FAR-1 — FINANCIAL ACCOUNTING & REPORTING 1

Topic: STATEMENT OF CASH FLOWS — IAS 7

1 TOPIC OVERVIEW

WHAT IS IT?
IAS 7 prescribes how to present a statement of cash flows reflecting changes in an entity's cash and cash equivalents during the period, classified by operating, investing and financing activities.

WHY IMPORTANT?
Profit ≠ cash. Every entity needs cash to operate, pay obligations, and reward investors — the SCF shows exactly how cash was generated and used, unaffected by accounting policy choices.

CORE PRINCIPLE
Classify every cash movement into operating, investing, or financing; non-cash transactions are excluded entirely but disclosed separately elsewhere.

2 KEY DEFINITIONS [IAS 7:6-9]

Cash: Cash on hand and demand deposits. Bank overdrafts repayable on demand are included as a component of cash and cash equivalents.

Cash equivalents: Short-term, highly liquid investments readily convertible to known amounts of cash, subject to an **insignificant risk** of value changes — normally maturity of 3 months or less from acquisition. Equity investments excluded unless in-substance cash equivalents.

Cash flows: Inflows and outflows of cash and cash equivalents — **excludes** movements between items that are themselves cash/cash equivalents (e.g. depositing cash on hand into a bank account).

Operating activities: Principal revenue-producing activities and anything else that isn't investing or financing.

Investing activities: Acquisition/disposal of long-term assets and other investments not in cash equivalents.

Financing activities: Activities changing the size/composition of contributed equity and borrowings.

WORKED CHECK — CASH EQUIVALENTS [Example 01 & 03]
Listed ordinary shares → NOT a cash equivalent (significant risk of value change). Prize bonds and 2-month treasury bills → cash equivalents. Trade receivables, PPE, inventory → never cash equivalents (not investments / not readily convertible). Total cash & cash equivalents = cash in hand + demand deposits + ≤3-month term deposits + qualifying short-term investments + prize bonds **− bank overdraft** (a 2-year term deposit and trade receivables are excluded).

3 CLASSIFICATION — OPERATING, INVESTING OR FINANCING? [IAS 7:6,10,12,14,16,17]

Activity	Examples of cash flows
Operating	Receipts from sale of goods/services, royalties/fees/commissions; payments to suppliers and employees; income tax paid (unless specifically identifiable with financing/investing).
Investing	Payments to acquire/construct PPE, intangibles, other long-term assets; receipts from their sale; payments/receipts for equity or debt instruments of other entities (excl. cash equivalents/held for trading); loans and advances made/repaid.
Financing	Proceeds from issuing shares; proceeds from issuing debentures/loans/bonds/mortgages; repayments of amounts borrowed.

A single transaction can split across categories — e.g. a loan repayment's **interest** element may be operating while the **capital** element is financing.

4 WORKED CLASSIFICATION CHECK [Example 05]

Item	Classification
Cash received from customers / cash sales	Operating
Proceeds from disposal of PPE	Investing
Right issue of shares / repayment of loan	Financing
Dividend paid / Interest paid	Financing **or** Operating (policy choice)
Interest received by a trading entity	Investing
Salaries paid / Taxes paid	Operating
Purchase of a patent/software / Advance paid to supplier	Investing / Operating
Depreciation / Bonus issue / Impairment loss	**Non-cash** — not in the SCF at all

PRESENTATION FORMAT & INTEREST, DIVIDEND, TAX

5 OVERALL SCF STRUCTURE [IAS 7:6,10,12,14,16,17]

Cash generated from (used in) operating activities	X/(X)
Cash generated from (used in) investing activities	X/(X)
Cash generated from (used in) financing activities	X/(X)
Net increase (decrease) in cash and cash equivalents	**X/(X)**
Cash and cash equivalents at beginning of period	X
Cash and cash equivalents at end of period	**X**

6 INTEREST, DIVIDEND & TAX CLASSIFICATION [IAS 7:31–34]

Item	Suggested classification*	Alternative
Interest paid	Operating (deducted in P&L)	Financing (cost of obtaining finance)
Interest received	Investing (return on investment)	Operating (added in P&L)
Dividend received	Investing (return on investment)	Operating (added in P&L)
Dividend paid	Financing (cost of obtaining finance)	Operating (shows ability to pay dividends from operating cash)

*Based on the illustrative example accompanying IAS 7. Each item is disclosed **separately** and classified **consistently** period to period. **Income tax** cash flows are separately disclosed and classified as **operating** unless specifically identifiable with financing/investing activities.

7 NON-CASH TRANSACTIONS [IAS 7:43]

Investing/financing transactions that don't require cash are **excluded** from the SCF entirely — e.g. conversion of debt to equity, bonus issue of shares, revaluation and/or impairment of non-current assets. They must still be **disclosed elsewhere** in the financial statements.

