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Presentation of Consolidated Statement of Cash Flows under IAS 7, Statement of Cash Flows

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The consolidated financial statements must includ a specific statement, regarding cash flows from all activities of the entity, called „consolidated statement of cash flow". Information for preparing cash flow statements can be found in all other components of the financial statements, such as financial position, statement of comprehensive income and statement of changes in equity. The cash flow statement shall report cash flows during the period classified by operating, investing and financing activities. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the entity and the amount of its cash and cash equivalents. An entity shall report cash flows from operating activities using either the direct method or the indirect method under IAS 7, Statement of Cash Flows.

Keywords: *Cash and cash equivalents, direct method, indirect method, Cash flows from operating, investing and financing activities*

The functionality of an economic entity is mainly supplied with necessary data by bookkeeping activity. Bookkeeping activity elaborates and submits the main sources (instruments), which provide information used by the entity's management, such as: accounts, trial balances, finacial statements (statement of financial position, statement of comprehensive income, statement of cash flows, statement of changes in equity, notes of financial statements and accounting policies), reports regarding costs, revenus, economic and statistic keys.

Management's activity can be carried out under optimal conditions and the development of correct economic decisions can be achieved if and only if a informational system is set up and this system can provide all necessary data. The informational system can be defined by its components such as all data, information, information flows and procedures, which are designed to contribute to the foundation, development and implementation of the entity's objectives (F.Văduva, 2009, pp 201).

The statement of cash flows represents – together with statement of financial position and statement of comprehensive income – a key components of annual financial statements of an entity. The statement of cash flows provides necesasary information for the financial statements'ussers regarding to the assessing of entity's solvency and liquidity.

This statement is sometimes named „financing board" or „treasury board" but these two phrases are not the most appropiate due to the fact that this statement represents, in fact, a „process report and not a status report"(Octavian Thor Pleter, 2005, pp 325).

Conceptual approaches about the cash flow statement

A1) *What is the purpose of preparation of this statement?* The purpose of the statement of cash flows is to provide information about the amounts paid and proceeds from operating activities during a specific period of time. This statement indicates the range of entities financing and investment activities.

This statement is a vital part of annual financial statements due to the fact that one of the main concerns of the entity's owners is to know whether the reporting entity has the ability to generate enough cash flows in order to cover the payments to them. In other words this statement enables entity's investors and creditors to assess the followings: (i) the ability to generate future cash flows, (ii) the ability to pay debts and dividends, (iii) the reasons for the difference between profit's value and amounts paid/cashed, (iv) both monetary and non-monetary issues of financing and investing transactions.

A2) *What are the advantages of presenting of this statement?* The benefits of presentation of a statement of cash flows, along with a statement of financial position (named in the past as „balance sheet") and a statement of comprehensive income (named before as „Income statement) are highlighted by IAS 7 „Statement of cash flows", as follows:

• provides an image of the entity's financial structure (including liquidity and solvency of entity) and its ability to influence the cash flows' amounts and the moment when these cash flows are generated;

• provide additional information to the users of financial statements to assess changes in assets, liabilities and equity of an entity;

• the effects of management decisions regarding financial policies can be analyzed in a credible manner;

• this statements increases the comparability of operating performance's of different companies, because it is canceled the effects of using different accounting treatments for the same transactions or events.

A3) *Where are defined the terms?* Definition of terms is presented in IAS 7, which states that:

• 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 flow statement includes only the effective cash and cash equivalents inflows and outflows. Therefore there are excluded all transactions not directly affect cash and cash equivalents receipts and payments.

A4) *How are defined the activities of an entity?* It is necessary – for preparing the statement of cash flows – to define the entity's activities on three levels:

• financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity. Financial activities include: (i) cash proceeds from issuing shares or other equity instruments, (ii) cash payments to owners to acquire or redeem the entity's shares, (iii) cash payments to owners to acquire or redeem the entity's shares, (iv) cash repayments of amounts borrowed and (v) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

• investing activities are the acquisition and disposal of long-term assets (property, plant and equipment, investment property and other simillar assets) and other investments not included in cash equivalents.

• operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities. Operating activities include: (i) cash receipts from the sale of goods, rendering of services , royalties, fees, commissions and other revenue, (ii) cash payments to suppliers for goods and services, (iii) cash payments to and on behalf of employees, (iv) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities and (v) cash

receipts and payments from contracts held for dealing or trading purposes
It can be seen that any incorrect choice can lead to changes in the composition and size of cash flows. Furthermore there is the risk to lead to wrong decisions about future policy relating to payments and receipts due to the potential lack of knowledge or misinterpretation of cyclical fluctuations of previous mentioned levels.

