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DOCUMENT OF THE ACCOUNTING ADVISORY FORUM

# *CASH FLOW STATEMENTS*

DIRECTORATE-GENERAL XV
Internal Market and Financial Services

CONTENTS

**PREFACE**

This document deals with Cash Flow Statements. It has been prepared by the Accounting Advisory Forum (Forum) as an advisory document to the Commission. The views expressed in this document do not necessarily represent a Commission's official position.

The Forum is an advisory body of experts from main parties interested in accounting in the European Union. The Forum is not a standards-setting body. Its main function is to advise the Commission on accounting matters and possible ways to facilitate further harmonisation. The members of the Forum are invited on a personal basis. Their opinions, as expressed in this document, do not commit the organisations by whom they have been nominated, nor do they reflect the unanimous view of all the members.

The purpose of this publication is to stimulate discussions among standards-setters, preparers, users and auditors of accounts in Member States on the subject of Cash Flow Statements. The document examines the various possibilities for furthering the presentation of comparable and equivalent information within the context of the Accounting Directives.

This document includes a reproduction of IAS 7 "Cash Flow Statements".[1]

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## INTRODUCTION

1. Demand for a financial statement that assists users to assess a company's financial performance has increased considerably in recent years. Profit and loss accounts show the economic performance of a company, but alone they may not be sufficient to allow an understanding of its financial activity as the basis of making economic decisions, because the reported results and the cash flows of an enterprise are often wide apart in the short term, although in the long run such differences tend to disappear. This is why, in several countries, efforts have been made in order to enhance the financial information already contained in the profit and loss account and in the balance sheet by recommending or requiring a statement that provides a special insight into the financial activity for the year.

2. Various models have been proposed, to provide users with a basis to assess the ability of an enterprise to generate financial resources and its need for such resources, as well as the relationship between the generation of such resources and their employment. In meeting this objective, these statements are important not just in their own right, but also because they enhance the usefulness of the other statements, by being complementary to them and by often constituting a useful means of co-ordinating them. Other advantages usually recognised in these models are that they provide a description of the changes in financial resources and can be useful not only in analysing the past but also in making predictions. On the other hand, it is often pointed out that they suffer from difficulties in defining the terms used and from other problems relating to the nature of the other financial statements to which they are complementary.

3. The above mentioned models fall into two basic categories, depending on whether the analysis of the financial performances of an enterprise is conducted by focusing on the movements in its cash, or by looking at movements involving a wider range of assets, typically, although not exclusively, at movements in net working capital. These two approaches can also be combined in a single model (see further, Annex 2). Which approach is preferred often depends on the importance given to the various objectives in providing financial information that these analyses are supposed to satisfy. The use of a model based on the cash flow approach, in fact, does not diminish the usefulness of the information which can be obtained from a model based on the working capital approach, and vice-versa. Users and preparers have often to select the approach which seems to better suit their specific needs, and must be ready to renounce to the different perspective of information which they would enjoy if the other approach were followed.

4. When the focus is mainly on cash and liquidity, the cash flow statement is usually chosen, because it highlights movements in liquidity, and permits to understand how exactly cash has been generated and employed. It is also particularly useful to predict amounts of cash available for future investments. On the contrary, when the attention is concentrated on the whole effects of the financial management of the enterprise, without attaching too much importance to the fact that they have implied cash movements or not[2], the preference is often given to the working capital statement. This in fact gives an amount which reflects all the economic aspects of the

[2] For example, in the case of issues of own shares or the conversion of debts into capital.

ordinary activities of a company, while the cash flow statement provides users with a detailed analysis of cash flows.

5. In recent years there has been an increased use of cash flow statements. Investors, financial analysts[3], trade unions[4] and users in general show a clear preference for cash flow statements. Several standard setters[5] and stock exchanges[6] are increasingly convinced that cash flow statements are an extremely useful instrument, and therefore either require or recommend their use. A large number of preparers have promptly responded to these requests because they find cash flow statements also a very important management information tool. This trend can be explained by the increasing importance which is currently attached to indicators such as the ability of a company to generate and maintain adequate levels of liquidity, to pay back loans and obligations, to distribute dividends and to give early signs of financial distress.

6. It is understood that having sufficient cash is essential to the survival of any business. Cash flow statements indicate the ability of an entity to generate cash and cash equivalents. Shareholders, potential investors, creditors and other users look at cash in assessing the amounts, timing and certainty of prospective cash receipts from dividends or interests and the proceeds from sale, redemption or maturity of securities or loans and, more generally, in assessing a company's capability to meet its obligations when due. Cash flow Statements are also an easily understandable measure of performance and usually provide a good indication of financial distress. They can therefore be particularly useful to help less experienced users of financial reports to well understand the financial position of an enterprise.

7. When used in connection with profit and loss accounts and balance sheets, cash flow statements permit the financial information given by those statements to be examined under a "cash" point of view. This additional angle of observation is deemed very useful by most users and preparers, because it is not influenced by accruals and matching and therefore does not involve conventions and estimates. It may also enhance the comparability of the reporting of operating performances by different enterprises, as it eliminates most of the effects of using different accounting treatments for the same transactions and events.
The joint use of cash flow statements, balance sheets and profit and loss accounts also helps users in better evaluating the changes in net assets of an enterprise and in its financial structure (including its liquidity and solvency), as well as its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities. Moreover, this may permit to better appreciate the quality of the profits reported.

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[3] The European Federation of Financial Analysts strongly supports the preparation of cash flow statements.

[4] Requirements of the European Trade Union Confederation (published in 1977) are rather similar to IAS7.

[5] In Denmark, Portugal and the United Kingdom, for example.

[6] IOSCO is endorsing IAS7, which is also accepted by the US SEC.

## OBJECTIVE AND STRUCTURE OF THE DOCUMENT

8. Cash flow statements are dealt with in International Accounting Standard 7 "Cash flow statements". This standard is largely used throughout the world. From a European point of view, an agreement in general can be expressed with the guidelines provided therein[7]. However, European standard setting bodies and other organisations concerned with these matters might need to know to which extent such guidelines are applicable in a European context. The purpose of the present document is therefore to give them arguments in favour or against the approach contained in that standard, whenever it seems useful to comment on it in the light of current European practices and regulations.

9. The structure of this document has been organised in the order used by IAS7, but that standard has not been taken up and integrated into the text. The objective, in fact, is to concentrate on the differences arising from the European context, while providing the reader with an easy reference to IAS7 (attached as Annex 1), knowledge of which is essential to understanding this paper. All the parts of IAS7 not explicitly mentioned in this document should be considered as agreed in general.
   Examples of a cash flow statement, of a net working capital statement and of a statement which provides a linkage between the two, drawn up using the figures contained in IAS7-Appendix 1, have been attached as Annex 2, in order to show the different sorts of information that these kinds of statements can provide.
   A FEE survey on cash flow statements has also been attached to this document (see Annex 3), as a useful overview of the current situation in Europe.

10. IAS7 does not address in detail a number of technical problems, concerning for example foreign currency translation effects and the treatment of subsidiaries in consolidation.

    Although such problems are not analysed in this document, it is recognised that these areas may deserve further examination in the near future.

## SCOPE

11. Paragraphs 1 to 3 of IAS7 require all enterprises to present a cash flow statement, because companies need cash for essentially the same reasons, regardless of the nature of their activities and of whether cash can be viewed as the product of the enterprise or not.

12. From a European point of view, this requirement cannot be fully accepted, because it is necessary to consider the different role that accounts play, depending on the size and structure of the entities to which they refer. Separate considerations should therefore be expressed for large, medium, small and listed companies, as well as groups.

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[7] According to the opinion of the Contact Committee on the Accounting Directives, as the Directives do not deal with cash flow statements, the requirements of IAS7 do not raise any problem of conformity with the general principles contained in the Accounting Directives. See the document "An examination of the conformity between the International Accounting Standards and the European Accounting Directives", Luxembourg, 1996, paragraph 2.

13. Large companies should be required to provide cash flow statements because, as for the other part of the financial information, this is in the interests of both shareholders and third parties. Listed companies (regardless of their size), in order to be admitted to quotation, have to present a funds statement in accordance with Council Directive 80/390/EEC. In a number of Member States this requirement is now interpreted as meaning the publication of a cash flow statement.

14. In order to avoid increasing the burden on small companies, they should not be required to provide a cash flow statement. The preparation of a cash flow statement is nevertheless recommended in their own interest, both to highlight areas of financial risk for owners/managers and to improve their relationships with creditors, notably lending bankers.

15. As far as medium-sized companies are concerned, it would appear useful that they also prepare and publish cash flow statements. However, other factors might have to be taken into account in judging the extent to which this recommendation can be applied to these companies. In fact reasons for not increasing burdens on medium-sized companies might still prevail over the consideration of providing shareholders and third parties with additional financial information.

16. As far as insurance and banking institutions are concerned, there is no reason why they should be exempted from the obligation of preparing some form of analysis of their cash flows. However, the specific nature of the business should be taken into account in deciding the form of cash flow statement to be prepared. As work is being done on this matter, this document will not deal specifically with cash flow statements of insurance and banking institutions.

17. Groups should be required to draw up consolidated cash flow statements, which should reflect the cash flows of the group as a whole.

18. Besides the considerations expressed in paragraph 15 above, when companies are exempted from preparing annual or consolidated accounts, they should accordingly also be exempted from the preparation of the respective cash flow statements. Because cash flow statements are complementary to profit and loss accounts and balance sheets, it would in fact be logical for them to be provided whenever these statements are prepared.[8] Definitions of small and medium sized companies and conditions under which companies are required to draw up annual and consolidated accounts are contained in the 4th and 7th Directives.

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8 There are differing views on the usefulness of requiring the preparation of cash flow statements for wholly owned subsidiaries. Some argue that these companies should always be exempted from the obligation to prepare cash flow statements, because these would give information of limited use for 100% subsidiaries (which are almost always under the strict central treasury control of their parent companies). However, the need to protect minority interests would prevent this exemption being applied to subsidiaries controlled with less than a 100% ownership. Others contest these arguments and are convinced that cash flow statements are always a necessary part of the financial information of an enterprise, if not for shareholders at least for creditors and other third parties. In addition, it might be difficult to justify different cash flow reporting requirements for subsidiaries, depending on the percentage of control (100% or less).

## DEFINITIONS

19. IAS7 (para. 6) states: "cash flows are inflows and outflows of cash[9] and cash equivalents". Cash equivalents are defined as "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[10]. Although there is no agreement on a single definition, the one proposed by the standard seems to be generally acceptable. In fact, while an extended definition is likely to include items which are not really liquid, a restricted one, which does not include cash equivalents, is likely to cause distortions and seems not to reflect the reality of the cash management policies of companies (reporting entities often do not keep cash immediately available, but invest any cash in excess of their immediate needs in short-term and highly liquid instruments[11]).

20. As indicated in IAS7 (para. 7), an investment should normally be considered as a cash equivalent when it has a short maturity of, say, three months or less from the date of acquisition. The time limit is justified on the basis that, over a longer period, a change in interest rates could significantly affect the value of the investment. The relevant date is maturity on acquisition (and not the period to maturity)[12], to avoid misleading reclassifications arising from the passage of time rather than cash flows arising from actual transactions. However, any limit to the maturity of items that can qualify as cash equivalent is somewhat arbitrary because different companies may distinguish between cash management and investments on different ranges of time to maturity. Therefore, a period different from the three months indicated above can also be considered as acceptable in defining cash equivalents, provided that this different definition is explained and consistently followed by the enterprise over time.

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9 Cash includes: cash in hand and deposits repayable on demand, as well as other kind of accounts with banks or other financial institutions where the customer may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty. Cash also includes cheques and payment orders already emitted but still to be cashed. Cash includes the above even if they are denominated in foreign currencies.

10 Not all items that can be realisable immediately and without risks can be considered as cash equivalents. Cash equivalents are held for the purpose of meeting short-term cash commitments and are in fact used in place of cash, as a means of earning interests on temporarily idle funds. The following (non-exhaustive) examples may provide some clarification on this point:

Commercial receivables and liabilities within three months are not cash equivalents, because they are part of the trading activities of the enterprise and are not held for the purpose of employing money, but are the result of a sale or purchase of goods and/or services. In the same way, acceptance credits, promissory notes and other financial documents relating to trading activities are not cash equivalents, unless they have been traded (bought and sold) as investments (i.e. a way of investing money) and are held to meet short-term cash commitments, in which case they can be considered as cash equivalents, provided that the other criteria of the definition are met.

Commercial paper held by a company is a cash equivalent because it represents a short-term, highly liquid investment held to meet short-term cash commitments. Commercial paper, however, is not a cash equivalent for the issuer.

11 The UK's ASB has recently proposed, in the revision of its standard on cash flow statement, a restricted definition of cash flows, limited to movements in cash (i.e. excluding any cash equivalents). Movements in current asset investments held as readily disposable stores of value (i.e. both disposable by the reporting entity without curtailing or disrupting its business and traded in an active market) would now be shown under a separate headline called "management of liquid resources".

12 For example, both a one-month Treasury bill and a five-years Treasury note purchased within three months from maturity qualify as cash equivalents. However, a Treasury note purchased five years ago does not become a cash equivalent when its remaining maturity is three months or less. If an investment purchased with more than three months to maturity became a cash equivalent when its remaining maturity period fell to three months, the cash flow statement would reflect as cash flows the maturing of investments where no external cash flow have occurred.

