Edexcel

A Level

Accounts

CODE: (4AC1)

Unit 02 - Section 03

Statement of cash flow

Chapter 05 – Statement of cash flows

INTRODUCTION

Cash is crucial for a business's success, and a statement of financial position provides a snapshot of cash balances but does not detail how a business finances its activities. The statement of profit or loss explains net worth changes but does not provide liquidity information. Simple organizations, like clubs and not-for-profit associations, limit their accounting to cash receipts and payments.

WHAT IS A STATEMENT OF CASH FLOWS?

The **statement of cash flows** is a summary of the cash receipts and payments over a particular period. All payments of a particular type, for example cash payments to acquire additional non-current assets, are added together to give just one figure, which appears in the statement. The net total of the statement is the net increase or decrease of the cash and cash equivalents of the business over the period.

THE CONTENTS AND FORMAT OF THE STATEMENT CASH FLOW

There is a standard format for a statement of cash

flows; this is set out in accordance with International Accounting Standard (IAS) 7. IAS guidelines divide the statement into three distinct sections. They

cover:

- cash flows from **operating activities**
- cash flows from **investing activities**
- cash flows from **financing activities.**

From these activities, the net increase or decrease in cash can be calculated. This is then shown at the end of the statement of cash flow, with the opening and closing balances of cash and cash equivalents.

A typical statement of cash flows is shown below:

Statement of cash flows for Cash Generation plc for the year ended 31 December 2019

		£ 000s	£ 000s
Cash flows from operating activities	1		
Profit from operations	A	x	
Add: Depreciation on non-current assets	B	x	
Add: Loss on sale of non-current assets	C	x	
Less: Profit on sale of non-current assets	C	x	
Operating cash flow before working capital changes		xxx	
(Increase)/decrease in inventories	D	x	
(Increase)/decrease in trade and other receivables	E	x	
Increase/(decrease) in trade and other payables	F	x	
Cash generated from/used in operations		xxx	
Less: Interest paid	G	x	
Less: Tax paid	H	x	
Net cash from/used in operating activities			xxx
Cash flows from investing activities	2		
Payments to purchase non-current assets	I	x	
Add: Proceeds from disposal of non-current assets	J	x	
Add/less: Sale/purchase of shares in other companies	K	x	
Add: Dividends received	L	x	
Net cash from/used in investing activities			xxx
Cash flows from/used in financing activities	3		
Redemption of shares – OSC and SP separately	M	x	
Add: Proceeds from share issues – OSC and SP separately	N	x	
Add: Proceeds from bank loans and debentures	O	x	
Less: Dividends paid	P	x	
Less: Repayment of loans and debentures	Q	x	
Net cash from financing activities			xxx
Net increase/decrease in cash and cash equivalents	4		xxx
Cash and cash equivalents at the beginning of the year	5		xxx
Cash and cash equivalents at the end of the year	5		xxx

Notes:

1 The numbers and letters in the second column reference the explanations that follow.

2 The relevant extracts from the full statement will be reproduced in the explanations that follow.

Profit from operations (A)

This is the starting point for the statement of cash flows. It is the profit for the year before interest and taxation is deducted (Net Profit Before Interest and Tax, NPBI). This would be obtained from the statement of profit or loss and other comprehensive income. In the examination, you are frequently given a profit figure that includes elements that appear elsewhere in the statement of cash flows. If this is the case it is necessary to calculate the profit from operations.

If profit on ordinary activities after tax is given, it is necessary to add back into the profit the interest paid and tax paid (from the previous year). If the company has received interest, it must be deducted. If profit on ordinary activities before tax is given, it is necessary to add back the interest paid during the year.

Cash flows from operating activities	**1**	
Profit from operations	A	x
Add: Depreciation on non-current assets	B	x
Add: Loss on sale of non-current assets	C	x
Less: Profit on sale of non-current assets	C	x
Operating cash flow before working capital changes		xxx

Profit from operations (A)

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If **profit on ordinary activities after tax** is given, it is necessary to add back into the profit the interest paid and tax paid (from the previous year). If the company has received interest, it must be deducted.

If **profit on ordinary activities before tax** is given, it is necessary to add back the interest paid during the year.

Depreciation of non-current assets (B)

Depreciation is a non-cash transaction that reduces the profit but is not a cash outflow, because no cash has been deducted for depreciation. It must be added back. This also applies to the amortisation of intangible assets such as a copyright.

Loss/profit on disposal of non-current assets (C)

The profit or loss on the sale of non-current assets represents a notional amount, it is neither a cash inflow nor cash outflow. It is the sales proceeds that are the cash flow. A loss on disposal reduces profit with no corresponding cash inflow and so must be added back, while a profit on disposal increases profit with no corresponding cash inflow and so must be deducted.

The next section of the statement of cash flows accounts for the inflows and outflows resulting from the changes in working capital over the year. This section of the statement of cash flows, reproduced here, follows the accruals concept.

Operating cash flow before working capital changes		xxx
(Increase)/decrease in inventories	D	x
(Increase)/decrease in trade and other receivables	E	x
Increase/(decrease) in trade and other payables	F	x
Cash generated from/used in operations		xxx

(Increase)*/decrease in inventories (D)

An increase in inventory over the year will lead to an increase in cash outflows (when a business purchases more inventory during the year, more cash will be paid) and therefore the amount will be deducted. A decrease in inventory over the year will result in less outflows and is added to the statement.