8 CALCULATING INTEREST PAID & TAX PAID

AMOUNT PAID (INTEREST / TAX)

Expense + Opening accrual (payable) – Closing accrual (payable)

WORKED CHECK [Examples 06–07]

Interest payable: opening Rs.4,000, closing Rs.6,000, P&L charge Rs.22,500 → paid = **22,500+4,000−6,000 = Rs.20,500**. Tax payable: opening Rs.53,000, closing Rs.61,000, tax expense Rs.77,000 → paid = **77,000+53,000−61,000 = Rs.69,000**. (Same answer either via a T-account or the formula.)

9 FINDING PROFIT BEFORE TAX

Profit before tax = Profit after tax (found as the balancing figure in a **retained earnings account**: opening RE + profit after tax − dividends = closing RE) **+** tax expense added back. [Example 08: opening RE Rs.4,000, closing Rs.6,000, dividend Rs.20,000 paid → profit after tax (balancing) = **Rs.22,000**; + Rs.3,000 tax = **Profit before tax Rs.25,000**.]

10 CALCULATION ROADMAP — SCF QUESTIONS

1. Identify cash/non-cash, then classify activity
2. Choose direct or indirect method
3. Adjust profit for non-cash items & investing/financing income-expense
4. Apply working capital changes
5. Separately disclose interest & tax paid
6. Sum to net change in cash

REPORTING OPERATING CASH FLOWS — INDIRECT & DIRECT

11 INDIRECT METHOD — ADJUSTMENTS & WORKING CAPITAL [IAS 7:18,20]

Start from profit before tax and reverse: (a) non-cash items (depreciation, bad debts, etc.); (b) income/expense tied to investing/financing (gain/loss on disposal, dividend received); (c) finance cost (since interest paid is disclosed separately).

✔ WORKING CAPITAL CHANGES INCLUDED

Increase in assets → outflow; decrease in assets → inflow; increase in liabilities → inflow; decrease in liabilities → outflow (inventory, trade receivables/payables, accrued salaries, etc.)

✘ EXCLUDED FROM WORKING CAPITAL

Cash/cash equivalents; other receivables/payables relating to non-current assets; short-term investments; short-term borrowings; interest payable; tax payable (all handled elsewhere/separately).

12 FULL WORKED EXAMPLE — INDIRECT vs DIRECT METHOD [Example 09 pattern]

Cash flows from operating activities (both methods reach the same figures)	
Cash generated from operations (Note 1)	293,000
Interest paid [50,000+30,000−45,000]	(35,000)
Income taxes paid [40,000+52,000−43,000]	(49,000)
Net cash from operating activities	**209,000**

Note 1 — INDIRECT method	
Profit before tax	190,000
Add: Depreciation	25,000
Add: Finance costs	50,000
Operating profit	265,000
Inventories [124,000−118,000]	(6,000)
Trade receivables [233,000−219,000]	14,000
Trade payables [125,000−102,000]	23,000
Accrued salaries [5,000−8,000]	(3,000)
Cash generated from operations	**293,000**

Note 1 — DIRECT method	
1.1 Cash received from customers [Revenue 1,280,000 + decrease in receivables 14,000]	1,294,000
1.2 Cash paid to suppliers & employees [Cost of sales+Dist.+Admin. − Depreciation add-back + WC changes]	(1,001,000)
Cash generated from operations	**293,000**

Cash received from customers = revenue (+ other customer-related income) adjusted for receivables/unearned income movements. **Cash paid to suppliers & employees** = operating expenses (excl. finance cost) adjusted for non-cash items and remaining working capital changes.

13 BAD & DOUBTFUL DEBTS — GROSS vs NET RECEIVABLES

Two acceptable approaches — but **always use the gross-receivables method in exams when the data is available**.

Method	Treatment
Gross receivables (exam default)	Add back bad debts expense & doubtful debts (allowance) expense as adjustments; working capital change uses the movement in **gross** receivables.
Net receivables	No separate bad/doubtful debts adjustment; working capital change uses the movement in **net** receivables (after allowance).

WORKED CHECK [Example 11]

Gross receivables 480→500, allowance 12→15, bad debts written off Rs.8m. **Gross method:** add back bad debts Rs.8m + doubtful debts increase Rs.3m; WC change = [(500+8)−480] = **(28)**. **Net method:** no add-backs; WC change = [485−468] = **(17)**. Both give the same final cash figure.

INVESTING & FINANCING CASH FLOWS, EXAM STRATEGY & RECAP

14 INVESTING ACTIVITIES — CALCULATION TIPS [IAS 7:21; IAS 20:28]

Focus on PPE, CWIP, investment property, long & short-term investments (excl. held-for-trading/cash equivalents). Include income from these assets (rent, dividends received). Build T-accounts: **PPE** (additions/disposals/depreciation), **Accumulated depreciation** (depreciation charge), **Disposal** (gain/loss, proceeds). Adjust for non-cash items (revaluation gains, assets acquired on credit/non-cash consideration). Combine current+non-current portions of the same item (e.g. deferred grant) to save time.