21. Bank overdrafts are normally repayable on demand, but they may also be used as a source of finance which extends for a significant period of time (and particularly more than three months). For this reason it seems important to stress the point that para. 8 of IAS7 should be interpreted to have the sense that companies should be required to examine duly the substance of their bank overdrafts and to allocate them accordingly, either as part of cash and cash equivalents (and therefore netting them off against the positive balances of cash and cash equivalents) or as part of the financing activity of the enterprise. Bank overdrafts used for long-term financing should in no case be considered as parts of cash or cash equivalents.

## PRESENTATION

22. IAS7 states that cash flow statements should report cash flows during the period classified at least by operating, investing and financing activities. Each company should therefore assign flows to one activity or the other in a way which is the most appropriate to its business.

23. It is important to stress the following considerations:

a) The presentation chosen must be consistently followed by the enterprise over the years and any departures must be fully disclosed.

b) As cash flow statements are supposed to be complementary to the balance sheet and the profit and loss account, it seems logical that they have a similar status. Accordingly, they should be considered part of the annual accounts and, as such, should be audited and published.

c) Comparative figures should be provided to the same extent that they are provided for the corresponding profit and loss account and balance sheet.

d) Cash flows should be reported to the extent that they are material for the analysis of the financial performances of an enterprise, considering also the level of detail required for the preparation of the profit and loss account and the balance sheet by the 4th and 7th Directives [13].

## REPORTING THE ACTIVITIES

### Reporting the Operating Activities

24. As indicated in paragraph 18 of IAS7, two basic methods of reporting operating activities exist: the direct method and the indirect method. Under the direct method, operating activities are reported separately disclosing major classes of gross cash receipts and gross cash payments. Under the indirect method, cash flows from operating activities are calculated by adjusting net profit (or loss) for the effect of transactions of a non-cash nature. The use of both the direct and indirect methods is allowed.

[13] Cash flow statements are complementary to balance sheets and profit and loss accounts, and should therefore give information directly related to that contained in those statements. Accordingly, European companies are expected to prepare cash flow statements with a level of detail which is logically deriving from that used in the preparation of the related balance sheets and profit and loss accounts. For example, when an abridged profit and loss account or balance sheet is presented, the cash flow also can be limited to the corresponding abridged information. On the other hand, if Member States require details in addition to those imposed by the Accounting Directives, there should be no problem in their requiring similar details for cash flow statements.

25. Some of the advantages of the direct method are the following:

a) The direct method is the only one that shows the full amount of the cash inflows and outflows arising from the operating activities. As a result, the cash flow statement provides evidence of all actual inflows and outflows generated and employed by the company and therefore would be more consistent with the objective of the statement.

b) The direct method provides information about the amount of sales that have actually resulted in cash inflows. This can be very useful in better assessing the economic value of sales shown in the profit and loss account.

26. Some of the advantages of the indirect method are the following:

a) The reconciliation of the result from the profit and loss account and the cash generated by or used in operating activities is useful to understand the "liaison" between economic activities and the generation and absorption of cash.

b) The application of the direct method may involve significant incremental costs over those already required to apply the indirect method, when the level of detail of cash inflows and outflows includes subcategories of receivables (segmental information) or payables (suppliers and employees).

27. In order to reap the benefits of both methods, while maintaining the focus of the statement on cash receipts and payments, it should be required that, where the direct method of reporting operating activities is applied, a reconciliation of net income and net cash flow from operating activities is provided.

28. It seems useful to remind the reader of the fact that the accounting information necessary to report the operating activities using both the direct and indirect methods of presentation can be obtained :

a. in a direct way, by collecting figures directly from the accounting records of the enterprise ( as indicated in IAS7 paragraphs 19a and 20/2nd indent)

b. in an indirect way, by adjusting items shown in the profit and loss account ( as described in IAS7 paragraphs 19b and 20/1st indent).

The way of obtaining the financial information indicated sub a. ("direct way") requires the company to have available an accounting system that enables the correct recording and allocation of cash inflows and outflows immediately when they occur : for this reason it is at present uncommon.

**Reporting the Investing and Financing activities**

29. In addition to what is contained in IAS7 para. 21, some people would like to add that additional information of net debt is very useful. This could be obtained partly by including a subtotal with the heading "cash flow before financing" and partly by a reconciliation of the movements in cash and cash equivalents to movements in net debt.

**Reporting on a net basis**

30. Reporting cash flows on a net basis is permitted by IAS7 in a limited number of cases (see IAS7, paras. 22-24). This is because, in general, meaningful assessments of cash flow require reporting of gross, rather than net, cash receipts and cash payments. For the few items specified in these paragraphs, however, information on both cash receipts and cash payments may be no more relevant than information about only the net change.

## FOREIGN CURRENCY

31. In paragraphs 25 to 28, IAS7 requires that cash flows arising from transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying the exchange rate as of the date when the cash is received or paid (date of the cash flow), except where hedged.

32. It seems useful to remark that, for practical purposes, the use of the average exchange rate of the period can be considered as a close approximation.

33. Another important comment to the IAS7 requirement is that, as far as consolidated accounts of non-integrated operations are concerned, the use of the closing rate of exchange should be considered as acceptable, provided that it has been used in the conversion of the other statements. In fact, as indicated in the document on foreign currency translation (Doc XV/304/91 rev.5, paragraphs 33-34), the closing rate is applicable in the conversion of profit and loss accounts of non integrated operations. In order to be consistent with this approach and not to create distortions (particularly when the indirect method is applied) the use of such an exchange rate is also admitted in the preparation of cash flow statements.

## EXTRAORDINARY ITEMS

34. According to IAS7 (para. 29), extraordinary items should be classified as arising from operating, investing and financing activities as appropriate, and separately disclosed.

## INTEREST AND DIVIDENDS

35. IAS7, in its para.31, requires that cash flows from interest and dividends paid and received are classified in a consistent manner from period to period either as operating, investing or financial activities, and disclosed separately. The classification in one category or another depends on the different appreciation that companies have of the role that these items play in their accounts.

36. Considering the fact that no general consensus on this matter exists, there is no reason to not adopt a similar broad approach. It should be noted, however, that an alternative solution, which is at present gaining support, is seen by many people as giving more guidance and, at the same time, improving comparability. This would consist in requiring that cash flows relating to interest and dividends paid and received are shown together, by allocating them under a separate heading, usually after the cash flows from operating activities.

## TAXATION

37. No particular remarks seem necessary to the requirements of paras. 35 and 36 of IAS7, where it is stated that income taxes should be separately disclosed and usually classified as operating activities, unless they can be specifically identified with financing or investing activities. As it is often difficult to allocate them appropriately, they are usually shown in one place.

38. Further comments seem to be necessary on VAT and other sales taxes. Some consider that the inclusion of these kinds of taxes in cash flows would introduce a discrepancy between the figures contained in the profit and loss account and those shown in the cash flow statement. On the other hand, it has been pointed out that their exclusion results in amounts being shown as inflows and outflows which are not those that actually occurred. In conclusion, sales taxes have only a short-term effect on the entity's overall position but including them in the cash flow statement has an effect limited to the net amount to be paid or received from authorities. Therefore, it seems impossible to state a preference for one treatment or another. The policy chosen by the enterprise in this respect must be clearly disclosed and consistently followed over the years.

## INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES

39. No specific comments on the contents of IAS7 paras. 37 and 38 seem necessary.

## ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES AND OTHER BUSINESS UNITS

40. No specific comments on the contents of IAS7 paras. 39-42 seem necessary.

## NON-CASH TRANSACTIONS

41. No specific comments on the contents of IAS7 paras. 43 and 44 seem necessary.

## COMPONENTS OF CASH AND CASH EQUIVALENTS

42. It seems useful to underline the requirements provided by IAS7 para. 45, where the importance of a clear description of the components of cash and cash equivalents is highlighted. Without this provision in fact, differences in cash management policies between entities and resulting differences in how cash equivalents are defined could significantly reduce the comparability of cash flow statements. For instance, it could be useful to indicate which part of marketable securities can be considered as cash equivalent and which cannot.

## DISCLOSURES

43. The disclosures indicated in IAS7, as well as those expressly mentioned in this document (paras. 20, 23a), 38) should be included in the notes to the accounts. It should be emphasised that the disclosure of the additional information mentioned in IAS7 paras. 50, 51, 52 is encouraged but not required.

# ANNEX 1

### INTERNATIONAL ACCOUNTING STANDARD 7 (REVISED 1992)

(TEXT WITHOUT APPENDIX)

## CASH FLOW STATEMENTS

This revised International Accounting Standard became effective for financial statements covering periods beginning on or after 1 January 1994, and superseded International Accounting Standard 7, Statement of Changes in Financial Position.

IAS 7 (revised 1992)

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**International Accounting Standard 7 (revised 1992)**

# Cash Flow Statements

**Objective**

IAS (revised 1992)

# INTERNATIONAL ACCOUNTING STANDARD 7

(revised 1992)

## Cash Flow Statements

*The standards, which have been set in bold italic type should be read in the context of the background material and implementation guidance in this Standard, and in the context of the Preface to International Accounting Standards. International Accounting Standards are not intended to apply to immaterial items (see paragraph 12 of the Preface).*

## Objective

Information about the cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation.

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

## Scope

***1. An enterprise should prepare a cash flow statement in accordance with the requirements of this Standard and should present it as an integral part of its financial statements for each period for which financial statements are presented.***

2. This Standard supersedes International Accounting Standard IAS 7, Statement of Changes in Financial Position, approved in July 1977.

3. Users of an enterprise's financial statements are interested in how the enterprise generates and uses cash and cash equivalents. This is the case regardless of the nature of the enterprise's activities and irrespective of whether cash can be viewed as the product of the enterprise, as may be the case with a financial institution. Enterprises need cash for essentially the same reasons however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors. Accordingly, this Standard requires all enterprises to present a cash flow statement.

## Benefits of Cash Flow Information

4. A cash flow statement, when used in conjunction with the rest of the financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, 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 enterprise 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 enterprises. It also enhances the comparability of the reporting of

operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

5. Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also 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.

## Definitions

***6. The following terms are used in this Standard with the meanings specified :***

***<u>Cash</u> comprises cash on hand and demand deposits.***

***<u>Cash equivalents</u> 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.***

***<u>Cash flows</u> are inflows and outflows of cash and cash equivalents.***

***<u>Operating activities</u> are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.***

***<u>Investing activities</u> are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.***

***<u>Financing activities</u> are activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise.***

## Cash and Cash Equivalents

7 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 equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. 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. 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.

8. Bank borrowings are generally considered to be financing activities. However, in some countries, bank overdrafts which are repayable on demand form an integral part of an enterprise’s cash management. In these circumstances, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.

9. Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an enterprise rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

## Presentation of a Cash Flow Statement

***10 The cash flow statement should report cash flows during the period classified by operating, investing and financing activities.***

11 An enterprise presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities of the financial position of the enterprise and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

12 A single transaction may include cash flows that are classified differently. For example, when the cash repayment of a loan includes both interest and capital, the interest element may be classified as an operating activity and the capital element is classified as a financing activity.

**Operating Activities**

13 The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows to repay loans, maintain the operating capability of the enterprise, 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.

14 Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net 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 receipts and cash payments of an insurance enterprise 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

g) cash receipts and payments from contracts held for dealing or trading purposes.

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

15 An enterprise 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. Similarly, 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 enterprise.

**Investing Activities**

16 The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are :

a) cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalised 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 enterprises 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 enterprises and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

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.

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.

**Financing activities**

17 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 enterprise. 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 enterprise's shares;

c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short 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.

## Reporting Cash Flows from Operating Activities

***18 An enterprise should 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 net 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.***

19 Enterprises are encouraged to report cash flows from operating activities using the direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

a) from the accounting records of the enterprise; or

b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial institution) and other items in the income statement 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.

20 Under the indirect method, the net cash flow from operating activities is determined by adjusting net 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 taxes, unrealised foreign currency gains and losses, undistributed profits of associates, and minority interests; and

c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the income statement and the changes during the period in inventories and operating receivable and payables.

## Reporting Cash Flows from Investing and Financing Activities

***21 An enterprise should 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.***

## Reporting Cash Flows on a Net Basis

***22 Cash flows arising from the following operating, investing or financing activities may be reported on a net basis :***

***a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise; and***

***b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.***

23 Examples of cash receipts and payments referred to in paragraph 22 (a) are :

a) the acceptance and repayment of demand deposits of a bank;

b) funds held for customer by an investment enterprise; and

c) rents collected on behalf of, and paid over to, the owners of properties.

Examples of cash receipts and payments referred to in paragraph 22 (b) are advances made for, and the repayment of :

a) principal amounts relating to credit card customers;

b) the purchase and sale of investments; and

c) other short-term borrowings, for example, those which have a maturity period of three months or less.

***24 Cash flows arising from each of the following activities of a financial institution may be reported on a net basis :***

***a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;***

***b) the placement of deposits with and withdrawal of deposits from other financial institutions; and***

c) ***cash advances and loans made to customers and the repayment of those advances and loans***

## Foreign Currency Cash Flows

***25 Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow.***

***26 The cash flows of a foreign subsidiary should be translated at the exchange rates between the reporting currency and the foreign currency at the dates of the cash flows.***

27 Cash flows denominated in a foreign currency are reported in a manner consistent with International Accounting Standard IAS 21, Accounting for the Effects of Changes in Foreign Exchange Rates. This permits the use of an exchange rate that approximates the actual rate. For example, a weighted average exchange rate for a period may be used for recording foreign currency transactions or the translation of the cash flows of a foreign subsidiary. However, IAS21 does not permit use of the exchange rate at the balance sheet date when translating the cash flows of a foreign subsidiary.

28 Unrealised 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 cash flow statement 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.