(Increase)*/decrease in trade and other receivables (E)

An increase in trade and other receivables reduces the cash inflow (because more trade receivables delay their payments, which means less cash received from trade receivables) and so needs to be deducted. A decrease in these will increase cash inflows, so they are added to the cash flow from operating activities.

Increase/(decrease)* in trade and other payables (F)

An increase in trade and other payables will mean less cash flows out of the company (because the company holds up the payment to trade payables, which means more cash is kept in the bank account), increasing cash flow, and is therefore added. A decrease in these will mean an increase in cash outflows, and so an increase in trade and other payables is deducted.

The next section of the statement of cash flow looks at changes resulting from interest paid and tax paid.

Cash generated from/used in operations		xxx	
Less: Interest paid	G	x	
Less: Tax paid	H	x	
Net cash from/used in operating activities			xxx

Less interest paid (G)
This is required for the interest paid on bank overdrafts, bank loans and debentures. It is based on the *actual* cash payments. If a company receives interest as a result of normal operating activities, this should be added to the cash flows in this section.

Less taxation paid (H)

Taxation paid includes only the payments and receipts made during the period. Any provisions created in the accounts are ignored as they do not involve any movement of cash. Here, again, you must remember to deduct all payments.

Cash flows from investing activities (2)

This is the second section of the statement of cash flows. It covers cash inflows and outflows arising from investments made by the company. These investments include capital expenditure and the sales proceeds from the disposal of non-current assets and investments in other companies.

The relevant extract from the full statement of cash flow is reproduced below for reference.

Cash flows from investing activities	2		
Payments to purchase non-current assets	I	x	
Add: Proceeds from disposal of non-current assets	J	x	
Add/less: Sale/purchase of shares in other companies	K	x	
Add: Dividends received	L	x	
Net cash from/used in investing activities			xxx

Payments to purchase non-current assets (I)
The purchase of non-current assets will represent an outflow of cash and be deducted.

Proceeds from disposal of non-current assets (J)
These are a cash inflow and are added.

Sale/purchase of shares in other companies (K)
Companies often invest in other companies. If a company purchases shares in another company, this will be a cash outflow and subtracted from the cash flow. Conversely, if a company sells shares they held in other companies, the sales proceeds must be added to the cash flow.

Add dividends received (L)
These are a receipt of cash and so are added. The total of these give **net cash from (used in) investing activities**.

Cash flows from financing activities (3)

The section 'cash flows from financing activities' is concerned with the issue and redemption of share capital, the acquisition of new loans and the repayment of existing long-term debt. It also includes dividend payments. The relevant section is shown below:

Cash flows from/used in financing activities	3		
Redemption of shares – OSC and SP separately	M	x	
Add: Proceeds from share issues – OSC and SP separately	N	x	
Add: Proceeds from bank loans and debentures	O	x	
Less: Dividends paid	P	x	
Less: Repayment of loans and debentures	Q	x	
Net cash from financing activities			xxx

Less redemption of shares (M)

If a company buys back shares, it will result in a cash outflow. If the shares were redeemed with a share premium, then the ordinary share capital element and share premium element should be shown separately.

Add proceeds from share issues (N)

This is a cash inflow, so it is added.

Add proceeds from bank loans and debentures (0)

These are cash inflows; each source of capital should be shown separately.

Less dividends paid (P)

These are a cash outflow. You need to ensure that you account for the interim and the final dividends that are paid, showing each payment separately.

Less repayment of loans and debentures (Q)

This is a cash outflow, so it is deducted. The totals of these give net cash from financing activities.

The final part of the statement of cash flows looks at the increase or decrease in the cash and cash equivalents over the year, and the resulting figure should reconcile with the difference between the opening and closing balances found in the statements of financial position.

Net increase/decrease in cash and cash equivalents	4	xxx
Cash and cash equivalents at the beginning of the year	5	xxx
Cash and cash equivalents at the end of the year	5	xxx

Net increase/decrease in cash and cash equivalents (4)

This represents the increase or decrease in the cash and cash equivalents over the financial year. It is the total of the three sections of the statement of cash flows.

Cash and cash equivalents at the beginning and end of the year (5)

These figures are taken from the relevant statements of financial position. To obtain the correct balances, you must look at the current assets and current liabilities of the statements to calculate the actual cash and cash equivalents.

If all the calculations are correct, the change in the cash and cash equivalents (4) should reconcile with the opening and closing balances.

SUBJECT VOCABULARY

cash inflows movements of cash into a business
cash outflows movements of cash out of a business
financing activities changes in the equity and borrowings of a business
investing activities acquisition and disposal of non-current assets
operating activities activities of a company that produce revenue and do not include investing or financing activities
statement of cash flows a financial statement showing the cash inflows and the cash outflows of a company

THE IMPORTANCE OF LIQUIDITY TO A COMPANY

Cash is crucial for a company's functioning as it settles claims, pays employees, and buys inventory. Failure to find cash to pay trade payables, including taxation due, can lead to liquidation. Analysts and users closely monitor cash to assess a business's ability to survive and capitalize on commercial opportunities. Understanding liquidity is essential for understanding ratios and Chapter 4 of this book. The statement of cash flows is now part of standard accounting statements.