

CASH FLOW STATEMENT

16 APRIL 2015

Section A: Summary Content Notes

A complete cash flow statement looks like this:

CASH FLOW STATEMENT FOR YEAR ENDED...

	Notes	
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash generated from operations	1	<input type="text"/>
Interest paid		
Dividends paid	3	
Taxation paid	4	
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of non-current assets		<input type="text"/>
Proceeds from disposal of non-current assets		<input type="text"/>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issue of share capital		<input type="text"/>
Repurchase of shares		
Proceeds from/Repayments of long-term borrowings		
NET CHANGE IN CASH AND CASH EQUIVALENTS		
Cash and cash equivalents: beginning of year	2	<input type="text"/>
Cash and cash equivalents: end of year	2	<input type="text"/>

NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED...

1	
RECONCILIATION BETWEEN PROFIT BEFORE TAXATION AND CASH GENERATED FROM OPERATIONS	
Profit before taxation	<input type="text"/>
Adjustment in respect of:	
Depreciation	<input type="text"/>
Interest expense	<input type="text"/>
Operating profit before changes in working capital	<input type="text"/>
Changes in working capital	
Increase/Decrease in inventory	<input type="text"/>
Increase/Decrease in trade and other receivables	<input type="text"/>
Increase/Decrease in trade and other payables	<input type="text"/>
Cash generated from operations	<input type="text"/>

notes for...

2	CASH AND CASH EQUIVALENTS	Net change	Year 2	Year 1
	Bank			
	Cash float			
	Petty cash			

3.	DIVIDENDS PAID Amount owing at the end of the previous year Total dividends for year paid and declared Amount owing at the end of the current year Amount paid	_____ _____
4.	TAXATION PAID Amount owing at the end of the previous year Income Statement amount Amount owing at the end of the current year Amount paid	_____ _____

Follow the steps below to complete the cash flow statement:

1. Note for Reconciliation Between Profit Before Taxation And Cash Generated From Operations

NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED...

1	RECONCILIATION BETWEEN PROFIT BEFORE TAXATION AND CASH GENERATED FROM OPERATIONS	
	Profit before taxation	a
	Adjustment in respect of:	
	Depreciation	b
	Interest expense	c
	Operating profit before changes in working capital	d
	Changes in working capital	
	Increase/Decrease in inventory	e
	Increase/Decrease in trade and other receivables	f
	Increase/Decrease in trade and other payables	g
	Cash generated from operations	h

a) Profit before taxation: This is found in the income statement. Note that you have to use profit **before** taxation here, i.e. net profit before tax in the income statement. You will sometimes need to calculate this figure from other figures.

- If you are given profit after tax, use the formula

$$\text{Profit before tax} = \text{Profit after tax} \times \frac{100}{(100 - \text{tax rate})}$$

- If you are given income tax, use the formula

$$\text{Profit before tax} = \text{Income tax} \times \frac{100}{\text{tax rate}}$$

Sometimes the question will require you to draw up an appropriation account or work backwards from a formula (e.g. Earnings per share) to get this figure.

b) Depreciation: This is the total depreciation for the year, from the income statement. It must be **added back** to profit before taxation because it is a non-cash item that was originally subtracted to get the net profit. You may be required to calculate depreciation for the year on fixed assets to get this figure (e.g. the question might not tell you how much the depreciation was, but tell you that Equipment and Vehicles are depreciated at a rate of 15% on cost).

c) Interest expense: This is the total interest expense for the year as shown in the income statement. It must also be **added back** to profit before taxation because it is a cash flow from financing activities. Again, the question might require you to calculate interest by giving you a mortgage bond, an interest rate and various repayments.

d) Operating profit before changes in working capital: This is a + b + c.

e) Increase/decrease in inventory: Calculate this figure by subtracting inventory at the beginning of the year from inventory at the end of the year to see how much inventory has increased/decreased during the year. Remember that inventory = trading stock + consumable stores on hand. If you have an **increase**, you must **subtract** this figure while a **decrease** must be **added**.

