

# IAS 7 Statement of Cash Flows

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## Objective

- The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows which classifies cash flows during the period from operating, investing and financing activities.

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## Scope

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

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### Benefits of cash flow information (1/2)

- A statement of cash flows, when used in conjunction with the rest of the financial statement
  - 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 is useful in assessing the ability of the entity to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different entities.

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### Benefits of cash flow information (2/2)

- enhance 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.
- useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.

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### Definitions

- **Cash** comprises cash on hand and demand deposits.
- **Cash equivalents**
  - are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.
- **Cash flows** are inflows and outflows of cash and cash equivalents.

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### Cash and cash equivalents (1/2)

- Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.

For an investment to qualify as a cash

- \* it must be readily convertible to a known amount of cash
- \* be subject to an insignificant risk of changes in value.
- \* 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.

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### Cash and cash equivalents (2/2)

- Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date.

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### Presentation of Statement of Cash Flows

- The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.
- An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business.

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### Operating activities (1/5)

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

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### Operating activities (2/5)

- Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity.
  - (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 receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;
  - (f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and

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### Operating activities (3/5)

- Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in recognized profit or loss. The cash flows relating to such transactions are cash flows from investing activities.
- However, cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale are cash flows from operating activities.
- The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities

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**Operating activities (4/5)**

- An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities

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**Operating activities (5/5)**

- cash advances and loans made by financial institutions are usually classified as operating activities since they relate to the main revenue-producing activity of that entity.

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**Investing activities (1/4)**

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

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### Investing activities (2/4)

- Only expenditures that result in a recognized asset in the statement of financial position are eligible for classification as investing activities.
  - (a) cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalized development costs and self-constructed property, plant and equipment;
  - (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 considered to be cash equivalents or those held for dealing or trading purposes);
  - (d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

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### Investing activities (3/4)

- (e) cash advances and loans made to other parties (other than advances and loans made by a financial institution);
- (f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);
- (g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
- (h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

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### Investing activities (4/4)

- When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

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### Financing activities (1/2)

- are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.
- The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the entity.

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### Financing activities (2/2)

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

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### Reporting cash flows from operating activities

- An entity shall report cash flows from operating activities using either:
  - (a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
  - (b) the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

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**Reporting cash flows from investing and financing activities**

- An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis.

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**Foreign currency cash flows (1/3)**

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

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**Foreign currency cash flows (2/3)**

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

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### Foreign currency cash flows (3/3)

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

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### Interest and dividends (1/5)

- Cash flows from interest and dividends received and paid shall each be disclosed separately.
- Each shall be classified in a consistent manner from period to period as either operating, investing or financing activities.

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### Interest and dividends (2/5)

- The total amount of interest paid during a period is disclosed in the statement of cash flows whether it has been recognised as an expense in profit or loss or capitalised in accordance with IAS 23 Borrowing Cost

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### Interest and dividends (3/5)

- Interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution.
- However, there is no consensus on the classification of these cash flows for other entities.

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### Interest and dividends (4/5)

- Interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of profit or loss.
- Alternatively, interest paid and interest and dividends received may be classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

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### Interest and dividends (5/5)

- Dividends paid may be classified as a financing cash flow because they are a cost of obtaining financial resources.
- Alternatively, dividends paid may be classified as a component of cash flows from operating activities in order to assist users to determine the ability of an entity to pay dividends out of operating cash flows.

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### Taxes on income

- Cash flows arising from taxes on income shall be separately disclosed and shall be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

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### Non - cash transactions (1/2)

- Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

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### Non-cash transactions (2/2)

- Many investing and financing activities do not have a direct impact on current cash flows although they do 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 as these items do not involve cash flows in the current period.
  - (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; and
  - (c) the conversion of debt to equity.

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**Disclosures**

- An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the statement of financial position.
  
- 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 group.

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