## Extraordinary Items

***29 The cash flows associated with extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.***

30 The cash flows associated with extraordinary items are disclosed separately as arising from operating, investing or financing activities in the cash flow statement, to enable users to understand their nature and effect on the present and future cash flows of the enterprise. These disclosures are in addition to the separate disclosures of the nature and amount of extraordinary items required by International Accounting Standard IAS8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.

## Interest and Dividends

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

32 The total amount of interest paid during a period is disclosed in the cash flow statement whether it has been recognised as an expense in the income statement or capitalised in accordance with the allowed alternative treatment in International Accounting Standard IAS23, Borrowing Costs.

33 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 enterprises. Interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of net 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.

34 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 enterprise to pay dividends out of operating cash flows.

## Taxes on income

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

36 Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in a cash flow statement. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transaction. Therefore, 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. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

## Investments in Subsidiaries, Associates and Joint Ventures

37 When accounting for an investment in an associate or a subsidiary accounted for by use of the equity or cost method, an investor restricts its reporting in the cash flow statement to the cash flow between itself and the investee, for example, to dividends and advances.

38 An enterprise which reports its interest in a jointly controlled entity (see International Accounting Standard IAS31, Financial Reporting of Interests in Joint Ventures) using proportionate consolidation, includes in its consolidated cash flow statement its proportionate share of the jointly controlled entity’s cash flows. An enterprise which reports such an interest using the equity method includes in its cash flow statement the cash flows in respect of its investments in the jointly controlled entity, and distributions and other payments or receipts between it and the jointly controlled entity.

## Acquisitions and Disposals of Subsidiaries and Other Business Units

***39 The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as investing activities.***

***40 An enterprise should disclose, in aggregate, in respect of both acquisitions and disposals of subsidiaries or other business units during the period each of the following :***

***a) the total purchase or disposal consideration;***

***b) the portion of the purchase or disposal consideration discharged by means of cash and cash equivalents;***

***c) the amount of cash and cash equivalents in the subsidiary or business unit acquired or disposed of; and***

***d) the amount of the assets and liabilities other than cash or cash equivalents in the subsidiary or business unit acquired or disposed of, summarised by each major category.***

41 The separate presentation of the cash flow effects of acquisitions and disposals of subsidiaries and other business units as single line items, together with the separate disclosure of the amounts of assets and liabilities acquired or disposed of, helps to distinguish those cash flows from the cash flows arising from the other operating, investing and financing activities. The cash flow effects of disposals are not deducted from those of acquisitions.

42 The aggregate amount of the cash paid or received as purchase or sale consideration is reported in the cash flow statement net of cash and cash equivalents acquired or disposed of.

## Non-cash Transactions

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

44 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 enterprise. The exclusion of non-cash transactions from the cash flow statement is consistent with the objective of a cash flow statement as 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 enterprise by means of an equity issue; and

c) the conversion of debt to equity.

**Components of Cash and Cash Equivalents**

***45 An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.***

46 In view of the variety of cash management practices and banking arrangements around the world and in order to comply with International Accounting Standard IAS 1, Disclosure of Accounting Policies, an enterprise discloses the policy which it adopts in determining the composition of cash and cash equivalents.

47 The effect of any change in the policy for determining components of cash and cash equivalents, for example, a change in the classification of financial instruments previously considered to be part of an enterprise's investment portfolio, is reported in accordance with International Accounting Standard IAS8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.

**Other Disclosures**

***48 An enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by the group.***

49 There are various circumstances in which cash and cash equivalent balances held by an enterprise are not available for use by the group. Examples include cash and cash equivalent balances held by a subsidiary that operates in a country where exchange controls or other legal restrictions apply when the balances are not available for general use by the parent or other subsidiaries.

50 Additional information may be relevant to users in understanding the financial position and liquidity of an enterprise. Disclosure of this information, together with a commentary by management, is encouraged and may include :

a) the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities;

b) the aggregate amounts of the cash flows form each of operating, investing and financing activities related to interests in joint ventures reported using proportionate consolidation;

c) the aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity; and

d) the amount of the cash flows arising from the operating, investing and financing activities of each reported industry and geographical segment (see International Accounting Standard IAS14, Reporting Financial Information by Segment).

51 The separate disclosure of cash flows that represent increases in operating capacity and cash flows that are required to maintain operating capacity is useful in enabling the user to determine whether the enterprise is investing adequately in the maintenance of its operating capacity. An enterprise that does not invest adequately in the maintenance of its operating capacity may be prejudicing future profitability for the sake of current liquidity and distributions to owners.

52 The disclosure of segmental cash flows enables user to obtain a better understanding of the relationship between the cash flows of the business as a whole and those of its components parts and the availability and variability of segmental cash flows.

## Effective Date

***53 This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1994.***

# ANNEX 2

The following examples are intended to provide the reader with a clearer understanding of the different sorts of information given by the various kinds of statements which have been quoted in the document.

Part A contains appendix 1 of IAS7, which provides a numerical example of  a cash flow statement as described in that standard.

Part B contains an example of working capital statements.

Part C contains a model which integrates a cash flow approach and a working capital statement.

All examples are drawn up by using figures contained in Appendix 1 of IAS7 and are based on the same case assumptions, so that comparisons between the examples are possible.

## ANNEX 2 PART A

**INTERNATIONAL ACCOUNTING STANDARD 7 (REVISED 1992)**
**CASH FLOW STATEMENT**

## APPENDIX 1

**CASH FLOW STATEMENT FOR AN ENTERPRISE OTHER THAN A FINANCIAL INSTITUTION**

*The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.*

1. The examples show only current period amounts. Corresponding amounts for the preceding period are required to be presented in accordance with International Accounting Standard IAS 5, Information to be Disclosed in Financial Statements.

2. Information from the income statement and balance sheet is provided to show how the statements of cash flows under the direct method and indirect method have been derived. Neither the income statement nor the balance sheet are presented in conformity with the disclosure and presentation requirements of International Accounting Standards.

3. The following additional information is also relevant for the preparation of the statements of cash flows :

- all of the shares of a subsidiary were acquired for 590. The fair values of assets acquired and liabilities assumed were as follows :

| | |
|---|---|
| inventories | 100 |
| accounts receivable | 100 |
| cash | 40 |
| property, plant and equipment | 650 |
| trade payables | 100 |
| long-term debt | 200 |

- 250 was raided from the issue of share capital and a further 250 was raised from long-term borrowings.

- interest expense was 400 of which 170 was paid during the period. 100 relating to interest expense of the prior period was also paid during the period.

- dividends paid were 1,200.

- the liability for tax at the beginning and end of the period was 1 000 and 400 respectively. During the period, a further 200 tax was provided for. Withholding tax on dividends received amounted to 100.

- during the period, the group acquired property, plant and equipment with an aggregate cost of 1,250 of which 900 was acquired by means of finance leases. Cash payments of 350 were made to purchase property, plant and equipment.

- plant with original cost of 80 and accumulated depreciation of 60 was sold for 20.

- accounts receivable as at end of 19-2 include 100 of interest receivable.

**CONSOLIDATED INCOME STATEMENT FOR THE PERIOD ENDED 19-2**

| | |
|---|---|
| Sales | 30,650 |
| Cost of sales | (26,000) |
| | ---------- |
| Gross profit | 4,650 |
| Depreciation | (450) |
| Administrative and selling expenses | (910) |
| Interest expense | (400) |
| Investment income | 500 |
| Foreign exchange loss | (40) |
| | --------- |
| Net profit before taxation and extraordinary item | 3,350 |
| Extraordinary item - Insurance proceeds from earthquake disaster settlement | 180 |
| | ----------- |
| Net profit after extraordinary item | 3,530 |
| Taxes on income | (300) |
| | ----------- |
| Net profit | 3,230 |

**CONSOLIDATED BALANCE SHEET AS AT END OF 19-2**

| | | 19-2 | | 19-1 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | | 410 | | 160 |
| Accounts receivable | | 1,900 | | 1,200 |
| Inventory | | 1,000 | | 1,950 |
| Portfolio investments | | 2,500 | | 2,500 |
| Property, plant and equipment at cost | 3,730 | | 1,910 | |
| Accumulated depreciation | (1,450) | | (1,060) | |
| Property, plant and equipment net | | 2,280 | | 850 |
| Total assets | | 8,090 | | 6,660 |
| **Liabilities** | | | | |
| Trade payables | | 250 | | 1,890 |
| Interest payable | | 230 | | 100 |
| Income taxes payable | | 400 | | 1,000 |
| Long term debt | | 2,300 | | 1,040 |
| Total liabilities | | 3,180 | | 4,030 |
| **Shareholders Equity** | | | | |
| Share capital | | 1,500 | | 1,250 |
| Retained earnings | | 3,410 | | 1,380 |
| Total shareholders equity | | 4,910 | | 2,630 |
| Total liabilities and shareholders equity | | 8,090 | | 6,660 |

## DIRECT METHOD CASH FLOW STATEMENT (PARAGRAPH 18A)

| | | 19-2 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash receipts from customers | 30,150 | |
| Cash paid to suppliers and employees | (27,600) | |
| Cash generated from operations | 2,550 | |
| Interest paid | (270) | |
| Income taxes paid | (900) | |
| Cash flow before extraordinary item | 1,380 | |
| Proceeds from earthquake disaster settlement | 180 | |
| *Net cash from operating activities* | | 1,560 |
| **Cash flows from investing activities** | | |
| Acquisition of subsidiary X, net of cash acquired (Note A) | (550) | |
| Purchase of property, plant and equipment (Note B) | (350) | |
| Proceeds from sale of equipment | 20 | |
| Interest received | 200 | |
| Dividends received | 200 | |
| *Net cash used in investing activities* | | (480) |
| **Cash flows from financing activities** | | |
| Proceeds from issuance of share capital | 250 | |
| Proceeds from long-term borrowings | 250 | |
| Payment of finance lease liabilities | (90) | |
| Dividends paid * | (1,200) | |
| *Net cash used in financing activities* | | (790) |
| **Net increase cash and cash equivalents** | | 290 |
| **Cash and cash equivalents at begging of period (note C)** | | 120 |
| **Cash and cash equivalents at end of period (note C)** | | 410 |

* This could also be shown as an operating cash flow.

**INDIRECT METHOD CASH FLOW STATEMENT (PARAGRAPH 18B)**

| | | 19-2 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net profit before taxation, and extraordinary item | 3,350 | |
| Adjustments for : | | |
| Depreciation | 450 | |
| Foreign exchange loss | 40 | |
| Investment income | (500) | |
| Interest expense | 400 | |
| Operating profit before working capital changes | 3,740 | |
| Increase in trade and other receivable | (500) | |
| Decrease inventories | 1,050 | |
| Decrease in trade payables | (1,740) | |
| Cash generated from operations | 2,550 | |
| Interest paid | (270) | |
| Income taxes paid | (900) | |
| Cash flow before extraordinary item | 1,380 | |
| Proceeds from earthquake disaster settlement | 180 | |
| *Net cash from operating activities* | | 1,560 |
| **Cash flows from investing activities** | | |
| Acquisition of subsidiary X net of cash acquired (Note A) | (550) | |
| Purchase of property, plant and equipment (Note B) | (350) | |
| Proceeds from sale of equipment | 20 | |
| Interest received | 200 | |
| Dividends received | 200 | |
| *Net cash used in investing activities* | | (480) |
| **Cash flows from financing activities** | | |
| Proceeds from issuance of share capital | 250 | |
| Proceeds from long-term borrowings | 250 | |
| Payment of finance lease liabilities | (90) | |
| Dividends paid (*) | (1,200) | |
| *Net cash used in financing activities* | | (790) |
| **Net increase in cash and cash equivalents** | | 290 |
| **Cash and cash equivalents at beginning of period (Note C)** | | 120 |
| **Cash and cash equivalents at end of period (Note C)** | | 410 |

* This could also be shown as an operating cash flow.

**NOTES TO THE CASH FLOW STATEMENT (DIRECT METHOD AND INDIRECT METHOD)**

**A. ACQUISITION OF SUBSIDIARY**

During the period the group acquired subsidiary X. The fair value of assets acquired and liabilities assumed were as follows :

| | |
|---|---|
| Cash | 40 |
| Inventories | 100 |
| Accounts receivable | 100 |
| Property, plant and equipment | 650 |
| Trade payables | (100) |
| Long-term debt | (200) |
| Total purchase price | 590 |
| Less: : Cash of X | (40) |
| Cash flow on acquisition net of cash acquired | 550 |

**B. PROPERTY, PLANT AND EQUIPMENT**

During the period, the Group acquired property, plant and equipment with an aggregate cost of 1,250 of which 900 was acquired by means of finance leases. Cash payments of 350 were made to purchase property, plant and equipment.

**C. CASH AND CASH EQUIVALENTS**

Cash and cash equivalents consist of cash on hand and balances with banks, and investments in money market instruments. Cash and cash equivalents included in the cash statement comprise the following balance sheet amounts :

| | **19-2** | **19-1** |
|---|---|---|
| Cash on hand and balances with banks | 40 | 25 |
| Short-term investments | 370 | 135 |
| Cash and cash equivalents as previously reported | 410 | 160 |
| Effect of exchange rate changes | - | (40) |
| Cash and cash equivalents as restated | 410 | 120 |

Cash and cash equivalents at the end of the period include deposits with banks of 100 held by a subsidiary which are not freely remissible to the holding company because of currency exchange restrictions.

The Group has undrawn borrowing facilities of 2,000 of which 700 may be used only for future expansion.