A5) *What are the methods of determining net cash flows?* In determining the net cash flows there are two methods:

• the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed;

• the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

A6) *Direct method* shows the items that affected cash flow and the impact of those cash flows. Cash received from, and cash paid to, specific sources (such as customers and suppliers) are presented, as opposed to the indirect method's converting accrual-basis profit (or loss) to cash flow information by means of a series of add-backs and deductions. Entities are encouraged (under IAS 7, *Statement of cash flows*) to report cash flows from operating activities using the direct method. An important advantage of the direct method is that it allows to the users of financial statements to understand, in a more permissive way, the relationship between profit (loss) and cash flows of the entity. „During an accounting period cash flow available result as the difference between receipts and payments arising from the overall activity of the company is derived from operations management, investment and financing"[Gherghina, Duca, 2008, pp.528-533].

A7) *Indirect method* - used to determine cash flow from operating activities- starts from the differences between profit (loss) and cash flow. Barry J. Epstein and Eva K. Jermakowicz (2010) - the authors of the book named „IFRS 2010: Interpretation and Application of International Financial Reporting Standards" – consider that „one reason why the financial statement preparer community did not more quickly embrace a cash flow concept is that the accounting profession had long had a significant aversion to the cash basis measurement of entity operating performance. This was largely the result of its commitment to accrual basis accounting, which recognizes revenues when earned and expenses when incurred, and which views cash flow reporting as a back door approach to cash basis accounting".

Although the indirect method is more used in practice this method has a disadvantage. Under this method is more difficult, for the users of financial statements, to understand the presented information since this information does not reflect effective way of inflow or outflow of cash and cash equivalents. The indirect format begins with the amount of profit (or loss) for the year (difference between the revenue and expenses) which is adjusted as follow:

a) adjustments relating to income and expenses (which are included in profit/loss of the year) which are not part of operating activities such as:

• financical income are deducted and financial expenses are added (i.e. interest income or interest expense)

• revenue and expenses items not affecting cash are deducted or added (i.e. amortization and depreciation expense because they reduced the profit and they are non – monetary items)

• revenue and expenses generated by disposals of non – current assets (revenue are deducted and expenses are added due to the fact that these items are not related to operating activities, but they are part of investing activities where the cash flow is determined as difference between cas inflow and outflow).

b) adjustments resulting from changes in working capital structure (changes in inventory, accounts receivable, accounts payables , and other current accounts).

Since income and expenses, included in the profit (loss) of the year, are items which have been determined according to the accrual basis accounting rather then cash basis accounting, it is natural that the amounts of revenue to be different than amounts of cash received from customers. The adjustments relues are quite simple:

• the increase of operating current assets is deducted

• the decrease of operating current assets is added;

• the increase of operating liabilities is added;

• the decrease of operating liabilities is deducted;

In other words the statement of cash flows, prepared under indirect method, ilustrates changes in most parts of current assets and liabilities. Changes in inventory, accounts receivable, accounts payables, and other current accounts are used to determine the cash flow from operating activities. ABC entity prepares Consolidated Statement of Cash Flows at 31/12/2012. At this date the entity has the presented bellow data:

Consolidated Statement of comprehensive income at 31/12/2012
-in currency units -

Description	Amount
Revenue	1.581.250
Cost of sales	-1.243.326
Gross profit	337.924
Net operating expense	-268.750
Operating profit/(loss)	69.174
Interest income and other similar income	8.865
Interest expense and other similar expenses	-6.890
Profit before tax	71.149
Income tax expense (16% * Taxable profit 101.894 lei)	-16.303
Profit for the year, attributable	54.846
Non-controlling interest	2.750
Owners of the parent	52.096

Consolidated Financial position at 31/12/2012
- in currency units -

	31 December 2012	31 December 2011
Assets		
Non-current assets		
Property, plant and equipment—carried at cost less accumulated depreciation	5.362.500	3.492.500
Intangible assets	194.669	359.745
Total non-current assets	5.557.169	3.852.245
Current assets		
Inventories	1.181.825	1.071.900
Trade and other receivables	2.009.900	1.953.475
Cash and cash equivalents	729.575	717.450
Total current assets	3.921.300	3.742.825

Total assets	9.478.469	7.595.070
Liabilities and Equity		
Non – current liabilities	1.894.745	863.495
Current liabilities	3.431.498	2.535.875
Total liabilities	5.326.243	3.399.370
Equity		
Share capital – ordinary shares	1.176.000	1.099.500
Share premium	1.026.250	797.500
Share capital – preferred shares	57.450	57.450
Other reserve	346.500	346.500
Retained earnings	1.388.750	1.388.750
Profit for the year (attributable to owners of parent)	52.096	
Non – controlling interest	145.750	506.000
Total equity	4.152.226	4.195.700
Total Liabilities and Equity	9.478.469	7.595.070

ABC Entity acquired at 01 August 2012 all issued capital shares of S entity. The net assests acquired by ABC are presented in currency units bellow:

