

# THE RULES FOR THE CASH FLOW STATEMENT IN THE INTERNATIONAL FINANCIAL REPORTING STANDARD

*Anikó Türkössi*

Department of Economics and Rural Development, Faculty of Engineering,  
University of Szeged, H-6724 Szeged, Mars tér 7., Hungary  
e-mail: [turkaud@freemail.hu](mailto:turkaud@freemail.hu)

## ABSTARCT

Cash flow statement may provide considerable information about what is really happening in a business beyond that contained in either the income statement or the balance sheet. Analyzing this statement should not present an intimidating task; instead it will quickly become obvious that the benefits of understanding the sources and uses of a company's cash far outweigh the costs of undertaking some very straightforward analyses. The objective of IAS 7 is to require the presentation of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows, which classifies cash flows during the period according to operating, investing, and financing activities.

### Those who cares about a Cash Flow Statement?

- Executives want to know if the cash generated by the company will be sufficient to fund their expansion strategy
- Stockholders want to know if the firm is generating enough cash to pay dividends
- Suppliers want to know if their customers will be able to pay if offered credit
- Investors want to evaluate future growth potential
- Employees are interested in the overall viability of their employer as indicated by its ability to fund its operations

### Format of the Cash Flow Statement

The cash flow statement is divided into three sections:

*Cash flow from operating activities:* shows the results of cash inflows and outflows related to the fundamental operations of the basic line or lines of business in which the company engages. (Example: cash receipts from the sale of goods or services and cash outflows for purchasing inventory and paying rent and taxes.)

*Cash flow from investing activities:* associated with purchases and sales of non-current assets (Example: building and equipment purchases or sales of investments or subsidiaries.)

*Cash flow from financing activities:* associated with financing the firm (Example: selling and paying off bonds and issuing stock and paying dividends)

The three categories of activities - operating activities, investing activities and financing activities - generating inflows and outflows of cash are presented in the exhibit below.

**Table 1. Cash in process**

<i>Cash received from operating activities</i>	<i>Cash received from investing activities</i>	<i>Cash received from financing activities</i>
	<b>INFLOWS</b>	
	<i>Cash and cash equivalents</i>	
	<b>OUTFLOWS</b>	
<i>Cash paid for operating activities</i>	<i>Cash paid for investing activities</i>	<i>Cash paid for financing activities</i>

Source: author's edition

The International Financial Reporting Standard (IFRS) in IAS 7 gives the rules how a company has to provide the cash flow statement on a standardized way for the users.

### **Fundamental Principle in IAS 7**

All entities that prepare financial statements in conformity with IFRS are required to present a statement of cash flows.

The statement of cash flows analyses changes in cash and cash equivalents during a period. Cash and cash equivalents comprise cash on hand and demand deposits, together with short-term, highly liquid investments that are readily convertible to a known amount of cash and that are subject to an insignificant risk of changes in value. Guidance notes indicate that an investment normally meets the definition of a cash equivalent when it has a maturity of three months or less from the date of acquisition. Equity investments are normally excluded, unless they are in substance a cash equivalent (e.g. preferred shares acquired within three months of their specified redemption date). Bank overdrafts which are repayable on demand and which form an integral part of an entity's cash management are also included as a component of cash and cash equivalents.

### **Presentation of the Statement of Cash Flows**

Cash flows must be analyzed between operating, investing and financing activities.

Key principles specified by IAS 7 for the preparation of a statement of cash flows are as follows:

*Operating activities* are the main revenue-producing activities of the entity that are not investing or financing activities, so operating cash flows include cash received from customers and cash paid to suppliers and employees. Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities. Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss.

The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity have generated sufficient cash flows to repay loans, maintain the operating capability of the entity, pay dividends and make new investments without recourse to external sources of financing.

*Investing activities* are the acquisition and disposal of long-term assets and other investments that are not considered to be cash equivalents. Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows.

The aggregate cash flows arising from obtaining and losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.

*Financing activities* are activities that alter the equity capital and borrowing structure of the entity. Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity. The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the entity.

An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities.

The main aim of cash flow is to deal with the so called non-cash transactions. In that case investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

Cash flows arising from transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

The cash flows of a foreign subsidiary shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

Unrealized gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period as realized gains or losses.

### **The Hungarian standard for Cash Flow statement**

The Hungarian rules for cash flow statement keeps the order of the international rules. It is laid down in Act on Accounting Appendix 7. giving the method for the presentation of cash flow statement, which is compulsory to prepare for those entrepreneurs whose financial report is the so called annual financial report.

### **REFERENCES**

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3. Act on Accounting year 2000 - C