f) Increase/decrease in trade and other receivables: Calculate this figure by subtracting trade and other receivables at the beginning of the year from trade and other receivables at the end of the year. It is very important to take note of the following:

- Trade and other receivables = Debtors + Accrued income + Prepaid expenses
- You must **not** include any accrued income or prepaid expenses that involve SARS (income tax) or interest because there is an adjustment for these later on. So remember to **exclude SARS** and **Interest** from this calculation.
- Again, just like inventory, you must **add a decrease** and **subtract an increase**.

g) Increase/decrease in trade and other payables: Calculate this figure by subtracting trade and other receivables at the beginning of the year from trade and other payables at the end of the year. It is very important to take note of the following:

- Trade and other payables = Creditors + Accrued expenses + Deferred income
- You must **not** include any accrued expenses or deferred income that involve SARS (income tax), shareholders for dividends or interest because there is an adjustment for these later on. So remember to **exclude SARS, Shareholders for dividends** and **Interest** from this calculation.
- This time, you must **add an increase** and **subtract a decrease**.

notes for...

h) Cash generated from operations: This is the operating profit before changes in working capital (d) plus/minus the changes in working capital (e, f and g). Rewrite this figure next to cash generated from operations on the face of the cash flow statement, like this:

CASH FLOW STATEMENT FOR YEAR ENDED...

	Notes	
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash generated from operations	1	h
Interest paid		i
Dividends paid	3	j
Taxation paid	4	k
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of non-current assets		l
Proceeds from disposal of non-current assets		m
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issue of share capital		n
Proceeds from/Repayments of long-term borrowings		o
NET CHANGE IN CASH AND CASH EQUIVALENTS		
Cash and cash equivalents: beginning of year	2	p
Cash and cash equivalents: end of year	2	q
		r

Now return to the face of the cash flow statement to fill in the other missing figures. Start with interest, dividends and taxation paid. Remember that these are all outflows of cash and must be shown in brackets.

i) Interest paid: This is the total amount of interest actually paid during the year – i.e. the amount of cash that left the business' bank account to pay interest. Use the following calculation:

$$\text{Interest paid} = \text{Amount in income statement} + \text{Interest owed at the beginning of the year} - \text{Interest owed at the end of the year}$$

The interest owed at the beginning of the year will be an accrued expense, as will the interest owed at the end of the year. The amount in the income statement is the same figure as in (c) in note 1.

Sometimes, the business will have prepaid some of its interest for the year. If this happens, the calculation becomes:

$$\text{Interest paid} = \text{Amount in income statement} - \text{Prepaid interest at the beginning of the year} + \text{Prepaid interest at the end of the year}$$

Notice how the signs change in the calculation. Make sure you understand this calculation clearly!

j) Dividends paid: This is the total amount of dividends actually paid during the year (excluding dividends declared but not paid, and including dividends declared last year but paid this year). The calculation can be done in note 3:

3. DIVIDENDS PAID

- Amount owing at the end of the previous year
- Total dividends for year paid and declared
- Amount owing at the end of the current year
- Amount paid

	s
	t
	u
	v
	v

s = Balance on the shareholders for dividends account at the beginning of the year.

t = Total dividends (paid + declared) for the year. This is the balance on the Ordinary Share Dividends account for the year, but the question might require you to calculate this figure (e.g. by saying that a dividend of 45c per share was declared if there are 100 000 ordinary shares)

u = Balance on the shareholders for dividends account at the end of the year.

$$v = s + t - u$$

Alternative method

Note that you may also use a T-account to calculate the amount paid – if you draw up your Shareholders for Dividends and Ordinary Share Dividends accounts, then the amount paid is the Bank amount on the Debit side of these accounts added together. For example, if your ledger accounts look like this,

+ DIVIDENDS ON ORDINARY SHARES -						
Bank	CPJ	(a)		Appropriation	GJ	
Shareholders for dividends	GJ					

- SHAREHOLDERS FOR DIVIDENDS +						
Bank	CPJ	(b)		Balance	b/d	
				Dividends on ordinary shares	GJ	

then the amount paid for dividends = (a) + (b). These are the two bank amounts in the general ledger – i.e. the dividend paid is usually last year’s final dividend plus this year’s interim dividend. Use whichever method you find more logical!

