares its financial statements for the year ended 31 December 20X2 (including comparative information) in accordance with the *IFRS for SMEs*. Financial statements for 20X2 and 20X1 are the following:

XYZ Group

Consolidated statement of comprehensive income and retained earnings for the year ended 31 December 20X2

	20X2	*20X1*
	CU	*CU*
Revenue	6,863,545	5,808,653
Other income	88,850	25,000
Changes in inventories of finished goods and work in progress	3,310	(1,360)
Raw material and consumables used	(4,786,699)	(4,092,185)
Employee salaries and benefits	(936,142)	(879,900)
Depreciation and amortisation expense	(272,060)	(221,247)
Impairment of property, plant and equipment	(30,000)	–
Other expenses	(249,482)	(145,102)
Finance costs	(26,366)	(36,712)
Profit before tax	654,956	457,147
Income tax expense	(270,250)	(189,559)
Profit for the year	384,706	267,588
Retained earnings at start of year	2,171,353	2,003,765
Dividends	(150,000)	(100,000)
Retained earnings at end of year	2,406,059	2,171,353

Note: other income in 20X2 includes dividends received of CU25,000 and gain on disposal of property, plant and equipment of CU63,850.

XYZ Group
Consolidated statement of financial position at 31 December 20X2

	20X2	*20X1*	*20X0*
Assets	*CU*	*CU*	*CU*
Current assets			
Cash	28,700	22,075	18,478
Trade and other receivables	585,548	573,862	521,234
Inventories	57,381	47,920	45,050
	671,629	643,857	584,762
Non-current assets			
Investment in associate	107,500	107,500	107,500
Property, plant and equipment	2,549,945	2,401,455	2,186,002
Intangible assets	850	2,550	4,250
Deferred tax asset	4,309	2,912	2,155
	2,662,604	2,514,417	2,299,907
Total assets	3,334,233	3,158,274	2,884,669

Liabilities and Equity	*20X2* *CU*	*20X1* *CU*	*20X0* *CU*
Current liabilities			
Bank overdraft	83,600	115,507	20,435
Trade payables	431,480	420,520	412,690
Interest payable	2,000	1,200	–
Current tax liability	271,647	190,316	173,211
Provision for warranty obligations	4,200	5,040	2,000
Current portion of employee benefit obligations	4,944	4,754	4,571
Current portion of finance lease obligations	21,461	19,884	18,423
	819,332	757,221	631,330
Non-current liabilities			
Bank loan	50,000	150,000	150,000
Long-term employee benefit obligations	5,679	5,076	5,066
Finance lease obligations	23,163	44,624	64,508
	78,842	199,700	219,574
Total liabilities	**898,174**	**956,921**	**850,904**

Equity	*20X2* *CU*	*20X1* *CU*	*20X0* *CU*
Share capital	30,000	30,000	30,000
Retained earnings	2,406,059	2,171,353	2,003,765
	2,436,059	2,201,353	2,033,765
Total liabilities and equity	3,334,233	3,158,274	2,884,669

XYZ Group
Consolidated statement of cash flows for the year ended 31 December 20X2 (indirect method)

	20X2	*20X1*
	CU	*CU*
Cash flows from operating activities		
Profit for the year	384,706	267,588
Adjustments for non-cash income and expenses:		
Non-cash finance costs[(a)]	800	1,200
Non-cash income tax expense[(b)]	79,934	16,348
Depreciation of property, plant and equipment	270,360	219,547
Impairment loss	30,000	–
Amortisation of intangibles	1,700	1,700
Cash flow included in investing activities:		
Gain on sale of equipment	(63,850)	–
Changes in operating assets and liabilities:		
Decrease (increase) in trade and other receivables	(11,686)	(52,628)
Decrease (increase) in inventories	(9,461)	(2,870)
Increase (decrease) in trade payables[(c)]	10,120	10,870
Increase in current and long-term employee benefit payable	793	193
Net cash from operating activities	**693,416**	**461,948**

