



Profit is Prince, but Cash is King!

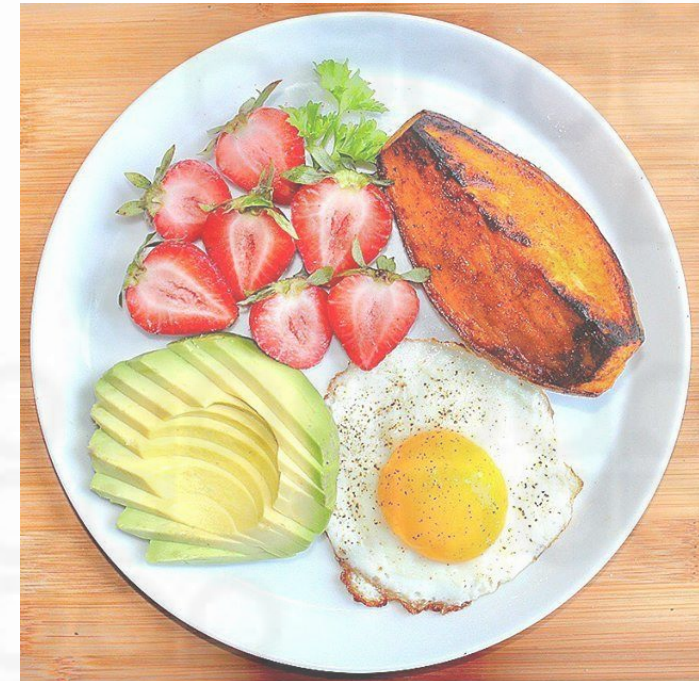
A conversation about the statement of cash flows

YOUR KEY TO THE TAX COMMUNITY

Welcome

On the lunch plate today

1. **Tax focus points** touching on statements of cash flow
(general, approach)
1. **Accounting focus points** touching on statements of cash flow
(S7 of the IFRS for SMEs)
3. Conclusionary remarks



Introduction

- ✓ **The first step:** reconcile the movement in cash and cash equivalents from prior year to current year – this is the beacon around which your SoCF will be built
 - ✓ *What is deemed to be “cash and cash equivalents”?*
- ✓ What is **presented** in the statement of cash flows?
 - ✓ Four main sections:
 - Cash generated from/used in **operating activities**
 - Direct versus indirect approach impacts this section especially
 - Cash generated from/used in **investing activities**
 - Cash generated from/used in **financing activities**
 - **Net increase/decrease** in cash and cash equivalents

Cash flows from operating activities

- ✓ Principal revenue-producing activities of the entity
- ✓ Therefore, cash flows from operating activities generally result from the transactions that link to the determination of **profit or loss**
- ✓ Examples:
 - cash receipts from the sale of goods and the rendering of services;
 - cash receipts from royalties, fees, commissions and other **revenue**;
 - cash payments to suppliers for goods and services;
 - cash payments to and on behalf of employees;
 - cash payments or refunds of income tax, unless they can be specifically identified with financing and investing activities; and
 - cash receipts and payments from investments, loans and other contracts held for dealing or trading purposes, which are similar to inventory acquired specifically for resale

Basic premise...

- ✓ Adjust profit or loss for the following **three main categories**, by:
 - **Reversing non-cash items included in profit or loss**
 - For example: depreciation, gains or losses on disposal, fair value adjustments, foreign exchange gains or losses, and any other items that don't have bank (cash) as one of the elements in the supporting journal entry!
 - **Removing items that are included in profit or loss but appear elsewhere in the statement of cash flow**
 - Items that have their own line items (e.g., interest paid)
 - Items that should appear in other sections of the statement of cash flow (per accounting policy)
 - **Reversing the impact of accrual accounting out of profit or loss – this impact is evident in:**
 - Trade receivables (impacting cash receipts from clients)
 - Inventories (impacting cash paid to suppliers and employees)
 - Trade payables (impacting cash paid to suppliers and employees)

The safest approach (1)

✓ If all else fails, think of the T-account!

Inventory			
Opening balance	100 000	Closing balance	1 800 000
∴ Bank (purchases, ex VAT)	3 000 000	Cost of sales	1 300 000
TOTALS	3 100 000		3 100 000

Reconciliation:

- Amount included in profit or loss as cost of sales
- Increase in inventory (R1.8m – R100k)
- Cash purchases

R1 300 000

R1 700 000

R3 000 000

The safest approach (2)

✓ If all else fails, think of the T-account!

Trade receivables

Opening balance	100 000	Closing balance	400 000
Sales	1 000 000	∴ Bank	850 000
VAT	150 000		
TOTALS	1 250 000		1 250 000

Reconciliation:

- Amount included in profit or loss as revenue
- Increase in receivables (R400k – R100k)
- Cash receipts from clients

R1 000 000
(R300 000)
R700 000

Illustrative discussion



Direct method statement of cash flows		
		20X2
Cash flows from operating activities		
Cash receipts from customers	30,15	
Cash paid to suppliers and employees	(27,600)	
Cash generated from operations	2,55	
Interest paid	(270)	
Income taxes paid	(900)	
Net cash from operating activities		1,38
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 (<i>can also be shown as an operating cash flow</i>)	(1,200)	
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

Cash flows from investing activities

- ✓ Acquisition and disposal of long-term assets and other investments not included in cash equivalents
- ✓ Examples:
 - cash payments to acquire property, plant and equipment (including self-constructed property, plant and equipment), intangible assets and other long-term assets;
 - cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
 - cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments classified as cash equivalents or held for dealing or trading);
 - cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments classified as cash equivalents or held for dealing or trading);
 - cash advances and loans made to other parties;
 - cash receipts from the repayment of advances and loans made to other parties;
 - cash payments for futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the payments are classified as financing activities; and
 - cash receipts from futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the receipts are classified as financing activities.

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Cash flows from financing activities

- ✓ Activities that result in changes in the size and composition of the contributed equity and borrowings of an entity
- ✓ Examples:
 - cash proceeds from issuing shares or other equity instruments;
 - cash payments to owners to acquire or redeem the entity's shares;
 - cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;
 - cash repayments of amounts borrowed; and
 - cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Illustrative discussion



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Indirect method statement of cash flows		
		20X2
Cash flows from operating activities		
Profit before taxation	3,35	
Adjustments for:		
Depreciation	450	
Foreign exchange loss	40	
Investment income	(500)	
Interest expense	400	
	3,74	
Increase in trade and other receivables	(500)	
Decrease in inventories	1,05	
Decrease in trade payables	(1,740)	
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Consolidated statement of cash flows

- ✓ Unique factors impact a **consolidated** statement of cash flows
- ✓ Examples and their impact:
 - acquisitions/disposals of subsidiaries affecting consolidated assets and liabilities;
 - increase/decrease in existing shareholdings, resulting in gain/loss of control;
 - dividends paid to non-controlling interests (outside shareholders) to be determined using a reconstruction of the NCI account at consolidated level;
 - pro forma journal entries; and
 - fair value adjustments due to business combinations, equity accounting of associates and joint ventures, etc.

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