

## **8.8 Cash Flow Statements {LC Accounting Syllabus }**

The student is introduced to

- o the importance of cash flow statements
- o the distinction between profit and cash
- o the distinction between items that do and do not involve the movement of cash
- o the different sources of cash inflows and outflows
- o the impact of the movement in working capital on cash f l o w s
- o the preparation of simple cash flow statements.

On completion the student should

- o understand the importance of cash flow statements/data
- o be able to explain the difference between profit and cash
- o be able to identify and treat items not involving the movement of cash
- o be able to identify and classify the sources of cash inflows and cash outflows
- o be able to prepare a simple cash flow statement
- o be able to advise the management on the organisation's financial position using cash flow statements (HL )

## 5.16. CASH FLOW STATEMENTS (section 8.8)

### Importance of cash flow statements

The accountancy profession requires companies to prepare a cash flow statement which allows users of accounts to assess the liquidity, viability and financial adaptability of the company. The cash flow statement shows the cash flows generated and absorbed by the company's activities under standard headings which are required by Financial Reporting Standard 1 Cash Flow Statements.

### Distinction between profit and cash

- Meaning of cash – cash is defined as cash on hand and deposits repayable on demand less bank overdrafts (a knowledge of cash equivalents is not required).
- An understanding of the difference between profit and cash
- Reasons why an increase in profit may not give rise to a similar increase in cash in the current period.

### Distinction between items that do and do not involve the movement of cash

- Effect of these items on cash flows
- Treatment of these items in the cash flow statement

### Main sources of cash inflows

- Profits
- Proceeds from the sale of fixed assets
- Introduction of capital
- Receipts of loans
- Investment income

### Main sources of cash outflows

- Losses
- Purchases of fixed assets
- Repayments of loans
- Dividend payments
- Tax payments

### Preparation of cash flow statements

- Simple cash flow statements for either companies or sole traders using the indirect method
- Identification of cash flows by examination of opening and closing balance sheets, profit and loss account information and other relevant additional information
- Preparation of ledger accounts (or other suitable workings) for taxations, dividends and fixed assets to derive the associated cash flows. Ledger accounts may also be necessary to derive the depreciation charge, profit or loss on disposal of fixed asset.
- Adjustment of operating profit/loss by items not involving the movement of cash and for changes in debtors, stocks and creditors to derive the cash flow from operating activity.
- Grouping of cash flows under the headings of FRS 1
  - Operating activities
  - Returns of investments and servicing of finance
  - Taxation
  - Investing activities
  - Financing
- Notes to the cash flow statement are not required but students are expected to show the adjustments made to operating profit to arrive at cash flows from operating activities

### Interpretation of cash flow statements (HL)

- Understanding of the usefulness of a cash flow statement
- Preparation of reports analysing and commenting on a company's financial position as revealed by the cash flow statement.

Students will be assessed on their ability to:

- Show an understanding of the importance of cash flow statements/data
- Explain the difference between cash and profit
- Identify and treat items not involving the movement of cash
- Identify and classify the sources of cash inflows and cash outflows
- Prepare a simple cash flow statement using the indirect method
- Advise the management on the organisation's financial position using cash flow statements (HL only)

# Cash Flow Statement

- When ? YR2 – after Final a/c & Depreciation
- How ?
  1. Handout Template
  2. Ordinary Level Questions
  3. Higher Level Questions ( 60 mark)
  4. Higher Level Questions ( 100 mark)
  5. Theory

# Cash Flow Statement

- Layout (format) prescribed in FRS 1
- *Direct method* / Indirect method(LC)
- Three separate presentations;
  - Reconciliation of Operating Profit to Net Cash Flow from Operating Activities.
  - Cash Flow Statement
  - Reconciliation of Movement in cash to Movement in Net Debt

100 mark Qs require Abridged P & L a/c (use any{ ORD ?}  
60 mark Question with top figures blotted out )

# Cash Flow Statement

## An approach to a Higher Level Question

'Notes' for	Cost of Fixed Assets
	Depreciation of Fixed Assets
	Change in Cash
	Change in Net Debt
	Interest
	Taxation
	Dividends

## Depreciation of Machinery A/C

• Disposal	38000	• Balance b/d	180000
• Balance c/d	202000	• P & L a/c	60000

## Disposal of Machinery A/C

• Cost [470-400]	470000	• Depreciation	38000
• Profit	3000	• Bank{proceeds}	35000

• Change in Cash	1/1/2005	31/12/05
Cash	+1000	+2000
Bank	<u>+10000</u>	<u>(6800)</u>
Net	+11000	(4800)
	Change	(15800)

Net Debt	1/1/05	31/12/05
Debentures	(180000)	(75000)
Govt Securities	-----	+12000
Cash	+1000	+2000
Bank	<u>+10000</u>	<u>(6800)</u>
Net Debt	(169000)	(67800)
Change		+101200

### Taxation

- **Paid** 38000
- Balance c/d 50000

- Balance b/d 43000
- P & L a/c 45000

### Interest

- **Paid** 6800
- Balance c/d 1200

- Balance b/d -----
- P & L a/c 8000

### Dividends

- **Paid** { Inc. Interim 21000 } 55000
- Balance c/d 45000

- Balance b/d 34000
- P & L a/c 66000

### 3. Cash Flow Statement

The following are the Balance Sheets of Butler Plc as at 31/12/2004 and 31/12/2005, together with an abridged Profit and Loss account for the year ended 31/12/2005:

