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IAS® Standard 7 Statement of Cash Flows

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CASE STUDY - IAS 7 STATEMENT OF CASH FLOWS

Introduction

Information about the entity's cash flows is fundamental for external users in assessing the entity's evolution and its prospects. The statement of cash flows presents the changes in cash and cash equivalents during an accounting period and complements the information reported in the statement of financial position and the statement of profit or loss.

The aim of this case study is to prepare and interpret the statement of cash flow. You are a junior analyst working with a bank and you prepare various analyses to support decision making (to grant loans or not).

The Case Information

You have on your desk the simplified financial statements of Cashy Co., a small, listed company applying for an additional loan. The owners of the Cashy Co. regularly decide to invest in additional property, plant and equipment, but they also cash in significant amounts of dividends. Now they must face a decrease in the market, resulting in increases in inventories, decrease in sales, profit, and cash. So, they apply for an additional loan to face the increasing challenges that they encounter.

The full financial statements are prepared in accordance with IFRS. However, to provide a more aggregated picture of the company, you prepared a synthesised statement of financial position and the statement of profit or loss. The simplified financial statements you prepared are the following:

Statement of financial position as of 31 December 20X1

Assets	20X1 (in CU)	20X0 (in CU)
Non-current assets		
Property, plant and equipment	180,000	160,000
Total non-current assets	**180,000**	**160,000**
Current assets		
Inventories	40,000	20,000
Accounts receivable	30,000	10,000
Cash and cash equivalents	10,000	30,000
Total current assets	**80,000**	**60,000**
Total assets	**260,000**	**220,000**
Equity and liabilities		
Share capital	80,000	80,000
Retained earnings	20,000	20,000
Profit	10,000	30,000
Total equity	**110,000**	**130,000**
Non-current liabilities		
Bank loans	80,000	50,000
Total non-current liabilities	**80,000**	**50,000**
Current liabilities		

Accounts payable Bank loans	50,000 20,000	30,000 10,000
Total current liabilities	**70,000**	**40,000**
Total equity and liabilities	**260,000**	**220,000**

Statement of profit or loss for the year ended 31 December 20X1

	20X1 (in CU)	20X0 (in CU)
Sales	180,000	210,000
Cost of merchandise sold/merchandise expense	(110,000)	(125,000)
Wages expenses	(30,000)	(22,000)
Depreciation expense	(10,000)	(10,000)
Interest expense	(12,000)	(8,000)
Income tax expense	(8,000)	(15,000)
Profit	10,000	30,000

Now you must continue the analysis, but you misplaced the entity's full financial statements. However, you are confident that you can prepare a simplified statement of cash flow based on the simplified versions of the financial statements presented above. You remember that Cashy Co. employs the indirect method to present its operating cash flow and classifies interest paid as operating and dividends paid as financing cash flows. All bank loans are long term. The changes in the values reported in the statement of the financial position are a very good representation of the entity's main cash flows incurred for the specific elements over the period.

Discussion Questions

Prepare the entity's statement of cash flows for the year 20X1. What is a preliminary indication of the entity's prospects based on this?

SOLUTION OF CASE STUDY - IAS 7 STATEMENT OF CASH FLOWS

First, we analyse the changes in the amounts reported in the statement of the financial position to identify the main investing and financing cash flows.

The change in property, plant and equipment indicates acquisitions. The net change in amount is CU20,000, but the statement of profit or loss indicates CU10,000 depreciation for the year. Therefore, the value of non-current acquisitions is CU30,000.

The 20X0 profit was appropriated. Since there is no change in retained earnings, it was fully distributed as dividends.

There are changes in the bank loans. The current portion of the bank loan from 20X0 (that is, of CU10,000) was paid in 20X1.

The current portion of the bank loan from 20X1 (CU20,000) was reclassified in current liabilities from the non-current ones. Therefore, the new bank loans contracted (affecting non-current liabilities) are CU50,000 (80,000 – (50,000 – 20,000)).

Statement of cash flows

Cash flows from operating activities (all amounts in CU)	
Profit	10,000
1) adjustment for non-cash income or expense items	
Depreciation expense	+10,000
2) adjustment for income or expense resulting in investing or financing cash flows	
Interest expense	0
3) changes in inventories, receivables, payables and other operating items	
Increase in inventories	(20,000)
Increase in accounts receivable	(20,000)
Increase in accounts payable	+20,000
= Net cash flows from operating activities (I)	=0
Cash flows from investing activities	
Cash payments to suppliers of non-current assets	(30,000)
= Net cash flow from investing activities (II)	=(30,000)
Cash flows from financing activities	
Cash received from bank loans	50,000
Payments for loan reimbursements	(10,000)
Dividends paid	(30,000)
= Net cash flow from financing activities (III)	=10,000
Total net cash flow (IV) = (I) + (II) + (III)	(20,000)
Cash and cash equivalents as of 01.01.20X0 (V)	30,000
Cash and cash equivalents as of 31.12.20X1 (VI) = (IV) + (V)	10,000

The statement of cash flows indicates the following:

- the entity does not generate a positive operating cash flow, which is crucial for the long-term stability of the business;
- the entity employed bank loans to finance investments but also to pay dividends (since there is no operating cash flow generated), which is again not a sustainable model.
- This may indicate that the entity may not receive any additional loans, as it may face cash issues in the future, given its current challenges and changes to financial position.