k) Taxation paid: This is the total amount of tax that was actually paid during the year and can be done using note 4:

4. TAXATION PAID

Amount owing at the end of the previous year	w
Income Statement amount	x
Amount owing at the end of the current year	y
Amount paid	<u><u>z</u></u>

w = Balance on the SARS (Income tax) account at the beginning of the year. A Cr balance is positive and a Dr balance is negative.

x = Total income tax for the year. This is the figure that appears in the income statement as taxation for the year (usually 30% of net profit before tax).

y = Balance on the SARS (Income tax) account at the end of the year. This time, a Dr balance is positive and a Cr balance is negative.

z = w + x – y (note that you will have to change the signs for Debit balances on the SARS (Income tax) account).

Alternative method

Note that you may also use a T-account to calculate the amount paid. Draw up your SARS (income tax) general ledger account as follows:

SARS (INCOME TAX)						
Bank	CPJ	(a)		Balance*	b/d	
Bank	CPJ	(b)		Bank	CRJ	(d)
Bank	CPJ	(c)		Income tax	GJ	

The amount of taxation paid is then all the Bank amounts on the debit side added together, i.e. (a) + (b) + (c). If there is a Bank amount like (d) on the Credit side (a refund from SARS), then this must be subtracted from the amount paid. Remember that we are trying to calculate the amount of cash that left the company to pay SARS this year, so it is only the Bank amounts that are relevant.

This is the end of the cash flows from operating activities section. Subtract (i), (j) and (k) from Cash generated from operations in order to arrive at the answer for Cash flows from operating activities (right at the top of the cash flow statement).

Next, you have to do cash flows from investing activities:

CASH FLOWS FROM INVESTING ACTIVITIES

Purchases of non-current assets
Proceeds from disposal of non-current assets

l
m

notes for...

l) Purchases of non-current assets: This figure represents the total rand amount of fixed assets purchased for cash during the year. You will usually need to calculate this using the following calculation:

Purchases of non-current assets

Carrying value of assets at the beginning of the year	
+ Additions	?
- Disposals at carrying value	
- Depreciation for the year	
= Carrying value of assets at the end of the year	_____

Since we want to calculate additions, we can solve for the question mark using the following formula:

Additions = Carrying value at the end + depreciation + disposals – carrying value at the beginning.

Because this is a purchase of assets, remember that it is an outflow of cash and must be shown as a negative figure.

m) Proceeds from disposal of non-current assets: This is the total cash amount received from the sale of fixed assets. You may be required to draw up an asset disposal account to calculate this. Remember that it is the total cash amount received (i.e. the Bank figure in the general ledger) and not just the profit on the sale of the asset. This figure represents an inflow and must be shown as a positive figure. As a calculation, you can draw up the Asset disposal T-account (remember your Grade 11 work) as follows:

ASSET DISPOSAL					
Vehicles/Equipment	GJ			Accumulated depreciation on vehicles / equipment	
				Bank	(a)
Profit on sale of asset		OR		Loss on sale of asset	

Revise the section on fixed assets if you are unsure of how to do this T-account. The figure that we are interested in is the Bank amount on the Credit side – remember, we want to know what the PROCEEDS from our disposal of assets are, not the profit or loss, and if you have done the T-account correctly you can transfer the figure next to Bank (marked (a) in the T-account) to your cash flow statement as proceeds from disposal of assets.

The next section of the cash flow statement is the cash flows from financing activities section.

CASH FLOWS FROM FINANCING ACTIVITIES

Proceeds from issue of share capital		n
Proceeds from/Repayments of long-term borrowings		o

n) Proceeds from the issue of share capital: This is the total amount of cash received from the issue of shares. Calculate it as follows:

Ordinary share capital at the end of the year – Ordinary share capital at the beginning of the year)

This figure is an inflow of cash and will therefore be positive. There could also be a repurchase of shares, in which case the figure is negative.

o) Proceeds from/Repayments of long-term borrowings: This shows the change in long-term mortgage loans. Simply take the balance on the loan account at the end of the year and subtract the balance on the loan account at the beginning of the year. If this figure is negative, it represents a repayment of the loan; if it's positive, it means more money was borrowed.

