ISSN: 0974-5823 Vol. 7 No. 1 January, 2022

International Journal of Mechanical Engineering

The Usefulness and Format of The Statement Of Cash Flows Based on IFRS

Mehta Gafari Lubis[1], Musawir Dai[2], Satria Sitorus[3], Iskandar Muda[4]

[1,2,3,4] Universitas Sumatera Utara, Medan, Indonesia

Abstract

The statement of cash flows, or the cash flow statement (CFS), is a financial statement that summarizes the amount of cash and cash equivalents entering and leaving a company. Like the income statement, it also measures the performance of a company over a period of time. However, it differs because it is not as easily manipulated by the timing of non-cash transactions. The CFS measures how well a company manages its cash position, meaning how well the company generates cash to pay its debt obligations and fund its operating expenses. As one of the three main financial statements, the CFS complements the balance sheet and the income statement. A company's cash flow statement is also prepared differently under GAAP and IFRS. This is most acutely seen in how interest and dividends are classified. International Financial Reporting Standards (IFRS) were created to bring consistency and integrity to accounting standards and practices, regardless of the company or the country. They were issued by the London-based Accounting Standards Board (IASB) and address record keeping, account reporting, and other aspects of financial reporting. IFRS fosters greater corporate transparency. IFRS specify in detail how companies must maintain their records and report their expenses and income. They were established to create a common accounting language that could be understood globally by investors, auditors, government regulators, and other interested parties. The standards are designed to bring consistency to accounting language, practices, and statements, and to help businesses and investors make educated financial analyses and decisions.

Keywords: Cash Flow Statement (CFS), IFRS.

1. INTRODUCTION

The statement of cash flows, or the cash flow statement (CFS), is a financial statement that summarizes the amount of cash and cash equivalents entering and leaving a company. Like the income statement, it also measures the performance of a company over a period of time. However, it differs because it is not as easily manipulated by the timing of non-cash transactions.

For example, the income statement includes depreciation expense, which does not have an actual cash outflow associated with it. It is simply an allocation of the cost of an asset over its useful life. A company has some leeway to choose its depreciation method, which modifies the depreciation expense reported on the income statement. The CFS, on the other hand, is a measure of true inflows and outflows that cannot be as easily manipulated.

The CFS measures how well a company manages its cash position, meaning how well the company generates cash to pay its debt obligations and fund its operating expenses. As one of the three main financial statements, the CFS complements the balance sheet and the income statement.

The CFS allows investors to understand how a company's operations are running, where its money is coming from, and how money is being spent. The CFS is important since it helps investors determine whether a company is on solid financial footing. Creditors, on the other hand, can use the CFS to determine how much cash is available (referred to as liquidity) for the company to fund its operating expenses and pay down its debts.

2. LITERATURE REVIEW

The main components of the cash flow statement are:

1) Cash from operating activities
2) Cash from investing activities
3) Cash from financing activities
4) Disclosure of non-cash activities, which is sometimes included when prepared under generally accepted accounting principles (GAAP).

It's important to note that the CFS is distinct from the income statement and the balance sheet because it does not include the amount of future incoming and outgoing cash that has been recorded as revenues and expenses. Therefore, cash is not the same as net income which, on the income statement, includes cash sales as well as sales made on credit.

The operating activities on the CFS include any sources and uses of cash from business activities. In other words, it reflects how much cash is generated from a company's products or services.

Generally, changes made in cash, accounts receivable, depreciation, inventory, and accounts payable are reflected in cash from operations. These operating activities might include:

1) Receipts from sales of goods and services
2) Interest payments
3) Income tax payments
4) Payments made to suppliers of goods and services used in production
5) Salary and wage payments to employees
6) Rent payments
7) Any other type of operating expenses[2]

In the case of a trading portfolio or an investment company, receipts from the sale of loans, debt, or equity instruments are also included because it is a business activity. There are two methods of calculating cash flow:

1) Direct Cash Flow Method

The direct method adds up all of the various types of cash payments and receipts, including cash paid to suppliers, cash receipts from customers, and cash paid out in salaries. This method of CFS is easier for very small businesses that use the cash basis accounting method. These figures can also be calculated by using the beginning and ending balances of a variety of asset and liability accounts and examining the net decrease or increase in the accounts. It is presented in a straightforward manner.