Description	**Amount**
Property, plant and equipment - equipments	825.000
Inventories	385.500
Trade and other receivables	633.419
Cash and cash equivalents	12.831
Overdraft	-22.000
Trade and other payables	-522.500
Interest-bearing loans	-330.500
Net assets	981.750

The value of the considaration paid by ABC entity for all issued capital shares of S entity is presented in currency units bellow:

Description	Amount
Shares	308.000
Cash	866.250
Total consideration paid	1,174,250

The amounts of non – current assets of ABC entity are presented at 31 December 2012 in currency units as follow:

Property, plant and equipment

Description	Amount
Balance at 31 December 2011	4.317.500
Property, plant and equipment - subsidiary	1.237.745
Acquisitions by financing leasing	27.500
Acquisitions	1.553.750
Disposals	-165.000
Balance at 31 December 2012	6.971.495
Accumulated depreciation	
Balance at 31 December 2011	825.000
Recorded during the year	440.000
Property, plant and equipment - subsidiary	412.745
Related to the disposals	-68.750
Balance at 31 December 2012	1.608.995
Carrying amount at	
31 December 2012	5.362.500
31 December 2011	3.492.500

Intangible assets

Description	Goodwill	Licenses	Total
Balance at 31 December 2011	112.245	247.500	359.745
Acquisitions	192.500	0	192.500

Amortization during the year	-123.826	-233.750	-357.576
Balance at 31 December 2012	180.919	13.750	194.669

During the year the goodwill was tested and depreciated. The value of depreciation was CU 123.826.

ABC entity presents the following values, in currency units, for the equity items:

Equity	**Ordinary shares**	**Share premium**
Balance at 31 December 2011	1.099.500	797.500
Shares issued at acquisition date	76.500	231.500
Shares issue costs		-2.750
Balance at 31 December 2012	1.176.000	1.026.250

ABC entity recorded CU 40.570 divideds (debit in equity) during the year The annual interest rate paid for preferred shares is 8% for 2012 (8% for 2011).

Non – current and current liabilities are presented in currency units bellow:

Non – current liabilities	**31 December 2012**	**31 December 2011**
Long term debts - bonds (11%)	66.100	
Interest-bearing loans	1.289.900	
Financial leasing liabilities	538.745	863.495
Total	1.894.745	863.495

Current liabilities	**31 December 2012**	**31 December 2011**
Overdraft	41.125	0
Trade payables	1.567.184	962.797
Trade payables – for non – current assets acquired	880.155	591.328
Financial leasing liabilities	54.911	77.233
Tax on profit liabilities	653.303	704.875

Dividends	222.070	192.267
Interest liabilities for financial leasing	4.625	4.375
Interest liabilities for loans	8.125	3.000
Total	3.431.498	2.535.875

ABC entity distributed during the year all outstanding preferred dividends. Also the entity sold an equipment for CU 4.175 profit. The amount of the profit is included in the „Net operating expense" line from consolidated statement of comprehensive income.

Preliminary calculations of preparation of Consolidated Cash Flow Statement are listed bellow:

1. Decrease in inventories	**- in CU -**
Balance at 31/12/2012	1.181.825
Inventories from acquired subsidiary	-385.500
	796.325
Balance at 01/01/2012	1.071.900
Decrease in inventories	-275.575

2. Decrease in trade and other receivables	**- in CU -**
Balance at 31/12/2012	2.009.900
Trade and other receivables from acquired subsidiary	-633.419
	1.376.481
Balance at 01/01/2012	1.953.475
Decrease in trade and other receivables	-576.994
Sales during the year	1.581.250
Cash receipts from customers	2.158.244

3. Increase in trade and other payables	**- in CU -**
Balance at 31/12/2012	1.567.184
Trade and other payables from acquired subsidiary	-522.500
	1.044.684
Balance at 01/01/2012	962.797

Increase in trade and other payables	81.887

4. Interest paid	**- in CU -**
Balance at 01/01/2012	7.375
Interest expenses	6.890
Balance at 31/12/2012	-12.750
Interest paid during the year	1.515
Preferred dividends	4.596
Total	6.111

5. Dividends paid	**- in CU -**
Balance at 01/01/2012	192.267
Dividends declared during the year	35.974
Balance at 31/12/2012	-222.070
Dividends paid during the year	6.171

6. Dividends paid to non-controlling interests	**- in CU -**
Balance at 01/01/2012	506.000
Dividends declared during the year	2.750
Balance at 31/12/2012	-145.750
Dividends paid during the year	363.000

7. Income taxes paid	**- in CU -**
Balance at 01/01/2012	704.875
Income tax expense	16.303
Balance at 31/12/2012	-653.303
Income taxes paid during the year	67.875

8. Proceeds from sale of equipment	**- in CU -**
Profit from sale of equipment	4.175
Carrying value of equipment sold	96.250
Proceeds from sale of equipment	100.425