Abridged Profit and Loss Account for the year ended 31/12/2005				€
Operating profit				140,000
Interest for year				(8,000)
Profit before taxation				132,000
Taxation for year				(45,000)
Profit after taxation				87,000
Dividends - Interim	21,000			
- Proposed				(66,000)
Retained profits for the year				21,000
Retained profits on 1/12/2005				191,000
Retained profits on 31/12/2005				212,000

  

Balance Sheets as at		31/12/2005		31/12/2004	
	€	€		€	€
<b>Fixed Assets</b>					
Land and buildings at cost	825,000			750,000	
Less accumulated depreciation	(95,000)	730,000		(80,000)	670,000
Machinery at cost	400,000			470,000	
Less accumulated depreciation	(202,000)	198,000		(180,000)	290,000
		928,000			960,000
<b>Financial Assets</b>					
Quoted investments		130,000			100,000
<b>Current Assets</b>					
Stock	220,000			205,000	
Debtors	200,000			190,000	
Government securities	12,000			-	
Bank	-			10,000	
Cash	2,000			1,000	
	434,000			406,000	
<b>Less Creditors: amounts falling due within 1 year</b>					
Trade creditors	250,000			228,000	
Interest due	1,200			-	
Taxation	50,000			43,000	
Dividends	45,000			34,000	
Bank	6,800			-	
	(353,000)			(305,000)	
<b>Net Current Assets</b>		81,000			101,000
		1,139,000			1,161,000
<b>Financed by</b>					
<b>Creditors: amounts falling due after more than 1 year</b>					
9% Debentures		75,000			180,000
<b>Capital and Reserves</b>					
£1 Ordinary shares	830,000			790,000	
Share premium	22,000			-	
Profit and loss account	212,000	1,064,000		191,000	981,000
		1,139,000			1,161,000

The following information is also available:

- There were no disposals of Buildings during the year but new Buildings were acquired.
- There were no purchases of Machinery during the year. Machinery was disposed of for €35,000.
- Depreciation charged for the year on Machinery in arriving at the Operating profit was €60,000.

You are required to:

- Prepare the Cash Flow Statement of Butler Plc for the year ended 31/12/2005 including Reconciliation Statement(s). (48)
- Explain why Cash Flow Statements are prepared. (8)
- Identify a Non Cash expense and a Non Cash gain. (4)

(60 marks)

### (a) Reconciliation of operating profit to net cash flow from operating activities

	€	
Operating profit	140,000	(2)
Depreciation charges for the year	75,000	(4)
Profit on sale of machinery	(3,000)	(6)
Increase in stock	(15,000)	(2)
Increase in debtors	(10,000)	(2)
Increase in creditors	22,000	(2)
Net cash inflow from operating activities	209,000	(2)

### Cash Flow Statement of Butler Plc for the year ended 31/12/2005

	€	
<b>Operating Activities</b>		
Net cash inflow from operating activities	209,000	(1)
<b>Returns on investments and servicing of finance</b>		
Interest paid	(6,800)	(3)
<b>Taxation</b>		
Corporation tax paid	(38,000)	(3)
<b>Capital expenditure and financial investment</b>		
Investments	(30,000)	(3)
Payments to acquire tangible fixed assets	(75,000)	(2)
Receipts from sale of fixed assets	35,000	(2)
	(70,000)	
<b>Equity dividends paid</b>		
Dividends paid during the year	(55,000)	(3)
Net cash inflow before liquid resources and financing	39,200	
<b>Management of Liquid Resources</b>		
Purchase of Government securities	(12,000)	(2)
<b>Financing</b>		
Repayment of debentures	(105,000)	(1)
Receipts from issue of shares	40,000	(1)
Receipts from share premium	22,000	(1)
Decrease in cash	(2)	(15800)

### Reconciliation of net cash flow to movement in net debt

Decrease in cash during period	(15,800)	(1)
Cash used to purchase Government securities	12,000	
Cash used to purchase debentures	105,000	(1)
Change in net debt	101,200	(1)
Net debt at 1/1/2005	(169,000)	
Net debt at 31/12/2005	(67,800)	(1)



# Cash Flow Statements

## Most Common Mistakes

- Exact wording necessary in all cases.

Interest Paid Dividends Paid

Increase in Stock ( not ↑ Stock )

- Miscalculate Loss / Profit on Sale
- Miscalculate Depreciation
- Reconciliation of Net Cash flow to movement in Net Debt
- Theory – weakest section

2006 Explain why cash Flow are prepared

2010 Outline benefits of Cash Flow

BUT 2006 (b) (ii) Identify a Non Cash expense and a non cash gain

2010 (b) (ii) Distinguish between a cash expense and a non cash expense

# Cash Flow Statements

## SEC 'History' Higher

- 1997
- 1998
- 1999 Q 4
- 2000
- 2001 Q 4
- 2002
- 2003
- 2004 Q 4
- 2005
- 2006 Q 3
- 2007
- 2008 Q 6
- 2009
- 2010 Q 2