Worked check [Example 12: gain on disposal Rs.3m, cost Rs.60m, acc.dep Rs.45m at disposal; grant income Rs.25m recognised]	
Depreciation [acc.dep: 105+28−45=88] → charge	28
Purchase of plant [b/d 150 + bal. 90 – disposal 60 = c/d 180]	(90)
Sale proceeds [(60−45) NBV + 3 gain]	18
Receipts from government grant [b/d 60+20, c/d 80+24, less 25 to P&L → bal.]	49
Net cash used in investing activities	**(23)**

If a revaluation occurred, add the **gain on revaluation** into the PPE T-account (debit side, non-cash) before balancing for cash paid. If CWIP exists, prepare a separate CWIP T-account and transfer completed amounts into the PPE account.

15 FINANCING ACTIVITIES — CALCULATION TIPS

Focus on equity and borrowings (long & short-term). Find dividends paid via a **retained earnings account**. Combine share capital + share premium into one T-account for share proceeds. Adjust for non-cash items (bonus shares, shares issued for non-cash consideration, debt-to-equity conversion). Combine current + non-current portions of the same loan. Present loan proceeds and loan repayments **separately** (not netted).

Worked check [Example 15]	
Proceeds from issue of shares [Share capital+premium T-a/c, less bonus shares]	420,000
Receipt of loan	30,000
Repayment of loans [b/d 600+80, +30 received, c/d 520+55 → bal.]	(135,000)
Dividends paid [RE: opening+profit−bonus shares−closing → bal.]	(200,000)
Net cash from financing activities	**115,000**

16 USEFULNESS OF CASH FLOW INFORMATION [IAS 7:4,5,13,16,17]

OPERATING
Key indicator of whether operations generate enough cash to repay loans, maintain operating capacity, pay dividends, and invest — without external financing.

INVESTING
Shows the extent of spending on resources intended to generate future income and cash flows.

FINANCING
Useful for predicting future claims on cash by providers of capital (lenders, shareholders).

Cash flow info eliminates the effect of different accounting policy choices between entities — improving comparability. A profitable business can still fail from lack of cash; a loss-making one can survive if it has cash or access to liquid assets.

! ⚠ EXAM TRAPS — COMMON MISTAKES

- Including **depreciation, bonus issues, revaluations or impairments** as actual cash flows — all are non-cash and either adjusted for (depreciation) or excluded entirely.
- Recording a deposit of cash-in-hand into a bank account as a cash flow — movements **between** cash/cash equivalent items are never cash flows.
- Netting **loan proceeds against repayments**, or share issue proceeds against dividends — each major class must be shown gross and separately.
- Forgetting to separately disclose **interest paid and tax paid** even under the indirect method.
- Using **net** receivables when the question gives enough detail for the gross-receivables method — the gross method is the exam default whenever the data allows it.
- Including **interest payable or tax payable** as an ordinary working-capital change — both are used only in the interest-paid/tax-paid calculation, not general working capital.
- Forgetting to add back **finance cost** in the indirect method reconciliation before showing interest paid as a separate line.
- Mixing up which direction increases/decreases in assets vs liabilities go (asset up = cash out; liability up = cash in).
- Treating short-term investments or short-term borrowings as **operating** working capital items — they belong to investing/financing respectively.
- Forgetting to include a **gain or loss on disposal** as an adjustment when reconciling profit to operating cash flow (it isn't itself a cash flow — the actual cash flow is the sale proceeds under investing).

17 QUICK DECISION TREE — ANSWERING ANY IAS 7 QUESTION

1 Question given → 2 Cash or non-cash item? → 3 Operating, investing, or financing? → 4 T-account / formula for the missing figure → 5 Slot into SCF proforma → ✔ Final answer

IAS 7 — STATEMENT OF CASH FLOWS IN 60 SECONDS

Cash & cash equivalents: cash + demand deposits + ≤3-month liquid investments − bank overdraft.

3 categories: Operating (core business), Investing (long-term assets), Financing (equity/borrowings).

Interest/dividend paid = operating or financing; **received** = investing or operating (choose consistently).

Amount paid = expense + opening accrual − closing accrual.

Indirect method: profit before tax + non-cash items + finance cost ± working capital changes = cash generated from operations.

Direct method: cash received from customers − cash paid to suppliers/employees = same total.

Bad debts: use gross receivables method in exams whenever data allows.

Investing/financing: build T-accounts (PPE, acc. dep., disposal, share capital+premium, loans, retained earnings) to find missing cash figures.

Non-cash transactions (bonus issue, debt-to-equity, revaluation) — excluded from SCF, disclosed elsewhere.