**D. SEGMENT INFORMATION**

| | Segment A | Segment B | Total |
|---|---|---|---|
| Cash flows from: | | | |
| Operating activities | 1,700 | (140) | 1,560 |
| Investing activities | (640) | 160 | (480) |
| Financing activities | (570) | (220) | (790) |
| | 490 | (200) | 290 |

**ALTERNATIVE PRESENTATION**

**(INDIRECT METHOD)**

As an alternative, in an indirect method cash flow statement, operating profit before working capital changes is sometimes presented as follows :

| | | |
|---|---|---|
| Revenues excluding investment income | 30,650 | |
| Operating expense excluding depreciation | (26,910) | |
| Operating profit before working capital changes | | 3,740 |

## ANNEX 2 PART B

### Statement of source and application of funds

A working capital statement (statement of source and application of funds) aims at isolating the resources which an enterprise is mobilizing in order to finance its activities.

The logic behind the working capital statement is to identify the fund flows which justify changes in working capital, net changes in working capital requirements, and net increases in "cash and cash equivalents".

The model working capital statement reflects this logic and is generally structured in two parts :

- an analysis of real fund flows according to the aspect of financial policy to which they relate: self-financing (internally generated funds from operations), financing activities or investing activities;
- an analysis of changes in working capital, net changes in working capital requirements, and net increases in "cash and cash equivalents".

Such an analysis of changes in fund flows provides a very precise answer to the fundamental question which is at the centre of financial policy: is the enterprise financing its investments by generating sufficient funds through its operations, or does it need to resort to capital markets, either through increases in capital or through loans ?

The changes in working capital obtained from the captions of the balance sheet must correspond to the real fund flows shown by the analysis based on the different aspects of financial policy. The net working capital is by definition the difference between "permanent capital employed" (capital and reserves, provisions for liabilities and charges and amounts payable after one year) and fixed assets including amounts receivable after one year.

Changes in working capital are analysed between self-financing (internally generated funds from operations), financing activities, investing activities and other movements, detailing each time whether these are applications or origins.

As to net changes in working capital requirements, they are the difference between certain short-term assets (inventories, amounts receivable within one year, deferred charges and accrued income) and certain liabilities (non-financial amounts payable within one year, accrued charges and deferred income).

The working capital statement presented below corresponds to the classic presentation of a statement of source and application of funds based on net working capital.

From a financial point of view, such a statement must theoretically be a source of information on the different aspects of the enterprise's financial policy, and emphasises the data resulting from its operational activities, its investments and/or disinvestments, its dividend policy and its financing policy.

| Operations | Application of funds | Source of funds |
|---|---|---|
| **Operating activities** | | |
| Gross profit | | 4650 |
| Administrative and selling expenses | 910 | |
| **Cash flow from operating activities** | | |
| Financial incomes (charges) | 400 | 500 |
| Extraordinary items | | 180 |
| Taxes on income | 300 | |
| **Internally generated funds from operations (capacity)** | | **3.720** |
| Dividends paid | 1.200 | |
| **A. Internally generated funds from operations** | | **2.520** |
| Property, plant and equipment | 1.250 | 20 |
| Investments | 550 | |
| Long term accounts receivable | | |
| **B. Investing activities** | **1780** | |
| Capital and share premium increase | | 250 |
| Long term loans | | 250 |
| Finance leases | 90 | 900 |
| **C. Financing activities** | | **1310** |
| **D. Other movements** | 0 | 0 |

**Total A + B + C D** **2.050**

| | | |
|---|---|---|
| **Movements in working capital** | | **2.050** |

| | | |
|---|---|---|
| **Net changes in working capital requirements** | **1760** | |
| Inventories | | 950 |
| Amounts receivable within one year | 600 | |
| Amounts payable within one year | 1510 | |
| Income taxes payable | 600 | |
| **Net increase in cash (movement in treasury position)** | **290** | |
| Cash and cash equivalents | 250 | |
| Effect of exchange rates (note C example IAS 7) | 40 | |

## ANNEX 2 PART C

## PROPOSAL OF A MODEL INTEGRATING THE CASH FLOW AND THE WORKING CAPITAL APPROACHES .

As already discussed in paragraph 3 of the document, the cash flow and the working capital approaches can be combined in a single model. This could consist in a reconciliation of the cash flow and the working capital movements, taking account of those changes in working capital which do not generate corresponding movements in cash and cash equivalents within the same period. The example of such a model (based on the figures in the example in IAS7, Appendix 1) attached hereunder shows the following, basic characteristics:

- It can present movements starting from either cash flows or working capital movements.
- The captions are the same as those of a cash flow statement.
- The columns allow the connection between the cash and the working capital movements, by adjusting them with the cash movements that have already taken place and those which will take place in future periods. These movements represent the changes in working capital which do not give rise to movements of cash or cash equivalents in the period.

The discussion on such a statement would require the definition of an appropriate framework and, consequently, a more in-depth analysis. The major advantage recognised in this model is its capability of giving information on both cash flows and movements in a wider definition of liquidity, notably working capital. However, it could be argued that the model presents difficulties in the inclusion of comparative amounts and lacks the simplicity of the cash flow statement, which allows it to be easily understood.

| ANNEX 2 - PART C | WORKING CAPITAL FLOWS OF THE PERIOD | WORKING CAPITAL FLOWS THAT HAVE NOT YET RESULTED IN CASH FLOWS | CASH FLOWS RELATING TO WORKING CAPITAL MOVEMENTS OF EARLIER PERIODS | CASH FLOW OF THE PERIOD |
|---|---|---|---|---|
| I-OPERATING ACTIVITIES | 3 720 | (370) | (1 390) | 1 960 |
| Sales | 30 650 | (500) | | 30 150 |
| Suppliers and employees | (26 910) | | ( 690) | (27 600) |
| Interest and dividends received | 500 | (100) | | 400 |
| Interest paid | (400) | 230 | (100) | ( 270) |
| Taxes on income | (300) | | (600) | (900) |
| Extraordinary items | 180 | | | 180 |
| II-INVESTING | (1 780) | 900 | | (880) |
| Acquisition of subsidiary | (550) | | | (550) |
| Property, Plant and Equipment | (1 250) | 900 | | (350) |
| Sale of Equipment | 20 | | | 20 |
| III-FINANCING | 110 | (900) | | (790) |
| Proceeds from issuance of share capital | 250 | | | 250 |
| Proceeds from LTD | 250 | | | 250 |
| Payment of finance lease liabilities | 810 | (900) | | (90) |
| Dividends paid | (1 200) | | | (1 200) |
| BALANCE | 2050 | (370) | (1 390) | 290 |
| | Changes in Working Capital | | | Changes in Cash |

# ANNEX 3

Fédération des**Error! Reference source not found.**

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Européens

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FEE RESEARCH ON CASH FLOW STATEMENTS

1996

CONTENTS

## 1. INTRODUCTION.

The Fédération des Experts Comptables Européens (FEE) prepared in 1994 a survey for the European Commission Accounting Advisory Forum Committee on Cash Flow Statements covering all EU Member States and Norway and Switzerland. This survey has been updated as per the situation of 30 September 1996.

A copy of the questionnaire is attached as appendix II. In the following a summary of the responses received is provided. A summary in table form is provided in appendix I.

This research on cash flow statements covers the following countries:

European Union

Austria

Belgium

Denmark

Finland

France

Germany

Greece

Ireland

Italy

Luxembourg

Netherlands

Portugal

Spain

Sweden

United Kingdom

Outside European Union

Norway

Switzerland

## 2. LEGAL REQUIREMENTS ON CASH FLOW STATEMENTS

The law does not address cash flow statements as part of the financial statements in Austria, Belgium, Denmark, France, Germany, Greece, Ireland, Luxembourg, Netherlands, Spain, Sweden, Switzerland and the United Kingdom.

In **Finland**, the Accounting Act has no provisions with respect to funds statements. The Company law, however, requires limited liability companies (only major companies) to include a funds statement in their financial statements but the form of this statement is not determined in the law.

In **Germany**, in order to obtain a permission for the listing of securities, the prospectus has to include a statement of sources and application of funds for the three prior periods (§ 21 Abs. (1) N°. 2 Börsenzulassungsverordnung).

According to § 23 Börsenzulassungsverordnung the statement may be set up in the form of

- sources of funds (decrease of assets and increase of liabilities) and application of funds (increase of assets and decrease of liabilities) or

- funds flow statements (cash inflow/outflow).

In **Italy**, until the implementation of the Fourth Directive by law n° 127 of 17 April 1991, which came into force on 17 April 1993, Article 4 of law n° 136/1975, regarding the audit of listed companies, stated that the control of the accounts had to be made by applying the existing accounting principles, which are issued by the Chartered Accountants (Dottori Commercialisti and Ragionieri).

The new text of Article 2423 of the Civil Code, as amended by law 127/1991, requires that the notes on the accounts which are included in the annual accounts should provide a true and fair view of the economical and financial situation of the company. This may include the preparation of a statement, as recommended in the Accounting Principles issued by Dottori Commercialisti and Ragionieri, which should contain:

- the financial flows of the company during the period, and the amount of cash generated by the company, compared with the cash collected from external sources;

- the investments made by the company during the period;

- the increase/decrease in the assets and in the indebtedness;

- the sources and the uses of the funds.

In **Norway**, the Companies Act of 1976 addresses cash flow statements in § 11-8, second paragraph for large companies. Large companies are defined as companies with:

- total assets according to balance sheet which exceed NOK 10 million, or

- shares or bonds quoted on the stock exchange, or

- more than 200 employees.

The Companies Act requires a statement of changes in financial positions ("finance analysis"). Normally the large companies present a cash flow statement to fulfil the legal requirements. Also large enterprises other than limited liability companies have to present a statement of changes in financial position according to the Accounting Act of 1977 § 19 second paragraph.

In **Sweden** the law, however, requires that companies of a certain size prepare a statement of changes in financial position.

## 3. <u>RULES ISSUED BY OTHER REGULATORY BODIES ON CASH FLOW STATEMENTS</u>.

Other regulatory bodies, like stock exchanges, supervisory authorities or standard setting bodies, have not issued rules on cash flow statements in Belgium, France, Germany, Greece, Italy and Spain.

In **Austria**, according to the Securities Exchange Law the prospectus to obtain a permission for the listing of shares must include the information regarding the financial position and performance of the entity including a statement of sources and application of funds for the three preceding periods. A cash flow statement in the format of IAS 7 will also be accepted.

In **Denmark**, companies quoted on the Copenhagen Stock Exchange must meet the rules laid down by the Copenhagen Stock Exchange. In the present disclosure obligations of the Stock Exchange concerning issuers of listed securities, which became effective on 1 January, 1992 or later, it is stipulated as follows:

> "The annual accounts of public companies must contain a funds statement showing the cash flows of the year resulting from operating, investing, and financing activities" (article 15, section 4)."

The rules contain no further instructions as to the preparation of the cash flow statement. But the intention has no doubt been that the companies should largely follow the new IAS n̊ 7 until a specific Danish accounting standard on cash flow statements has been developed.

The Danish accounting standards are obligatory for quoted companies, as it appears from the disclosure obligations of the Copenhagen Stock Exchange concerning issuers of listed securities.

According to EC Directive 80/390/EEC the Danish Financial Supervisory Authority has made special requirements for the prospectus to be published in connection with application for quotation of securities at the Copenhagen Stock Exchange. The prospectus must contain i.a. a survey of the origin and use of the funds for the past three financial years (Order n̊ 709 of 18 October 1990, table A, item 5.1.6.).

There are no special requirements concerning the preparation of this survey that must be enclosed in the prospectus. It might thus be a cash flow statement or a funds statement.

In **Finland**, the Accounting Board (established by the Accounting Act) has issued a recommendation dealing with the preparation of a funds statement. The recommendation allows companies to use either a source and application of funds statement or a cash flow statement.

The standard practice is to disclose a source and application of funds statement. Cash Flow statements are rarely presented.

In **Ireland**, the listing Rules of the Stock Exchange specify that a plc whose shares are admitted to the Official List of the Stock Exchange must issue an annual report and annual accounts. Those accounts should be prepared in accordance with companies legislation, are to be audited, and must comply "in all material respects" with relevant accounting standards. This implies that the annual accounts of the plc will comply with Financial Reporting Standard (FRS) 1 "Cash Flow Statements" (see United Kingdom section 3 and 5 and Ireland section 5).

In **Luxembourg**, the Stock Exchange requires for companies out of countries where the law requires funds flow statements inclusion of these statements for the last three social years in the prospectus to be issued in the case of the admission to the official quotation or in the case of a public offer. However, a listed company is not requested to present a cash flow or funds flow statement in the annual report and accounts.

In **the Netherlands** the Council for Annual Reporting has issued a draft guideline 4.20 "Het kasstroomoverzicht" in February 1996.

Definition of cash flow

A cash flow statement ("kasstroomoverzicht") is defined as an overview of cash equivalents that have become available during the financial reporting period and of the use that has been made of these cash equivalents. Another name for a cash flow statement is a funds statement ("staat van herkomst en besteding der middelen"). A cash flow statement forms part of the accounts and contains comparable figures. The term cash in cash flow statement is used in its widest sense as cash equivalents. Cash equivalents are defined as cash, bank deposits, liquid bills of exchange and cheques, deposits payable on demand and highly liquid assets. Highly liquid assets are investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Gross or net method

According to the guideline it is not possible to compensate cash inflows with cash outflows.

Classification

The cash flow statement contains a classification in operational, investing and financing activities.

Method used

Both the direct and indirect method can be used for operational activities.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

Foreign currency cash flows are translated at transaction rate or at average rate. In case the indirect method is used cash flows from operational activities may be translated at the rate which is used to translate the profit and loss account. The differences due to exchange rate changes between the total net cash flow and the mutation in cash equivalents in the balance sheet has to be reported separately.