2) Indirect Cash Flow Method

Most companies use the accrual basis accounting method, where revenue is recognized when it is earned rather than when it is received. This causes a disconnect between net income and actual cash flow because not all transactions in net income on the income statement involve actual cash items. Therefore, certain items must be reevaluated when calculating cash flow from operations.

With the indirect method, cash flow is calculated by adjusting net income by adding or subtracting differences resulting from non-cash transactions. Non-cash items show up in the changes to a company’s assets and liabilities on the balance sheet from one period to the next. Therefore, a company’s accountant will identify the increases and decreases to asset and liability accounts that need to be added back to or removed from the net income figure, in order to identify an accurate cash inflow or outflow. The indirect cash flow method allows for a reconciliation between two other financial statements: the income statement and balance sheet.

3. METHODS

What Are International Financial Reporting Standards (IFRS)? International Financial Reporting Standards (IFRS) are a set of accounting rules for the financial statements of public companies that are intended to make them consistent, transparent, and easily comparable around the world.

IFRS currently has complete profiles for 166 jurisdictions. including those in the European Union. The United States uses a different system, the Generally Accepted Accounting Principles (GAAP).

International Financial Reporting Standards (IFRS) were created to bring consistency and integrity to accounting standards and practices, regardless of the company or the country. They were issued by the London-based Accounting Standards Board (IASB) and address record keeping, account reporting, and other aspects of financial reporting. IFRS fosters greater corporate transparency.

IFRS specify in detail how companies must maintain their records and report their expenses and income. They were established to create a common accounting language that could be understood globally by investors, auditors, government regulators, and other interested parties. The standards are designed to bring consistency to accounting language, practices, and statements, and to help businesses and investors make educated financial analyses and decisions.

They were developed by the International Accounting Standards Board, which is part of the not-for-profit, London-based IFRS Foundation. The Foundation says it sets the standards to “bring transparency, accountability, and efficiency to financial markets around the world."

IFRS covers a wide range of accounting activities. There are certain aspects of business practice for which IFRS set mandatory rules.

1) Statement of Financial Position: This is the balance sheet. IFRS influences the ways in which the components of a balance sheet are reported.
2) Statement of Comprehensive Income: This can take the form of one statement or be separated into a profit and loss statement and a statement of other income, including property and equipment.
3) Statement of Changes in Equity**:** Also known as a statement of retained earnings, this documents the company's change in earnings or profit for the given financial period.

4) Statement of Cash Flows**:** This report summarizes the company's financial transactions in the given period, separating cash flow into operations, investing, and financing.

In addition to these basic reports, a company must give a summary of its accounting policies. The full report is often seen side by side with the previous report to show the changes in profit and loss.

A parent company must create separate account reports for each of its subsidiary companies.

4. RESULTS DAN DISCUSSION

4.1. Result

In April 2001 the International Accounting Standards Board adopted IAS 7 *Cash Flow Statements*, which had originally been issued by the International Accounting Standards Committee in December 1992. IAS 7 *Cash Flow Statements* replaced IAS 7 *Statement of Changes in Financial Position* (issued in October 1977). As a result of the changes in terminology used throughout the IFRS Standards arising from requirements in IAS 1 *Presentation of Financial Statements* (issued in 2007), the title of IAS 7 was changed to *Statement of Cash Flows*.

In January 2016 IAS 7 was amended by *Disclosure Initiative* (Amendments to IAS 7). These amendments require entities to provide disclosures about changes in liabilities arising from financing activities.

Other Standards have made minor consequential amendments to IAS 7. They include IFRS 10 *Consolidated Financial Statements* (issued May 2011), IFRS 11 *Joint Arrangements* (issued May 2011), *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27) (issued October 2012), IFRS 16 *Leases* (issued January 2016) and IFRS 17 *Insurance Contracts* (issued May 2017).