The final section of the cash flow statement involves the change in cash and cash equivalents:

NET CHANGE IN CASH AND CASH EQUIVALENTS		p
Cash and cash equivalents: beginning of year	2	q
Cash and cash equivalents: end of year	2	r

notes for...

2	CASH AND CASH EQUIVALENTS	Net change	Year 2	Year 1
	Bank			
	Cash float			
	Petty cash			
		p	r	q

p) Net change in cash and cash equivalents: This shows by how much the business' cash position has changed over the year.

To calculate p on the face of the cash flow statement, simply add the three sections of the cash flow statement together – i.e. cash flows from operating activities + cash flows from financing activities + cash flows from investing activities (subtract them if they are negative!).

q) Cash and cash equivalents: beginning of year: This is the sum of Bank, Cash float and Petty cash at the beginning of the year.

r) Cash and cash equivalents: end of year: This is the sum of Bank, Cash float and Petty cash at the end of the year.

Complete note 2 by filling in the “Net change” column. Here, you subtract year 1 from year 2 for each of the three – Bank, Cash float and Petty cash. Add these totals together and they should equal p, the same figure on the face of the cash flow statement.

Section B: Exercises

Question 1

*Cash Flow Statements (30 marks, 20 minutes) Rating: **

Bailey Ltd has an authorised share capital of 500 000 ordinary shares. Shares in issue were sold to the public at the incorporation of Bailey Ltd.

Instructions:

- 1.1. Prepare the following with regards to the cash flow statement for 2007:
 - 1.1.1. Note showing the reconciliation between profit before taxation and cash generated from operations (20)
 - 1.1.2. Calculation of dividends paid (5)
 - 1.1.3. Calculation of taxation paid (5)

Extract from the Income Statement of Bailey Stores for the year ended 28 February 2007

Sales	600 000
Income tax	60 000
Net profit for the year after tax	90 000
Interest on loans	12 900
Depreciation: Equipment	?
Depreciation: Vehicles	27 200

Extract from the Balance Sheet of Bailey Stores as at 28 February 2007

	Notes	2007	2006
Fixed Assets (at carrying value)		544 400	437 600
Current Assets			
Inventory		134 000	162 000
Trade and other receivables		28 000	36 000
Cash and cash equivalents		66 800	16 400
Ordinary share capital		550 000	440 000
Accumulated profits / Retained income		72 000	32 000
Loan: Sharks Bank (15% pa)		76 000	96 000
Trade and other payables		75 200	84 000

notes for...

1.1.3.	Taxation paid	(5)

Section C: Solutions

Question 1

1.1 Notes to the Cash Flow Statement of Bailey Limited as at 28 February 2007 (20)

1.1.1	Reconciliation between profit before taxation and cash generated from operations	
	Profit before tax (60 000 ✓ + 90 000 ✓)	✓ 50 000
	Adjustment in respect of:	56 100
	Interest on loans	✓ 2 900
	Depreciation (27 200 ✓ + 16 000 ✓✓)	☑ 43 200
	Operating profit before changes in working capital	☑ 206 100
	Changes in working capital	☑ 29 900
	Decrease in inventory	☑☑☑28 000
	Decrease in trade and other receivables	☑☑☑10 800
	Decrease in trade and other payables	☑☑☑ (8 900)
	Cash generated from operations	☑ 236 000

1.1.2	Dividends paid		(5)
	Amount owing at the end of the previous year		☑12 000
	Dividends paid and recommended		☑☑☑50 000
	Amount owing at the end of the current year		☑ (20 000)
	Amount paid		☑ 2 000

1.1.3	Taxation paid		(5)
	Taxation owing at the end of the previous year		☑8 000
	Income Statement amount		✓☑60 000
	Taxation prepaid at the end of the current year		☑2 800
	Amount paid		☑ 70 800