It is recommended to provide a sub total in the cash flow overview of operational activities which includes all cash flows from operational activities except for cash flows from interest and dividends and tax. Cash flows from interest and dividends received will be included under operational activities unless it concerns a cash outflow from interest which has been capitalised as fixed assets (which will be recorded as investing activities). It is recommended to include paid dividends under financing activities, as a separate item. Cash flows arising from taxes on income will be included under operational activities unless they can be allocated to investing and financing activities. The detail of disclosure is indicated by examples based on IAS 7. Further it is required to give detailed explanation in the form of notes to the cash flow statement.

Financial institutions, credit institutions, and insurance undertakings

In the future there will be dealt with the cash flow statements of credit institutions and insurance companies.

In **Norway**, the Norwegian Accounting Standards Board (NASB) issued in 1995 a standard (NAS) on cash flow statements. The standard defines cash flow and sets out the lay-outs of cash flow statements. The standard succeeds recommendations from the Norwegian Institutes of State Authorised Public Accountants (NSRF) and the Norwegian Society of Financial Analysts (NFF).

Definition of cash flow

Cash is cash in hand and deposits repayable on demand with financial institutions. Cash equivalents convertible into known amounts of cash without notice, are treated as cash. Normally, short term investments repayable within three months from the date of the advance are classified as cash equivalents. Cash and cash equivalents in foreign currencies are normally treated as cash. Only the cash effect of transactions is included in the cash flow statement.

Gross or net method

The cash flow should be reported on a gross basis. There are exemptions for cash flow related to

- financial items with both high turnover rate, large amounts and short terms

- cash flow reflecting activities outside the company

Classification

The NAS requires that the cash flow statement should be classified into

- operating activities

- investing activities

- financing activities

Method used

The NAS equalises the direct and indirect method, but recommends the direct method. Most companies use the indirect method. A reconciliation to operating profits should be provided in both cases.

Treatment of foreign currency cash flow, extraordinary items, interest and dividends, and tax on income

Cash flows arising from transactions in a foreign currency are recorded by using the exchange rate at the date of cash flow. Cash flows from extraordinary items should be disclosed separately under the ordinary classification. Interests and received dividends should be classified under operating activities, and paid dividends should be classified under financing activities. Taxes on income are for practical reasons classified under operating activities.

Financial institutions, credit institutions and insurance undertakings

These institutions are obliged to present a cash flow statement. They are not exempted from the NAS on cash flow statements, but because of special problems the standard should be used as a guideline and not as a standard.

Other matters

Companies are recommended but not required to separate cash flows on investing activities between expansion and compensation.

In **Portugal**, the Comissão de Normalização Contabilistica (CNC) issued in July 93 a standard n°14 about "Cash-Flow Statements", which is very similar to the IAS 7 (revised). However, its application is not compulsory by law. CNC does not issue accounting standards for financial and insurance institutions.

However, the stock exchange authority - Comissão do Mercado de valores Mobiliarios (CMVM) - issued in November the Rule 93/11 making the presentation of this statement compulsory for companies other than financial and insurance undertakings with equity quoted on the stock exchange. This rule covers also the consolidated accounts.

In December 1993, CMVM issued the Recommendation 93/1, inviting all other listed companies to present the cash flow statement.

As to the contents of Directriz 14, the only differences and options compared to IAS 7 (revised) are the following:

- the interest paid is not presented in the operating activities but in the financing activities,
- the interest and dividends received are presented in the investing activities,
- the standard does not deal with the cash-flow statements of financial institutions, credit institutions and insurance undertakings.

In **Sweden** the Accounting Committee of the Swedish Institute of Authorised Public Accountants (FAR) has issued a recommendation on statements of changes in financial position. This recommendation makes a reference to IAS 7 and US Financial Accounting Standard n°95 and states that cash flow statements prepared in accordance with these statements are acceptable just as long as disclosure is made of activities without cash flow effect. The FAR recommendation also states that for international companies a statement of cash flows is normally preferable.

In **Switzerland**, the stock exchange has endorsed Accounting and Reporting Recommendation (ARR) n° 6 "Funds Flow Statement" issued by the Foundation for accounting and reporting recommendations (FER) as mandatory requirement for quoted companies as of 1 October 1996, applicable for annual accounts starting on or after 1 July 1996 (see chapter 5).

In the **United Kingdom**, the Accounting Standards Board issued FRS 1 "Cash Flow Statements", in September 1991. However, a revised standard FRS 1 (revised 1996) is to be published on 31 October 1996.

Definition of cash flow

FRS 1 defines cash flow is an increase or decrease in an amount of cash or cash equivalent resulting from a transaction. Cash is cash in hand and deposits repayable on demand with any bank or other financial institution. Cash includes cash in hand and deposits denominated in foreign currency (paragraph 2 of FRS 1). Cash equivalents are short term, highly liquid investments which are really convertible into known amounts of cash without notice and which were within three months of maturity when acquired; less advances from banks repayable within three month from the date of the advance. Cash equivalents include investments and advances denominated in foreign currencies provided that they fulfil the above criteria (paragraph 3 of FRS 1). Cash flow is an increase or decrease in an amount of cash or cash equivalent resulting from a transaction (paragraph 4) FRS 1 (revised) adopts a definition of cash flow that includes only cash in hand and deposits repayable on demand, less overdrafts and does not include cash equivalents. The adoption of the strict cash approach and the consequent introduction of a section covering the management of liquid resources:

- avoids an arbitrary cut-off point inthe definition of cash equivalents

- distinguishes cash flows arising from accumulating or using liquid resources from those for other investing activities

- provides information about treasury activities that was not previously available

Gross or net method

Cash flows from operating activities (in general the cash effects of transactions and other events relating to operating or trading activities) may be reported on a net or gross basis. In either case a reconciliation between the operating profit reported in the profit and loss account and the net cash flow from operating activities should be given as a note to the cash flow statement. Under FRS 1 all other cash flows are to be reported gross. However, FRS 1 (revised) allows cash flows relating to the management of liquid resources or financing to be shown net if they either:

a) relate in substance to a single financing transaction, or

b) are due to short maturities and high turnover occurring from roll over or reissue (for example, short term deposits or a commercial paper programme).

Classification

FRS 1 requires that the cash flow statement should list the inflows and outflows of cash and cash equivalents for the period classified under the following standard headings: operating activities; returns on investment and servicing of finance; taxation, investing activities; and financing in that order and showing a total for each standard heading and a total of the net cash inflow and outflow before financing. FRS 1 (revised) introduces a section dealing with the management of liquid resources and may split investing activities into "capital expenditure and financial investment" and "acquisitions and disposals" and reports equity dividends after these cash flows.

Method used

Under both FRS 1 and FRS 1 (revised) either the direct or indirect method of reporting cash flows from operating activities can be used but, as explained above, a reconciliation to operating profit should be provided in both cases.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

Under FRS 1 cash flows relating to interest and dividends are to be included under the heading "returns on investment and servicing of finance". FRS 1 (revised) removes equity dividends paid from this heading to a separate heading after 'acquisitions and disposals'. Under both standards tax on income is to be reported under "taxation". Where cash flows relate to items that are classed as exceptional items in the profit and loss account these exceptional cash flows should be shown under the appropriate standard headings, according to the nature of each item (paragraph 31 of FRS 1 and paragraph 37 of FRS 1 (revised)) but the effect of FRS 3 in the United Kingdom has been to abolish extraordinary items. Where a portion of a reporting entity's business is undertaken by a foreign entity, the cash flows of that entity are to be included in the cash flow statement on the basis used for translating the results of those activities in the profit and loss account of the reporting entity (paragraph 36 of FRS 1) and paragraph 41 of FRS 1 (revised). FRS 1 (revised) allows the actual rate to be used for intra group cash flows.

Financial institutions, credit institutions and insurance undertakings

FRS 1 exempts building societies and mutual life assurance companies from its requirements. FRS 1 (revised) limits the exemption for building societies to two years from its effective date (23 March 1997). Insurance companies should include the cash flows of their long term life, pensions and annuity businesses only to the extent that the cash flows are those of the insurance company itself rather than the cash flows of the long term funds. FRS 1 has no other special provisions for financial institutions. FRS 1 (revised) has adapted the formats slightly for banks and insurance companies - for example, a bank need not include a section on the management of liquid resources nor the reconciliation of cash flows to the movement in net debt - but the standard continues to require both banks and insurance companies to prepare cash flow statements.

Other matters

FRS 1 exempts small companies and, under certain circumstances, wholly owned subsidiary undertakings from its scope (paragraph 8 (a) and (c)). FRS 1 (revised) extends exemptions to 90 % owned subsidiaries, pensions funds and open-ended investment trusts that meet certain liquidity conditions. FRS 1 and FRS 1 (revised) requires that material transactions not resulting in cash flows should be disclosed in the notes to the cash flow statements if disclosure is necessary for an understanding of the underlying transactions.

FRS 1 (revised) requires a note reconciling the movement of cash in the period with the movement in net debt. "Net debt" is defined as borrowings, together with related derivatives, plus obligations under finance leases less cash and liquid resources.

The FRS 1 (revised) requires a note to identify the amounts and explain the circumstances where restrictions prevent the transfer of cash from one part of the business or group to another.

## 4. LAW AND OTHER REGULATIONS ON FUNDS STATEMENT OTHER THAN A CASH FLOW STATEMENT.

The preparation of a funds statement other than a cash flow statement as part of the financial statements is not addressed by law or other regulations in Belgium, Denmark, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Switzerland and the United Kingdom.

In **Austria**, according to the Securities Exchange Law the prospectus to obtain a permission for the listing of shares must include the information regarding the financial position and performance of the entity including a statement of sources and application of funds for the three preceding periods.

In **Belgium**, the National Bank has issued a lay-out of a fund statement other than a cash flow statement.

In **Finland**, preparation of a funds statement is mandatory for a limited liability company of a certain size (public companies, companies with a restricted equity over 2.000.000 FIM and companies with more than 500 employees). The recommendation issued by the Accounting Board gives general guidelines but in practice the company can choose the method of preparation and the form of the statement it considers appropriate.

Definition of funds

The recommendation does not clearly define the term "funds". Funds may include either cash and cash equivalents or working capital.

Classification

Funds from operating, investing and financing activities should be presented separately.

Method used

Both the direct and indirect methods can be used.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax income

The recommendation does not deal with foreign currency funds.

In **France** the preparation of a funds statement is not mandatory.

The accounting legislation in France does not consider the funds statement as being part of annual or consolidated accounts. The Plan Comptable Général (PCG), a government order of 1982, recommends its preparation and publication in the notes for companies using the optional extended system of presentation of financial statements.

Furthermore, the French law on the prevention of companies' difficulties requires its preparation (but not the publication) for companies exceeding 1 of the 2 criteria:

total turnover: 120 MFF

staff: 300 employees

This requirement applies only to annual accounts.

Definition of funds

The definition given by the PCG is: "Statement of funds and resources established to explain the movements of the company's assets and liabilities during the period".

This statement is optional in the individual accounts, recommended in the consolidated accounts. While no requirements are imposed, companies are encouraged to follow a specific model statement of funds and resources.

Gross or net method

Inflows and outflows are financial flows, not genuine cash flows. They describe the net movements between the opening and the closing balance sheet. In theory, it is not possible to offset funds inflows against funds outflows.

Classification

The funds statement is organised into two parts:

1) Statement of resources and application of funds:

   Resources:

   - funds from operations ("capacité d'autofinancement"),

   - proceeds from disposals,

   - capital increases in cash,

   - proceeds from borrowings.

   Application of funds:

   - purchase of fixed assets,

   - reimbursement of borrowings,

   - other

2) Movements in the net working capital movements are classified in operating, non-operating, and cash.

Method used

It is difficult to say if the direct or indirect method is used as the flows presented are not cash flows but financial flows.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

Exchange differences are not taken into account. That means that entries recorded to adjust receivables and payables according to the closing rate are deleted.

Financial institutions, credit institutions and insurance undertakings

No guidance is given according to the type of sector concerned.

For **Germany**, see section 2 "Legal requirements on cash flow statements".

In **Norway**, the Companies Act requires a finance analysis (statement of changes in financial position) for large companies as defined in section 2. The preparation of a finance analysis is in some cases used as an alternative to the cash flow statement.

In **Portugal**, the Portuguese Official Chart of Accounts (POC), revised in 1989 and 1991 by CNC, with the implementation of the Fourth and Seventh Directives, includes among the mandatory statements, a funds statement.

However, only a few undertakings prepare this statement, because it is not mandatory for the Tax Authorities.

With the disclosure of comparative figures of the previous year in the balance sheet the funds statement has hardly any interest to the investors.

In **Spain**, the "Plan general de Contabilidad" requires all companies which reach determinated parameters to prepare a statement of source and application of funds.

These parameters are two of the following, during two consecutive years:

assets: 300 million Ptas.

net sales: 600 million Ptas.

staff: 50 employees

The company is as well allowed to use other guidance.

Definition of funds

The following definition of funds is provided: obtained resources and application in fixed assets or working assets.

Gross or net method

Funds inflows are not allowed to be compensated with funds outflows.

Classification

The following classification is required:

- working capital and operating activities (short term)

- investing and financing activities (long term)

Method used

The indirect method is required.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

Positive foreign currency cash flows are obtained sources, negative flows are applications. Positive extraordinary items are obtained sources, negative flows are applications. Interest and dividends paid are applications of funds as well as tax on income.

