IAS 7 Cash flow statements

1 *IAS 7 Cash Flow Statements* governs how an entity should put together its cash flow statements.
2 In a very simple way, a cash flow statement shows opening cash plus any receipts in the period and minus any payments.
3 For preparing the cash flow statements of an entity, though, a greater level of detail is required.
4 So let's take a look at the elements of a cash flow statement.
5 First, there is cash.
6 IAS 7 defines the cash as being short term, that is, less than three months, highly liquid, subject to insignificant change in value risk, and readily convertible into cash.
7 One of the elements of a cash flow statement is cash flows from operating activities.
8 These include all cash receipts and payments an entity incurs through buying and selling goods or services in the normal course of business.
9 There are two methods of calculating cash flow from operating activities, namely, the direct method and the indirect method.
10 Under the direct method you will list all cash receipts from customers, payments to employees, payments to suppliers, interest paid, taxes paid, and dividends paid.
11 Under the indirect method you will start off with the net profit figure from the statement of comprehensive income and adjust it for any non-cash items—for example, depreciation, amortization, impairment, gains or losses on the sale of assets, or any change in working capital.
12 You should also adjust for any expenses incurred or sales made on credit, as these do not affect the cash position of the company.
13 Cash flows from investing activities relate to the acquisition and disposal of long-term assets and other investments that are not considered to be cash equivalents.
14 These will include sales and purchases of non-current assets, such as property, plant, and equipment; receipts or payments for long-term investments, and receipts or payments resulting from loans to other entities.
15 Cash flows from financing activities refer to the activities that cause changes to the contributed equity and borrowings of an entity—for example, when a company issues shares, when it issues debentures, or, generally, when it borrows money.
16 A cash flow statement has both positive and negative features.
17 Some of the benefits of using a cash flow statement are that:
18 it shows you the quality of profit being made, whether it's coming from the operating activities, or whether it's coming from ancillary or one of the investments;
19 it's harder to manipulate than the other statements, as it focuses purely on the cash paid and received, and cannot be affected by accounting policies;
20 it provides you with more information than you would probably receive otherwise through other statements,
21 and it gives you a good starting point to help value the business.
22 Some of the drawbacks are that:
23 it is prepared on a historical basis, and doesn't consider any future income, though this can be said for all financial statements;
24 it's not suitable for some industries, especially those that are capital intensive;
25 it also requires the other financial statements to properly interpret, such as the statement of comprehensive income and the statement of financial position.
26 If you'd like to learn more about accounting, please feel free to visit us on EruditeApe.com.