9. Payments for non-current assets	**- in CU -**

Balance at 31/12/2012	5.362.500
Carrying values of non-current assets from acquired subsidiary	-825.000
Acquisitions by financial leasing	-27.500
Carrying value of disposed non – current assets	96.250
Amortization expense	440.000
Increase in trade payables for non-currents assets acquired	-288.827
	4.757.423
Balance at 01/01/2012	3.492.500
Amounts paid for non-current assets acquisitions	1.264.923

10. Financial leasing liabilities	**- in CU -**
Balance at 01/01/2012	940.728
Additional during the year	27.500
Balance at 31/12/2012	-593.656
Amounts paid during the year	374.572

11. Loans	**- in CU -**
Balance at 31/12/2012	1.289.900
Loans from acquired subsidiary	-330.500
	959.400
Balance at 01/01/2012	0
Proceeds during the year	959.400

12. Long term debts - bonds	**- in CU -**
Balance at 31/12/2012	66.100
Balance at 01/01/2012	0
Proceeds during the year	66.100

13. Acquisition of subsidiary S (net of cash acquired)	**- in CU -**
Cash paid	866.250
(-) Cash acquired	-12.831

(+) Overdraft	22.000
Amounts paid	875.419

ABC entity prepares at 31 December 2012 the consolidated statement of cash flow based on previous calculations as follow:

Statement of cash flows for the year ended 31 December 2012	**- in CU -**
Cash flows from operating activities (Indirect method)	
Profit before tax	71.149
Adjustments for non-cash income and expenses:	
Amortization and depreciation expense (357.576 +440.00)	797.576
Profit on sale of property, plant and equipment	-4.175
Income from financial investments (see Comprehensive Income)	-8.865
Interest expense	6.890
Decrease in trade and other receivables (note 2)	576.994
Decrease in inventories (note 1)	275.575
Increase in trade and other payables (note 3)	81.887
Interest paid (note 4)	-6.111
Income taxes paid (note 7)	-67.875
Dividends paid to owners of ABC Entity (note 5)	-6.171
Net cash from operating activities	1.716.874
Cash flows from operating activities (Direct method)	
Cash receipts from customers (note 2)	2.158.244
Cash paid to suppliers	-285.864
Cash paid for all other operating expenses	-75.349
Interest paid (note 4)	-6.111
Income taxes paid (note 7)	-67.875
Dividends paid to owners of ABC Entity (note 5)	-6.171
Net cash from operating activities	1.716.874
Cash flows from investing activities	
Amount paid for acquisition of subsidiary S (net of cash acquired) (note 13)	-875.419

Proceeds from sale of property, plant and equipment (note 8)	100.425
Amount paid for purchase of property, plant and equipment (note 9)	-1.264.923
Interest received	8.865
Dividends received	0
Net cash used in investing activities	-2.031.052
Cash flows from financing activities	
Proceeds from long term debts – bonds (note 12)	66.100
Proceeds from long term loans (note 11)	959.400
Payment of finance lease liabilities (note 10)	-374.572
Dividends paid to non controlling interests (note 6)	-363.000
Payment of shares issue costs	-2.750
Net cash from financing activities	285.178
Net decrease in cash and cash equivalents	-29.000
Cash and cash equivalents at the beginning of the year	717.450
Cash and cash equivalents at the end of the year	688.450

Cash and cash equivalents at the end of the year CU 688.450 is calculated as difference between amounts of cash and cash equivalents (CU 729.575) and overdraft's amount (CU 41.125). „Change in net cash (ΔTN) from the beginning to the end of the financial year represent cash flow (CF). Liberates management operations cash flow as cash flow management consists of: net income, depreciation, interest" [Gherghina, Duca, 2012, pp.35].

Conclusions

The statement of cash flows reflects a decrease in cash and cash equivalents of CU 29.000 explained as mentioned bellow:

a) net cash used in investing activities (the entity paid the suppliers for non – current assets and paid for acquisition of the subsidiary S; these payments do not represents expenses from accrual basis accountancy point of view);

b) cash excess generated by operating activities has the effect for:

• DSO (Days Sales Outstanding) – 456 days
• DPO (Days Payables Outstanding) – 292 days
• Inventory Turnover - 330 days

The value of Current Ratio is 1.14 and that means that the entity can cover its current liabilities from current assets. However, the indicator is relevant if and only if the current debts payment conditions are the same with the collection terms relating to accounts receivables. The comparative analysis, of mentioned above keys, results an alarming situation regarding the general condition of the entity because it is facing with (i) overstock- difficulty in selling the inventories, (ii) cash gaps: time of collection of trade receivables are abnormal and the DSO is far higher than DPO, and (iii) also the entity has unpaid tax debts (i.e. tax on income liabilities from previous year).

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