Financial institutions, credit institutions and insurance undertakings

Special requirements have been issued for financial and credit institutions, and insurance undertakings.

In **Sweden** the law requires that companies of a certain size should prepare a statement of changes in financial positions. This is required for companies with assets of more than SEK 36 million (at present varies with a local insurance index) or more than 200 employees. Also if a company is publicly quoted a statement of changes in financial position is required.

The law does not set out the format. Instead the FAR recommendation sets out the procedure to be followed for preparation of a statement changes in financial position.

Format

The format follows the working capital format (essentially in conformity with the old IAS 7) starting with generated funds (internal and external) and usage of funds to arrive at the change in working capital. The change in working capital is to be analysed by component. In addition for companies directing the statement of changes in financial position towards the change in cash there is the possibility to classify the changes in working capital components (other than cash) as an adjustment of internally generated funds (this is now the most commonly used method). Interesting to note is also that the Swedish Association of Financial Analysts has in 1992 issued a recommendation adapted to IAS 7 which recommends the indirect method.

Gross or net method

Normally the net method is allowed. Consequently, for borrowing only the net change needs to be shown.

Classification

The recommendation does not, as indicated above, require a classification in operating, investing or financing activities although this classification or something similar to the same effect, is being used by many companies.

Method used

The indirect method is recommended. However, also the direct method is allowed to present the internally generated funds.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

There are no specific requirements for the treatment of foreign currency funds (or the effect of exchange rates in general) except that the translation adjustment under the current rate method can be reported separately after internally generated funds or be included in internally generated funds. Also the draft recommendation on translation of subsidiary financial statements says that when the current rate method is used the translation effect on fixed assets is to be reported separately.

The effect of extraordinary items on internally generated funds should be disclosed.

Financial items are to be included in internally generated funds whereas dividends can be placed both under usage of funds and as a deduction under internally generated funds.

There are no additional disclosure requirements.

Financial institutions, credit institutions and insurance undertakings

There are no specific recommendations for financial institutions, credit institutions and insurance undertakings. Interesting to note is that for banks and insurance companies the specific legislation for these companies does not require the preparation of a statement of changes in financial position.

## 5. RECOMMENDATIONS ISSUED BY NATIONAL PROFESSIONAL BODIES.

National professional bodies have not issued recommendations in Austria, Belgium, Finland, Greece, Luxembourg, Netherlands, Portugal, Spain and the United Kingdom.

In **Belgium**, a study on "the statement of origin and application of funds" has been issued as a part (p. 59-71) of a publication by the Institut des Réviseurs d'Entreprises, "Interpréter les comptes annuels", Bruxelles, IRE, 1985, 94 p. The Belgium Audit profession (Forum de revisorat) issued a statement in 1995, recommending a cash flow statement in addition to the published accounts. Reference is made to IAS 7.

In **Denmark**, the Institute of State-Authorised Public Accountants Association (FSR) issued in 1988 Accounting Standard n° 1 concerning the object and contents of the annual accounts. The standard states:

> "The annual accounts of major companies must contain a funds statement. In parent companies preparing consolidated accounts, the funds statement may be prepared on a consolidated basis alone" (paragraph 30).

In the explanatory part of the standard it is stated:

> "It is appropriate that major companies, i.e. companies who exceed 2 of the criteria of size mentioned in article 25, section 2 of the Annual Accounts Act (at present: balance sheet amount: 50 million DKK, net turnover: 100 million DKK and number of employees: 250), incorporate a funds statement in the annual accounts".

> (The relevant article of the Act is now article 64c, section 4, and the size criteria are at present increased to: 75 million DKK, 150 million DKK and 250 employees).

The Danish Accounting Standard no. 1 does not contain further instructions for methods for the preparation of cash flow statements.

The Danish Accounting standards Committee issued in May 1996 a Danish Accounting Standard no. 11 on "Cash Flow Statements". The Standard is based on IAS no. 7 (revised 1992). The following description is based on this new Standard. The Standard does not exempt the small companies.

Definition of cash flow

Cash flows are inflows and outflows of cash. Cash is cash funds and also short termed securities, without hindrance could be transformed into cash funds, and after which there is only insignificant risks for changes of value.

Cash funds are cash and cash deposits for free disposal in financial institutions. The conditions for classification of items as cash are that the items:

- are free at disposal
- without hindrance can be transformed into cash funds
- only has insignificant risk for changes of value and
- de facto has functions as funds available by enter into the company's current control of funds available.

Gross or net method

As a principal rule cash flows should be shown as gross cash flows. Off-setting inflows with connected outflows ought to be prevented because the presentation of both the size of cash flows and the distribution of these on main groups of the cash flow statement are essential for the understanding of the company's cash flows.

In certain situations gross cash flows do not express the size of the company's activities, why net cash flows could be shown instead. Net cash flows could be shown at:

- inflows and outflows on behalf of clients, when gross cash flows in actual belong under the clients activities, and the company cannot dispose over the cash flows, as an example collections and payments of rent to owners of properties.
- movements on operating credit, e.g. credit extensions, where there are speak of a formal fulfilment with adoption of a new loan.
- conversion of mortgage debt.
- re-placement of drawn bonds.

Classification

The cash flows statement should show the financial year's cash flows divided up into the following main groups and order:

- operating activity

- investment activity
- financing activity

Furthermore, the cash flow statement should show the financial year's changes in cash and also cash with the beginning and end of the financial year.

Method used

A company should show cash flows from operating activity at either:

- the indirect presentation or
- the direct presentation.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

Cash flows in foreign currency should in the cash flow statement be converted into the quotation of the payment day.

Cash flows concerning extraordinary items, interest, dividends and tax on income should appear as particular highlights in the cash flow statement. As a principal rule these are classified as operating activity.

Financial institutions, credit institutions and insurance undertakings

The Danish Accounting Standard no. 11 does not include financial institutions.

In **France**, the Ordre des Experts Comptables issued a recommendation on cash flow statements in 1988. It has been decided to review the 1988's recommendation of the Ordre des Experts Comptables. The sole recommended statement would be a cash flow statement. The provisions of the new recommendation would be close from those of IAS 7. This new recommendation is expected to be approved for beginning 1997.

Definition of cash flow

Flows presented are real cash flows and not monetary flows (the difference is: movements in cash).

Gross or net method

No offsetting is permitted.

Classification

Cash flows are classified in operating, investing and financing activities.

Method used

Two methods are provided for and allowed: the indirect method and a kind of direct method based on a cash analysis of the income statement. No recommendation for one or the other. Illustrative examples are given.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

The effect on cash of exchange differences is presented on a separate line just before "movement in cash".

Level of disclosure

The notes must include at least:

- computation of cash movement,
- link between net income and operating cash flow,
- effects of exchange differences on cash.

Financial institutions, credit institutions and insurance undertakings

No sectoral guidance. Please note that two other institutions issued illustrative examples of the funds statement:

- Centrale des bilans de la Banque de France
- Crédit National

(those models are close to the PCG's).

In **Germany**, the Institut der Wirtschaftsprüfer (IDW) has issued HFA 1/1995 "Die Kapitalflußrechnung als Ergänzung des Jahres- und Konzernabschlusses", which is a joint pronouncement of the IDW's Main Technical Committee (HFA) and the Working Group "Finanzierungsrechnung" of the Schmalenbach-Gesellschaft/Deutsche Gesellschaft für Betriebswirtschaft e.V. (professors and representatives from major preparers of financial statements).

A cash flow statement prepared under HFA 1/1995 is in line with IAS 7 (revised); the appendix to HFA 1/1995 indicates the additional disclosures which are necessary for an enterprise to achieve full compliance with IAS 7 (revised).

Definition of cash flow

Cash flows are inflows and outflows of cash and cash equivalents.

Cash and cash equivalents include cash on hand, cheques and demand deposits, if they are held for the purpose of meeting short-term cash commitments. For items to qualify as cash or cash equivalents they must be subject to an insignificant risk of not being convertible to cash and capable of being readily sold or have a maturity of no more than about three months.

Other items than the above may also - on a consistent basis - be included in cash or cash equivalents if they can be sold readily and are held as a liquidity reserve, for example securities other than equity investments. Bank overdrafts repayable on demand also qualify for inclusion in cash and cash equivalents if they form part of the enterprise's cash management. Disclosure of the composition of cash and cash equivalents should be made if either of these items is included.

Some changes in cash and cash equivalents, such as cash equivalents becoming cash, are not considered cash flows.

Gross or net method

Inflows and outflows should not be offset. However, a departure from this principle is permitted for items with large amounts and short maturity for reasons of practicality.

Classification

Cash flows should be reported according to the following categories:

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

Method used

Cash flow from investing activities and from financing activities are determined using the direct method. For cash flows from operating activities both the direct and the indirect method are permitted.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income.

Cash flows arising from transactions in foreign currency should be translated at the foreign exchange rate prevailing at the date of payment. Changes in the value of foreign currency items included in cash and cash equivalents resulting from changes in exchange rates do not qualify as inflows or outflows. The same applies to other changes in value, for example of securities. The effect of such changes on cash and cash equivalents should be disclosed separately.

Cash flows in connection with the hedging of items should be reported under the same classification as the hedged item or transaction.

Extraordinary items are reported under the category where they occur.

Interest payments, dividends received and taxes on income should be classified as cash flows from operating activities, unless inclusion in other cash flow categories can be justified. Dividends paid should be attributed to financing activities.

Level of disclosure

HFA 1/1995 recommends minimum formats for a cash flow statement: One when only the direct method is used, another when the indirect method is used for operating activities and the direct method for the other categories.

Financial institutions, credit institutions and insurance undertakings

The issue is not addressed in HFA 1/1995.

The Schmalenbach-Gesellschaft/Deutsche Gesellschaft für Betriebswirtschaft e.V (SG) and the financial analysts (DVFA) have developed jointly a definition for a cash flow figure: "Cash Flow nach DVFA/SG". However, no recommendation is made for the preparation of a complete cash flow statement as defined by IAS 7 (revised).

However, the "cash flow from operating activities" as calculated in accordance with HFA 1/1995 is not identical with the cash flow figures determined according to DVFA/SG. The "Jahres-Cash Flow" proposed by DVFA/SG takes into account only some of the items on which the cash flow from operating activities is based under HFA 1/1995.

In **Ireland**, the Accounting Standards Board - ASB - has issued Financial Reporting Standard 1 ("FRS 1") "Cash Flow Statements" which applies to all financial statements for reporting periods ending on or after 23 March 1992. FRS 1 is issued by the Institute of Chartered Accountants in Ireland in respect of its application in the Republic of Ireland. Compliance with FRS 1, as also with FRS 1 (revised) is considered to ensure compliance with IAS 7 "Statement of Changes in Financial Position". See for details section 3 on United Kingdom.

In **Italy**, the Accounting Principles issued by Dottori Commercialisti and Ragionieri in 1977 (Documents 1 and 2) have been published in January 1994 (Documents 11 and 12). However, with regard to cash flow statements, the 1994 recommendations did not introduce major differences compared to the 1977 document.

The recommendations are:

Gross or net method

It is not possible to compensate cash inflows with cash outflows: the gross method is suggested.

Classification

The cash flow statement classifies the flows on the basis of their nature:

a) investment operations (purchase and sale of technical fixed assets)

b) financial operations (collection and reimbursement of sources employed in the net worth or in the liabilities)

c) operating activities of the company, related to purchase, production and sale of goods and services which are included in the typical activity of the company.

Method used

The indirect method is suggested. The document n° 12 takes into consideration the direct method which represents in an analytical way the cash flows of the period, but it is considered much more difficult to prepare cash flow statements under the direct method.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

Extraordinary items which are not originating cash flows should adjust the net result to be taken as starting point for the calculation of the cash flow.

Interests and dividends are included in the financial operations, and their flows must be separately indicated in the statement.

Income tax is included in the operating activities.

Level of disclosure

It is suggested to show the comparative figures for the previous year.

Financial institutions, credit institutions and insurance undertakings

Cash flow statements of financial institutions, credit institutions and insurance undertakings are considered to be treated in a different way, and the professional body refers to a separate document which, so far, has not been prepared.

In **Norway**, the Norwegian Accounting Standards Board (NASB) issued in 1995 a standard (NAS) on cash flow statements. The standard succeeds recommendations from the Norwegian Institute of State Authorised Public Accountants (NSRF) and the Norwegian Society of Financial Analysts (NFF).

In **Portugal**, the professional body, Câmara dos Revisores Oficiais de Contas (CROC) had a strong influence on the implementation of the cash flow statement, by collaborating with the CNC when the standard was prepared and through providing courses on the matter.

In **Sweden**, the Accounting Committee of the Swedish Institute of Authorised Public Accountants (FAR) has issued a recommendation on statements of changes in financial position. This recommendation makes a reference to IAS 7 and US Financial Accounting Standard n° 95 and says that cash flow statements prepared in accordance with these statements are acceptable just as long as disclosure is made of activities without cash flow effect. The FAR recommendation also says that for international companies a statement of cash flows is normally preferable. See for details section 4 on the funds flow statement.

In **Switzerland**, the Foundation for accounting and reporting recommendations (FER) has issued recommendations concerning cash flow statements, Accounting and Reporting Recommendation (ARR) n° 6 "Funds Flow Statement". This will be integrated as minimum information for all quoted companies as required by the stock exchange as of 1 October 1996.

Definition of cash flow

The definition of the cash flow depends on the "fund" selected. Paragraph 14 of ARR 6 allows the following possibilities.

"14. The following funds are especially suited for judging the flow of funds from operations:

- cash

- net cash (cash less short-term loans payable)

- net monetary working capital (cash plus current receivables less current liabilities)

- net financial position (cash plus financial receivables less loans payable)

Net working capital is considered to be less suited for judging the flow of funds from operations."