IFRS Taxonomy 2017 – Illustrative examples Statement of cash flows:

Consolidated statement of comprehensive income for the period ended 20X2	
Sales	30,650
Cost of sales	(26,000)
Gross profit	4,650
Depreciation	(450)
Administrative and selling expenses	(910)
Interest expense	(400)
Investment income	500
Foreign exchange loss	(40)
Profit before taxation	3,350
Taxes on income	(300)
Profit	3,050 [(a)]

(a) The entity did not recognise any components of other comprehensive income in the period ended 20X2

Examples from IAS 7 representing ways in which the requirements of IAS 7 for the presentation of the statements of cash flows and segment information for cash flows might be met using detailed XBRL tagging.

Consolidated statement of financial position as at end of 20X2		
	20X2	**20X1**
Assets		
Cash and cash equivalents	230	160
Accounts receivable	1,900	1,200
Inventory	1,000	1,950
Portfolio investments	2,500	2,500
Property, plant and equipment net	2,280	850
Total assets	7,910	6,660
Liabilities		
Trade payables	250	1,890
Interest payable	230	100
Income taxes payable	400	1,000
Long-term debt	2,300	1,040
Total liabilities	3,180	4,030
Shareholders' equity		
Share capital	1,500	1,250
Retained earnings	3,230	1,380
Total shareholders' equity	4,730	2,630
Total liabilities and shareholders' equity	7,910	6,660

Direct method statement of cash flows

		20X2
Cash flows from operating activities		
Cash receipts from customers	30,150	
Cash paid to suppliers and employees	(27,600)	
Cash generated from operations	2,550	
Interest paid	(270)	
Income taxes paid	(900)	
Net cash from operating activities		1,380
Cash flows from investing activities		
Acquisition of subsidiary X, net of cash acquired	(550)	
Purchase of property, plant and equipment	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	200	
Net cash used in investing activities		(480)
Cash flows from financing activities		
Proceeds from issue of share capital	250	
Proceeds from long-term borrowings	250	
Payment of lease liabilities	(90)	
Dividends paid [1]	(1,200)	
[1] This could also be shown as an operating cash flow.		
Net cash used in financing activities		(790)
Effect of exchange rate changes		(40)
Net increase in cash and cash equivalents		70
Cash and cash equivalents at beginning of period		160
Cash and cash equivalents at end of period		230

Indirect method statement of cash flows			
			20X2
Cash flows from operating activities			
Profit before taxation		3,350	
Adjustments for:			
	Depreciation	450	
	Foreign exchange loss	40	
	Investment income	(500)	
	Interest expense	400	
		3,740	
	Increase in trade and other receivables	(500)	
	Decrease in inventories	1,050	
	Decrease in trade payables	(1,740)	
Cash generated from operations		2,550	
Interest paid		(270)	
Income taxes paid		(900)	
Net cash from operating activities			1,380
Cash flows from investing activities			
Acquisition of subsidiary X net of cash acquired		(550)	
Purchase of property, plant and equipment		(350)	
Proceeds from sale of equipment		20	
Interest received		200	
Dividends received		200	
Net cash used in investing activities			(480)
Cash flows from financing activities			
Proceeds from issue of share capital		250	
Proceeds from long-term borrowings		250	
Payment of lease liabilities		(90)	
Dividends paid [2]		(1,200)	
[2] This could also be shown as an operating cash flow.			
Net cash used in financing activities			(790)
Effect of exchange rate changes			(40)
Net increase in cash and cash equivalents			70
Cash and cash equivalents at beginning of period			160
Cash and cash equivalents at end of period			230

Indirect method statement of cash flows

– Notes to the statement of cash flows (direct method and indirect method)

Segment information

	Segment A	Segment B	Total
Cash flows from:			
Operating activities	1,520	(140)	1,380
Investing activities	(640)	160	(480)
Financing activities	(570)	(220)	(790)
	310	(200)	110

Reconciliation of liabilities arising from financing activities

	20X1	Cash flows	Non-cash changes		20X2
			Acquisition	New leases	
Long-term borrowings	1,040	250	200	-	1,490
Lease liabilities	-	(90)	-	900	810
Long-term debt	1,040	160	200	900	2,300