	20X2	20X1
	CU	CU
Cash flows from investing activities		
Proceeds from sale of equipment	100,000	–
Purchases of equipment	(485,000)	(435,000)
Net cash used in investing activities	**(385,000)**	**(435,000)**
Cash flows from financing activities		
Payment of finance lease liabilities	(19,884)	(18,423)
Repayment of borrowings	(100,000)	–
Dividends paid	(150,000)	(100,000)
Net cash used in financing activities	**(269,884)**	**(118,423)**
Net increase (decrease) in cash and cash equivalents	38,532	(91,475)
Cash and cash equivalents at beginning of year	(93,432)	(1,957)
Cash and cash equivalents at end of year	(54,900)	(93,432)

[(a)] Finance costs paid in cash	?	?
[(b)] Income taxes paid in cash	?	?
[(c)] Includes unrealised foreign exchange loss	1,000	—

Note

Cash and cash equivalents

	20X2	20X1
	CU	CU
Cash on hand	28,700	22,075
Overdrafts	(83,600)	(115,507)
	(54,900)	(93,432)

Prepare the XYZ Group's statement of cash flows for the year ended 31 December 20X2 (including comparative information) using the direct method.

Answer to case study 4

XYZ Group

Consolidated statement of cash flows for the year ended 31 December 20X2

	20X2	*20X1*
	CU	*CU*
Cash flows from operating activities		
Cash receipts from customers	6,876,859	5,781,025
Payments to suppliers and employees	(5,967,561)	(5,110,354)
Interest paid	(25,566)	(35,512)
Income tax paid	(190,316)	(173,211)
Net cash from operating activities	**693,416**	**461,948**
Cash flows from investing activities		
Proceeds on sale of equipment	100,000	–
Purchases of equipment	(485,000)	(435,000)
Net cash used in investing activities	**(385,000)**	**(435,000)**
Cash flow from financing activities		
Payment of finance lease liabilities	(19,884)	(18,423)
Repayment of borrowings	(100,000)	–
Dividends paid	(150,000)	(100,000)
Net cash used in financing activities	**(269,884)**	**(118,423)**
Net increase (decrease) in cash and cash equivalents	38,532	(91,475)
Cash and cash equivalents at beginning of year	(93,432)	(1,957)
Cash and cash equivalents at end of year	(54,900)	(93,432)

The calculations and explanatory notes below do not form part of the answer to this case study:

Cash receipts from customers = sales revenue + other income (less gain on disposal of property, plant and equipment in 20X2) less increase in trade and other receivables

20X1: CU5,808,653 + CU25,000 less CU52,628 = CU5,781,025

20X2: CU6,863,545 + CU88,850 less CU63,850 less CU11,686 = CU6,876,859

Payments to suppliers and employees = (a) Payments to suppliers for raw material and consumables + (b) Payments to employees + (c) Other payments from operations + Increase in inventories of finished goods and work in progress (less decrease in inventories of finished goods and work in progress)

20X1: CU4,087,225 + CU879,707 + CU142,062 + CU1,360 = CU5,110,354

20X2: CU4,785,200 + CU935,349 + CU250,322 less CU3,310 = CU5,967,561

(a) Payments to suppliers for raw material and consumables = raw material and consumables used + increase in inventories less increase in trade payables

20X1: CU4,092,185 + CU2,870 less CU7,830 = CU4,087,225

20X2: CU4,786,699 + CU9,461 less CU10,960 = CU4,785,200

(b) Payments to employees = employee salaries and benefits less increase of current portion of employee benefits less increase of long-term employee benefit obligation

20X1: CU879,900 less CU183 less CU10 = CU879,707

20X2: CU936,142 less CU190 less CU603 = CU935,349

(c) Other payments from operations = other expenses − increase (+ decrease) in provision for warranty obligations

20X1: CU145,102 less CU3,040 = CU142,062

20X2: CU249,482 + CU840 = CU250,322

Interest paid = interest expense less increase in accrued interest

20X1: CU36,712 less CU1,200 = CU35,512

20X2: CU26,366 less CU800 = CU25,566

Income taxes paid = income tax expense less increase in current tax payable + increase in deferred tax asset

20X1: CU189,559 less CU17,105 + CU757 = CU173,211

20X2: CU270,250 less CU81,331 + CU1397 =CU190,316

Cash flows from investing activities and financing activities are identical to those presented using the indirect method.