Statement of Cash Flows

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SAB&Tip

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The objective of a Statement of Cash Flows is to provide useful information on how an entity generates and utilizes cash in respect of historical changes in the cash and cash equivalents.

Cash flows from operating activities

This section enables the users of the financial statements to evaluate the cash component of the normal operating activities for the period, and in doing so, to assess the quality of the earnings. Cash generated from operations can be disclosed using either the *direct* or the *indirect* method.

Direct method

Under the direct method, cash generated from operations is disclosed as being the difference between gross cash receipts from customers, and gross cash paid to suppliers and employees. These amounts are determined either by referring to the entity's accounting records or making the necessary adjustments to sales and cost of sales, taking into account changes in inventories, receivables, payables, and other non-cash items.

Indirect method

Under the indirect method, cash generated by operations comprises two disclosable components:

Profit before working capital changes – This amount is calculated by adjusting profit before tax for those items that do not involve the flow of cash, as well as interest and investment income, as these items are disclosed separately (along with taxes on income); and

Changes in working capital – these are movements in current assets and current liabilities related to the operating activities of the entity.

The movements will include those movements in accrued income and expense, income received in advance and prepaid expense.

A note on items that are disclosed separately:

Interest and investment income (and taxes on income) are disclosed separately at their cash-only figures on the face of the statement of cash flows. In order to achieve this, these figures must be removed as adjustments to profit before tax (along with non-cash entries) and removed from the changes in working capital (ie accrued expense for interest or accrued income for investment income etc) in order to avoid double counting.

It can be seen from the above that the balances for interest and investment income shown as an adjustment to profit and loss, and disclosed separately as cash-only on the face of the statement of cash flows, can only be disclosed as the same figure if there are no items in changes in working capital relating to interest and investment income, which would mean that the figures in the statement of profit and loss were already at the cash-only balances.

Cash flows from investing activities

These figures are taken from the non-current asset section of the statement of financial position.

These cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows.

Only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities.

Cash flows from financing activities

These figures are taken from the equity and non-current liability section of the statement of financial position as appropriate.

The disclosure of these cash flows is useful in predicting claims on future cash flows by providers of capital to the entity.

Reporting cash flows on a net basis

Cash flows may be reported on a net basis only for the following activities:

- Cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customers rather than those of the entity; and
- Cash receipts and payments for items in which the turnover is quick, the amounts are large and the maturities are short.