Gross or net method

Not specifically addressed, but generally interpreted that the gross method should be used.

Classification

ARR 6 requires that

"1. The funds flow statement presents the flows of funds from:

- operations
- investing activities
- financing activities."

Method used

Both the direct and indirect method are allowed. The indirect method is more common.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

No special requirements other than paragraph 5 which requires that "translation differences are either to be shown separately in the funds flow statement or disclosed in the notes".

Level of disclosure

No special requirements. The flow of funds generated from operations is to be presented separately from the other funds flows and has to be defined.

Financial institutions, credit institutions and insurance undertakings

A special standard is in preparation.

## 6. DISCLOSURE OF CASH FLOW STATEMENTS IN PRACTICE IN THE FINANCIAL STATEMENTS.

In all countries surveyed except for Greece, cash flow statements are in practice, to a certain extent, disclosed in the financial statements. Below an overview is provided for each country.

**Austria**

In Austria, in practice, cash flow statements are disclosed in the financial statements. There are differences in disclosure level between listed and unlisted companies and between large and small companies.

In practice, usually IAS 7 and similar methods are followed.

Definition of cash flow

Cash flow is defined as inflow and outflow of cash and cash equivalents.

Gross or net method

The net method is usually used for operating activities, the gross method for investing and financing.

Classification

The cash flow statement contains a classification in operational, investing and financing activities.

Method used

In practice, usually the indirect method is used.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

These issues are addressed as far as cash flow can be derived from the financial statements.

Financial institutions, credit institutions and insurance undertakings

These cash flow statements are not really different from other companies.

**Belgium**

In Belgium, in practice, cash flow statements are disclosed in the financial statements. The companies disclosing a cash flow statement are those listed companies that are large companies. There is no uniformity in the form of cash flow statements; although the form that is mostly used is a statement of origin and application of funds ending in a treasury position. In 1993, however, this has changed, and most of the quoted companies have used a classification in operational, investing and financing activities.

Definition of cash flow

No uniform definition exists.

Gross or net method

No uniform method exists.

Classification

A classification in operating, investing and financing activities is usually applied.

Method used

The indirect method is used in practice.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

In the treatment of foreign currency cash flows the same currency as in the consolidated accounts is used. Extraordinary items are usually not separately disclosed. This applies also to interest and dividends and tax on income.

**Denmark**

In Denmark, in practice, cash flow statements are disclosed in the financial statements. For listed companies, the preparation of a cash flow statement is obligatory. There are no statistics showing the occurrence of cash flow statements in unlisted companies. It must be assumed - also for unlisted companies - that it has become more common to prepare cash flow statements during recent years, especially for companies of public interest, i.e. companies with investors, creditors, etc., who acquire their information from published annual accounts. However, it must be assumed that most unlisted companies do not prepare a cash flow statement. Undoubtedly, the relative number of companies who prepare cash flow statements tends to be greater among the large companies than among the small companies. Accounting standard ñ 1 requires that companies of a certain size prepare cash flow statements. There are no statistics to prove whether this actually happens.

Until a few years ago cash flow statements were often prepared in accordance with the working capital model which focuses on the difference between current assets and short term liabilities. This model has been recommended in most literature on this issue from the 1970's and 1980's. In later years models focusing on the cash flow of the company have become more frequent, inspired by international practice including the IAS 7 (revised) as well as the disclosure obligations of the Stock Exchange that require specification of cash flows in operating, investing, and financing activities.

With the publishing of the Danish Accounting Standard no. 11 on "Cash Flow Statements" in May 1996 there have been further attempts to adjust to the model in the Standard which are similar to IAS no. 7 (revised 1992).

Definition of cash flow

In practice, there is no unambiguous definition of cash flow whether including e.g. bank overdraft facilities should be part of the definition.

Gross or net method

In practice, the net method is often applied in the purchase of financial assets so that only net cash flow is used in the cash flow statement.

Method used

Almost all companies use the indirect method.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

Extraordinary items, interest and dividends, as well as taxes are usually mentioned under cash flow resulting from the operating activities and are frequently shown as separate items.

Financial institutions, credit institutions and insurance undertakings

Financial institutions usually do not prepare cash flow statements.

**Finland**

Cash flow statements are in practice disclosed in the financial statements. They are mandatory for limited liability companies with restricted equity of over 2 million FIM and for companies with more than 500 employees. They are also mandatory for all listed companies. There is no difference between listed and unlisted companies other than that listed companies must always prepare cash flow statements. In practice companies disclose cash flow statements only when it is mandatory.

Definition of cash flow

Cash flow statements start often from operating profit (loss) or from net profit (deficit) and are adjusted for the effects of transactions of a non-cash nature. There is not an exact definition for cash flow.

Gross or net method

The net method is usually used for separate classification but the gross method is sometimes used for financial items and investments.

Classification

Classification within the cash flow statement is usually in operating, investing and financing activities. Operating items are separately presented as a balancing item.

Methods used

Both the direct and indirect method are permitted. The indirect method is more common. The form of cash flow statements is freely choosable. However, the general model recommended by the Finnish Accounting Institute is often used.

Treatment of foreign currency cash flow, extraordinary items, interest and dividends and tax on income

Extraordinary items, financial items, dividends, share issues, tax on income and investments are usually showed separately.

Level of disclosure

Amounts in cash flow statements are usually in thousands.

Financial institutions, credit institutions and insurance undertakings

Cash flow statements of financial institutions, credit institutions and insurance undertakings are usually different from other companies.

**France**

Small companies seldom issue a funds or cash flow statement. Large companies, whether listed or not, usually do.

According to a recent survey on the financial year 1994 (l'information financière 100 groupes industriels et commerciaux), 93 % of the companies surveyed establish a consolidated funds statement or cash flow statement. It is considered in most of the cases as part of the financial statements.

Among the 93 companies publishing a statement, 50 issued a cash flow statement, 41 a funds statement and 2 both.

Cash flow statement: All companies used the indirect method and classified the flows in operating, investing and financing, 40 showed separately the impact of exchange differences, 16 companies offset increases and decreases in financial debt.

Funds statement: the practice is diverse.

**Germany**

The survey "Verbreitung und Entwicklungsstand der Finanzierungsrechnung in Deutschland - Eine empirische Analyse" by Dr. A. Haller and S. Jakoby is just published. The following is based on this survey.

The survey for Germany is based on the annual report for fiscal year 1991 of 100 companies chosen from the largest business and service companies, excluding banks and insurance companies. A majority of the companies surveyed (66%) disclose cash flow statements. A comparison with previous surveys shows that the number of companies publishing cash flow statements is steadily growing.

Difference between listed and unlisted companies

For the companies surveyed, 77% of the listed companies and 53% of the unlisted companies disclose cash flow statements.

Difference between large and small companies

For the companies surveyed, 84% of the 25 biggest but only 52% of the 25 smallest companies disclose a cash flow statement.

Definition of cash flow

Among the companies surveyed about 50% disclose cash flow statements in the form of source and application of funds (erweiterte Bewegungsbilanz) and about 50% disclose a cash flow statement by defining cash flow (Kapitalflußrecnung mit ausgegliedertem Fond). 40% of these companies include only cash and cash equivalents in the cash flow. Other companies also include net monetary items or net operating items in the cash flow. 75% of the companies disclosing a cash flow statement show the components of the financial position and their changes. The broader the definition of cash and cash equivalents the more detailed information is disclosed.

Gross or net method

No information available.

Classification

Due to the variety of classifications observed it is difficult to find typical categories. The classification source/application of funds is frequent. The classification by areas (i.e. financing, investing, operating) is also applied.

Method used

60% of the companies disclosing cash flow from operating activities apply the indirect method.

Treatment of foreign currency cash flows, extraordinary items, interest and dividends and tax on income

The impact of foreign currency translation was disclosed in 10% of the cash flow statements.

Financial institutions, credit institutions and insurance undertakings

These institutions were not included in the survey, as they usually do not disclose cash flow statements.

**Greece**

Cash flow statements are hardly prepared in practice. Only a few large companies publish cash flow statements.

**Ireland**

Cash flow statements in the formats set out in FRS 1 are generally included in audited financial statements of listed companies and of private companies in Ireland, except where a company avails of the exemptions contained in paragraph 8 of FRS 1. A significant exemption is that available to small companies as defined by Section 8 of the Companies (Amendment) Act, 1986, which implements in Ireland the Fourth Directive (78/660).

**Italy**

Cash flow statements are not disclosed in practice in the financial statements, except for the major listed companies.

**Luxembourg**

A few major Luxembourg companies do prepare and publish cash flow statements.

**Netherlands**

Cash flow statements are in practice disclosed in the financial statements. No data are available on the difference in use by small and large companies and companies that are, or are not quoted on a stock exchange, if any. Various classifications are used in the cash flow statement. Usually the indirect method is used with separate disclosure of extraordinary items, interest and dividends and tax on income.

**Norway**

Large companies, as defined in secion 2, disclose cash flow statement in their financial statements. The majority of large companies use a cash flow statement with classification into operating, investing and financing activities.

Some companies used the new accounting standard issued in October 1995 for the financial year 1995. It is expected that all companies will use the standard for the financial year 1996. Saga Petroleum AS has prepared a statement in conformity with the new NAS.

**Portugal**

Cash flow statements are in practice disclosed in the financial statements in line with the requirements as set out in section 2 "Legal requirements on cash flow statements".

**Spain**

In practice, only a few companies disclose cash flow statements. When they are disclosed, it usually concerns large listed companies.

**Sweden**

In practice, many companies disclose cash flow statements in their financial statements. Many publicly quoted companies are now using the method with classification into operating, financing and investing activities to comply with the terminology in IAS 7 (revised). Unlisted companies of a certain size are legally required to prepare a statement of changes in financial position. Small companies (below a legally defined size) are not required to issue a statement of changes in financial position.

<u>Definition of cash flow</u>

As in almost all cases when the indirect method is used there is no definition of cash flow (inflows and outflows).

<u>Gross or net method</u>

Changes in borrowings and loans are usually shown net.

Classification

The majority of Swedish companies now classify their cash flow statement in operating, investing and financing activities. A few companies use a fourth classification; funds invested/generated in current activities which refers to changes in inventories and commercial credits. Several companies, while following the main outline of IAS 7 (revised), have "invented" minor variations of their own. Whatever classification is used many Swedish companies still call their statements "statements of changes in financial position".

Method used

The indirect method is used almost without exception.

Treatment of foreign currency cash flows, extraordinary items, interest, dividends and income tax

Foreign currency cash flows are normally not separated from local currency cash flows, translation adjustments are usually included in financing activities. Extraordinary items are usually included in operating activities. Interest items are usually included in financing activities. Dividends received or paid are usually included in financing activities. Sometimes dividends paid are stated as a separate section.

Financial institutions, credit institutions and insurance undertakings

Banks and insurance companies are not legally required to prepare cash flow statements and consequently they do normally not prepare any such statements.

**Switzerland**

In practice, companies disclose cash flow statements in their financial statements. Most listed companies disclose a cash flow statement. For unlisted companies, this is less common practice. Large companies disclose more often cash flow statements than smaller companies. For small companies such a disclosure is even rare.

Most of the listed companies which disclose cash flow statements apply international recommendations on cash flow statements like IAS 7 (revised) or apply the Swiss FER recommendation (see section 3 "Rules issued by other regulatory bodies on cash flow statements", Switzerland).

**United Kingdom**

Companies falling in within the scope of FRS 1 in practice make the disclosures required by that accounting standard.

## 7. PROBLEMS WITH THE APPLICATION OF IAS 7 (REVISED).

No problems are perceived with the application of IAS 7 (revised) in Austria, Belgium, Denmark, Finland, France, Greece, Ireland, Italy, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

In **Austria**, a working group of the profession is dealing with IAS 7 (revised). A draft statement is expected to be issued by the end of 1996 or in the beginning of 1997.

In **Denmark**, the institute FSR intends to prepare a Danish standard on cash flow statements, largely corresponding to IAS 7 (revised). The deviations from IAS no. 7 are the following.

In the Danish Standard there is included an escape clause, so that securities could be classified as cash, even though they have a more than insignificant risk for changes of value. Is the escape clause used should securities, there do not meet the requirements, individually be stated as amounts in the notes.

The escape clause, which is not in agreement with IAS no. 7, was enacted because of the specific Danish conditions characterized by a large and liquid bond market.

The presentation and the demands of information concerning buying and selling of companies in the Danish Accounting Standard no. 11 correspond to cash flow statements in for example IAS no. 7.

There were striking appositions from the Danish Business Community against the demands of detailed information and on the other side a striking wish from the stock investors, that the information should be given. As result an escape clause concerning detailed information about buying and selling of companies was worked in.

It is not necessary to give detailed information, provided that there are only sold respectively bought one company, and the infirmation concerning this transaction is not essential to the understanding of the annual accounts. Omission ought to be caused by a special, necessary consideration to the company's agreement partners. There only ought to be omission of information concerning transactions there are of modest relevance in relation to the company's size.

The use of the escape clause should be stated in the notes.

In **France**, the standard setter, CNC studied the revised standard and concluded that there was no incompatibility with the French rules, though the cash flow statement should not out place the funds statement as provided for by the PCG. Both presentations are complementary.