Purchase of property, plant and equipment	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	200	
Net cash used in investing activities		(480)
Cash flows from financing activities		
Proceeds from issue of share capital	250	
Proceeds from long-term borrowings	250	
Payment of lease liabilities	(90)	
Dividends paid [2]	(1,200)	
[2] This could also be shown as an operating cash flow.		
Net cash used in financing activities		(790)
Effect of exchange rate changes		(40)
Net increase in cash and cash equivalents		70
Cash and cash equivalents at beginning of period		160
Cash and cash equivalents at end of period		230

4.2. DISCUSSION

Statement of Cash Flows provides information to help assess:

1. Entity's ability to generate future cash flows.
2. Entity's ability to pay dividends and meet obligations.

3. Reasons for difference between net income and net cash provided (used) by operating activities.
4. Cash investing and financing transactions during the period.

A company's cash flow statement is also prepared differently under GAAP and IFRS. This is most acutely seen in how interest and dividends are classified.

GAAP prescribes that interest paid and interest received should be classified as operating activities, while international standards are a bit more flexible. Under IFRS, a firm can choose its own policy for classifying interest based on what it considers to be appropriate. Interest paid can be placed in either the operating or financing section of the cash flow statement, and interest received in the operating or investing sections.

The same goes for dividends. GAAP specifies that dividends paid be accounted for in the financing section, and dividends received in the operating section. When following IFRS standards, companies have a choice of how they categorize dividends. Dividends paid can be put in either the operating or financing section, and dividends received in the operating or investing section. To summarize, here's a detailed breakdown of how the two standards differ in their treatment of interest and dividends.

CASH FLOW STATEMENTS: GAAP VS. IFRS

	GAAP	IFRS
Interest Paid	Operating Section	Operating OR Financing Section
Dividends Paid	Financing Section	Operating OR Financing Section
Interest Received	Operating Section	Operating OR Investing Section
Dividends Received	Operating Section	Operating OR Investing Section

Harvard Business School Online

Image by Matt Gavin © Harvard business School Online 2019

5. CONCLUTION

The CFS allows investors to understand how a company's operations are running, where its money is coming from, and how money is being spent. The CFS is important since it helps investors determine whether a company is on solid financial footing. Creditors, on the other hand, can use the CFS to determine how much cash is available (referred to as liquidity) for the company to fund its operating expenses and pay down its debts.

IFRS specify in detail how companies must maintain their records and report their expenses and income. They were established to create a common accounting language that could be understood globally by investors, auditors, government regulators, and other interested parties. The standards are designed to bring consistency to accounting language, practices, and statements, and to help businesses and investors make educated financial analyses and decisions.

REFERENCE

1. Chris B. Murphy. (2021), *Understanding the Cash Flow Statement*, http:// https://www.investopedia.com/investing/what-is-a-cash-flow-statement/
2. Financial Accounting IRFS 4th Edition (2019), *Chapter 14 Statement of Cash Flows*, Power Point (PPT) Copyright ©2019 John Wiley @ Son, Inc
3. Financial Accounting Standards Board (2021), *Statement of Financial Accounting Standar*ds No. 95 https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1218220128261&acceptedDisclaimer=true
4. International Financial Reporting Standards (2021), *Who Uses IFRS Standards?*, http://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-yurisdiction
5. International Financial Reporting Standards (2021), *About the International Accounting Standards (Board)*, https://www.ifrs.org/groups/international-accounting-standards-board/#about
6. International Financial Reporting Standards (2021), *IAS 1 Presentation of Financial Statements*, http://www.ifrs.org/issued-standards/ias-1-presentation-of-financial-statements/."
7. Matt Gavin. (2019), *GAAP VS. IFRS: WHAT ARE THE KEY DIFFERENCES AND WHICH SHOULD YOU USE?*, https://online.hbs.edu/blog/post/gaap-vs-ifrs
8. Standard 2021 Issued (2021), *IAS 7 Statement of Cash Flows*, https://www.ifrs.org/issued-standards/list-of-standards/ias-7-statement-of-cash-flows/