In **Germany**, the Institut der Wirtschaftsprüfer (IDW) has issued HFA 1/1995 "Die Kapitalflußrechnung als Ergänzung des Jahres- und Konzernabschlusses", which is a joint pronouncement of the IDW's Main Technical Committee (HFA) and the Working Group "Finanzierungsrechnung" of the Schmalenbach-Gesellschaft/Deutsche Gesellschaft für Betriebswirtschaft e.V. (professors and representatives from major preparers of financial statements). A cash flow statement prepared under HFA 1/1995 is in line with IAS 7 (revised); the appendix to HFA 1/1995 indicates the additional disclosures which are necessary for an enterprise to achieve full compliance with IAS 7 (revised).

In **Ireland**, it is considered that compliance with FRS 1 ensures compliance with IAS 7 (revised). See also commentary on certain differences between FRS 1 and IAS 7 (revised) below.

In **Luxembourg**, IAS 7 (revised) has not yet been studied by those responsible for setting and accepting standards.

In the **Netherlands**, the guideline on cash flow statements as issued by the Council of Annual Reporting is based on IAS 7 (revised). The Dutch guidelines makes, however, an exemption for bank and insurance companies.

In **Norway**, there are no major problems with application of IAS 7 (revised).

In **Portugal**, the only differences and options compared to IAS 7 (revised) are the following:

- the interest paid is not presented in the operating activities but in the financing activities,
- the interest and dividends received are presented in the investing activities,
- the standard does not deal with the cash flow statements of financial institutions, credit institutions and insurance undertakings.

In **Sweden**, many companies use a format complying with the terminology of IAS 7 (revised) but very few prepare a "true" cash flow statement in accordance with IAS 7 (revised).

In the **United Kingdom and Ireland**, FRS 1 and FRS 1 (revised) differs from IAS 7 (revised) in the following main respects:

1. FRS 1 (revised) defines cash flows to include only movements in cash (cash in hand and deposits repayable on demand, less overdrafts). IAS 7 defines cash flows as movements in both cash and cash equivalents. FRS 1 shows separately "returns on investment and servicing of finance", "taxation". FRS 1 (revised) also requires a separate heading for equity dividends paid and divides "investing activities" into "capital expenditure and financial investment" and "acquisitions and disposals". It also has an additional heading "Management of Liquid Resources" as a consequence of its narrow definition of cash it uses.

2. IAS 7 (revised) encourages the direct method of cash flow reporting. FRS 1 allow either the direct or the indirect method but requires a reconciliation of operating profit to net cash flow from operating activities.

3. IAS 7 (revised) allows net reporting of certain items (paragraphs 22 and 24) and certain other items for financial institutions (paragraph 24). FRS 1 requires gross reporting of all cash flows (except operating activities reported on the indirect method). FRS 1 (revised) allows cash flows to be shown net within the management of liquid resources and financing on similar grounds to those in paragraph 22(b) of IAS7. There is no permission to show cash flows relating to customers net.

4. IAS 7 (revised) requires cash flows of a foreign subsidiary to be translated at the exchange rate of the date of the cash flows whereas FRS 1 requires translation on the basis used for translating the results of those activities in the profit and loss account. FRS 1 (revised) allows actual rates to be used for intra group cash flows.

5. FRS 1 exempts small undertakings, wholly owned subsidiaries, building societies and mutual life assurance companies from its scope. FRS 1 (revised) also excludes 90 % owned subsidiaries, pension funds and open-ended investment funds, subject to certain liquidity requirements.

6. FRS 1 and FRS 1 (revised) requires cash flows to be shown net of value added tax. IAS 7 (revised) is silent on the treatment of sales taxes.

Appendix I

Definition of cash flow

| COUNTRY | DEFINITION ACCORDING TO RULES ISSUED BY OTHER REGULATORY BODIES OR NATIONAL PROFESSIONAL BODIES |
|---|---|
| EU COUNTRIES | |
| Austria | |
| Belgium | |
| Denmark | |
| Finland | |
| France | |
| Germany | Cash flows are inflows and outflows of cash and cash equivalents.<br><br>Cash and cash equivalents include cash on hand, cheques and demand deposits, if they are held for the purpose of meeting short-term cash commitments equivalents they must be subject to an insignificant risk of not being convertible to cash and capable of being readily sold or have a maturity of no more than<br><br>Other items than the above may also - on a consistent basis - be included in cash or cash equivalents if they can be sold readily and are held as a liquidity re equity investments. Bank overdrafts repayable on demand also qualify for inclusion in cash and cash equivalents if they form part of the enterprise's cash ma<br><br>Disclosure of the composition of cash and cash equivalents should be made if either of these items is included.<br><br>Some changes in cash and cash equivalents, such as a cash equivalents becoming cash, are not considered cash flows. |
| Greece | |
| Ireland/<br><br>United Kingdom | Cash is cash in hand and deposits repayable on demand with any bank or other financial institution. Cash includes cash in hand and deposits denominated i 1). Cash equivalents are short term, highly liquid investments which are really convertible into known amounts of cash without notice and which were acquired; less advances from banks repayable within three month from the date of the advance. Cash equivalents include investments and advances denomi they fulfil the above criteria (paragraph 3 of FRS 1). Cash flow is an increase or decrease in an amount of cash or cash equivalent resulting from a transacti a definition of cash flow that includes only cash in hand and deposits repayable on demand and does not include cash equivalents. |
| Italy | |
| Luxembourg | |
| Netherlands | Cash equivalents are defined as cash, bank deposits, liquid bills of exchange and cheques, deposits payable on demand and highly liquid assets. Highly liqui convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. |
| Portugal | IAS 7 |
| Spain | |
| Sweden | |
| NON-EU COUNTRIES | |
| Norway | Cash is cash in hand and deposits repayable on demand with financial institutions. Cash equivalents convertible into known amounts of cash without noti term investments repayable within three months from the date of the advance are classified as cash equivalents. |
| Switzerland | - cash<br>- net cash (cash less short-term loans payable)<br>- net monetary working capital (cash plus current receivables less current liabilities)<br>- net financial position (cash plus financial receivables less loans payable) |

Gross or net method

| COUNTRY | LEGISLATION, RULES | | PRACTICE | |
|---|---|---|---|---|
| | GROSS METHOD | NET METHOD | GROSS METHOD | NET METHOD |
| EU COUNTRIES | | | | |
| Austria | | | X | |
| Belgium | | | | |
| Denmark | | | X | X |
| Finland | | | | X |
| France | X | | | |
| Germany | X | | | |
| Greece | | | | |
| Ireland/ United Kingdom | X | X | X | X |
| Italy | X | | | |
| Luxembourg | | | | |
| Netherlands | X | | | |
| Portugal | IAS 7 | IAS 7 | | |
| Spain | X | | | |
| Sweden | | | | X |
| NON-EU COUNTRIES | | | | |
| Norway | X | X | X | X |
| Switzerland | X | | | |

Classification

| COUNTRY | CLASSIFICATION LEGISLATION/RULES | | PRACTICE |
|---|---|---|---|
| | OPERATIONAL/INVESTING/FINANCING | OTHER | OPERATIONAL/INVESTING/FINANCING |
| EU COUNTRIES | | | |
| Austria | | | X |
| Belgium | | | X |
| Denmark | X | | |
| Finland | X | | X |
| France | X | X (funds statement) | X |
| Germany | X | | X |
| Greece | | | |
| Ireland/<br>United Kingdom | X (with additional captions) | | X (with additional captions) |
| Italy | X | | |
| Luxembourg | | | |
| Netherlands | X | | X |
| Portugal | IAS 7 | | X |
| Spain | | X (funds statement) | |
| Sweden | | | X |
| NON-EU COUNTRIES | | | |
| Norway | X | | X |
| Switzerland | X | | X |

Method used

| COUNTRY | LEGISLATION, RULES | | PRACTICE | |
|---|---|---|---|---|
| | DIRECT METHOD | INDIRECT METHOD | DIRECT METHOD | INDIRECT METHOD |
| EU COUNTRIES | | | | |
| Austria | | | | X |
| Belgium | | | | X |
| Denmark | | | | X |
| Finland | X | X | | X |
| France | X | X | X | X |
| Germany | X | X* | | X |
| Greece | | | | |
| Ireland/<br>United Kingdom | X | X | X | X (very rare) |
| Italy | | X | | |
| Luxembourg | | | | |
| Netherlands | X | X | | X |
| Portugal | X (IAS 7) | X (IAS 7) | | |
| Spain | | X (required) | | |
| Sweden | | | | X |
| NON-EU COUNTRIES | | | | |
| Norway | X | X | X | X |
| Switzerland | X | X | | |

* permitted for cash flow from operating activities

Financial institutions, credit institutions and insurance undertakings

| COUNTRY | LEGISLATION, RULES | | PRACTICE | |
|---|---|---|---|---|
| | EXEMPTED | NOT EXEMPTED | EXEMPTED | NOT EXEMPTE |
| EU COUNTRIES | | | | |
| Austria | | | | X |
| Belgium | | | | X |
| Denmark | | | X | |
| Finland | | | X | |
| France | | X | | |
| Germany | | | | |
| Greece | | | | |
| Ireland/ United Kingdom | | X[14] | | |
| Italy | X | | | |
| Luxembourg | | | | |
| Netherlands | X | | | |
| Portugal | X | | | |
| Spain | | X (special requirements) | | |
| Sweden | X | | | |
| NON-EU COUNTRIES | | | | |
| Norway | | X | | X |
| Switzerland | | X (special requirements) | | |

14 Special formats are provided for banks and insurance companies and pension funds and open ended investment funds (subje

Appendix II

**Questionnaire on cash flow statements flow**

Research for the Accounting Advisory Forum Working Party on Cash Flow Statements

*The research is meant to result in a summary of the legal and other requirements on cash flow statements currently applicable in the Member States and some other countries. Please reply to the following questions. In order to assist you in completing the questionnaire a glossary of terms derived from IAS 7, Cash Flow Statements, is attached. The questions concern mainly the consolidated accounts.*

1) Does the law in your country deal with cash flow statements ?

   If yes, what are these legal requirements ? Please consider the following items in your reply and enclose a copy of the requirements.

   - definition of cash flow (what is included in the inflows and outflows in the statement ?)
   - is it possible to compensate cash inflows with cash outflows (gross or net method) ? If yes, for which items ?
   - classification within the cash flow statement (for example in operating, investing and financing activities)
   - method used (direct method, indirect method)
   - treatment of foreign currency cash flows, extraordinary items, interests and dividends and tax on income
   - level of disclosure
   - cash flow statements of financial institutions, credit institutions, and insurance undertakings: are they different from other companies ?

2) Are there any rules issued by other regulatory bodies (for example stock exchanges, supervisory authorities, standard setters) ?

   If yes, what are these rules ? Please consider the following items in your reply and enclose a copy of the rules:

   - definition of cash flow (what is included in the inflows and outflows in the statement ?)
   - is it possible to compensate cash inflows with cash outflows (gross or net method) ? If yes, for which items ?
   - classification within the cash flow statement (for example in operating, investing and financing activities)

- method used (direct method, indirect method)

- treatment of foreign currency cash flows, extraordinary items, interests and dividends and tax on income

- level of disclosure

- cash flow statements of financial institutions, credit institutions, and insurance undertakings: are they different from other companies ?

3) Is there any law in your country or are there any rules issued by regulatory bodies dealing with the preparation of a funds statement other than a cash flow statement ?

a) If yes, is the preparation of such a funds statement mandatory ?

b) In case the preparation of a funds statement is optional and a company decides to prepare this statement, should this company apply the guidance included in the rules, regarding the methods of preparation and presentation of the statement or is it allowed to use other guidance ?

c) What are these legal requirements and regulatory rules ? Please consider the following items in your reply and enclose a copy of the requirements.

- definition of funds (what is included in the inflows and outflows in the statement ?)

- is it possible to compensate funds inflows with funds outflows (gross or net method) ? If yes, for which items ?

- classification within the funds statement (for example in operating, investing and financing activities)

- method used (direct method, indirect method)

- treatment of foreign currency funds, extraordinary items, interests and dividends and tax on income

- level of disclosure

- funds statements of financial institutions, credit institutions, and insurance undertakings: are they different from other companies ?

4) Have the national professional bodies issued any recommendations ?

If yes, what are these recommendations ? Please consider the following items in your reply and enclose a copy of the recommendations.

- definition of cash flow (what is included in the inflows and outflows in the statement ?)

- is it possible to compensate cash inflows with cash outflows (gross or net method) ? If yes, for which items ?

- classification within the cash flow statement (for example in operating, investing and financing activities)

- method used (direct method, indirect method)

- treatment of foreign currency cash flows, extraordinary items, interests and dividends and tax on income

- level of disclosure

- cash flow statements of financial institutions, credit institutions, and insurance undertakings: are they different from other companies ?

5) Are cash flow statements in practice disclosed in the financial statements ?

If yes:

a) is there a difference between listed and unlisted companies ?

b) is there a difference between large and small companies ?

c) which form of cash flow statements are mostly used ? Please consider to the extent possible the following items in your response:

- definition of cash flow (what is included in the inflows and outflows in the statement ?)

- is it possible to compensate cash inflows with cash outflows (gross or net method) ? If yes, for which items ?

- classification within the cash flow statement (for example in operating, investing and financing activities)

- method used (direct method, indirect method)

- treatment of foreign currency cash flows, extraordinary items, interests and dividends and tax on income

- level of disclosure

- cash flow statements of financial institutions, credit institutions, and insurance undertakings: are they different from other companies ?

d) please provide an example (from a company in practice) of a cash flow statement in the form most used in practice.

6) Are there any problems with the application of IAS 7 in your country ?

## Glossary of terms

(derived from IAS 7, Cash Flow Statements)

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.

Financing activities are activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise.

Direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed.

Indirect method, whereby net 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.

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

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