Preparing your cash flow statement

The cash flow statement is an integral part of an entity's annual financial statements. This statement enables users to understand how cash was raised to fund activities, on which items the cash was spent, and what cash and cash equivalents entered and left the entity during a particular reporting period.

The Accounting Standards Board recently undertook a review of cash flow statements presented in the financial statements. The objective of the review was to assess compliance with the requirements in the Standard of GRAP on *Cash Flow Statements* (GRAP 2), and to identify practices that entities apply when they prepare their cash flow statements. The results of this review is published in a Research Paper that is available on the ASB's website at [add link to the Research Paper].

Why is preparing the cash flow statement challenging?

Quite often, the cash flow statement is the last component of the financial statements that are prepared before the financial statements are submitted to the auditors for audit and review. Entities frequently do not allocate sufficient resources to accurately and timely prepare the cash flow statement.

These reasons, along with a lack of skill and capacity within the entity, often leads to unnecessary mistakes in preparing the cash flow statement. A lack of adequate internal management processes and insufficient controls to ensure the accurate preparation of the cash flow statement also contributes to unnecessary errors and/or mathematical mistakes.

When preparers do not fully understand the nature of the entity's activities, often not all the items that need to be adjusted for in the cash flow statement, are adjusted or correctly reflected. Preparers over rely on software programs and templates that are used to prepare financial statements to make the required adjustments in preparing the cash flow statement.

For example, the transfer of assets in the public occurs often. When these goods in-kind are received by an entity in a non-exchange transaction, they are measured at fair value on the date of acquisition. In preparing the cash flow statement, goods in-kind need to be adjusted in the cash flow statement as it comprise a non-cash flow item. Without a proper understanding of the nature of the transaction, entities often omit adjusting for these items in the cash flow statement. If entities merely rely on the software program to identify these items, it may not be adjusted for at all in the cash flow statement.

Common areas where entities do not comply with GRAP 2

A previous article highlighted some of the common mistakes made by entities when preparing the cash flow statement. The review of GRAP 2 again highlighted these mistakes, along with some other common areas, such as:

- Not presenting items separately on the face of the cash flow statement – GRAP 2 requires certain items to be separately disclosed on the face of the cash flow statement. These include interest received, finance costs, taxation paid and cash dividends received and paid. Entities often omit presenting these items on the face of the cash flow statement as either operating, investing or financing cash flows.
- Separate presentation of non-cash adjustments and movements in working capital – In presenting the reconciliation of the surplus or deficit with the net cash flows from operating activities (the reconciliation), entities need to separate the adjustment for non-cash flow

items from movements in working capital. If these components are not separated in the reconciliation, users will find it difficult to understand the nature of the adjustments presented in the reconciliation and may not be able to link it back to the financial statements.

- Incorrect presentation of items in the cash flow statement – Quite often, entities incorrectly present movements in provisions, for example, leave pay, accrued leave, long-term service, performance bonuses, etc. as movements in working capital when in fact these comprise non-cash items.

- Incorrect classification of items in the cash flow statement – Some entities are uncertain about the treatment of some cash flow items, such as revenue received from insurance claims to cover losses and damages to assets. Revenue received from these claims should be reflected as investing activities as it represents a disposal of the property, plant and equipment that were insured. Instead, some entities incorrectly reflect the revenue as a cash flow from an operating activity.

  Another incorrect classification is the presentation of increases and decreases in short term borrowings or loans. Some entities reflect these movements incorrectly as movements in working capital instead as movements in cash flows from financing activities. The movements in short term borrowings or loans should be treated similarly to increases or decreases in long term borrowings or loans.

- Adjusting for amounts in the reconciliation that are not presented in the financial statements, or that differ from amounts presented elsewhere in the financial statements – Often amounts presented in the cash flow statement differ from amounts presented elsewhere in the financial statements. For example, adjustments for interest received and finance costs are included in the reconciliation as per the statement of financial performance, but with only some of the interest or finance costs presented as an operating, investing or financing activity on the face of the cash flow statement. In other instances, the interest received and finance costs are adjusted in the reconciliation, but the amounts adjusted, differ from that presented in the statement of financial performance or the notes to the financial statements.

  Reasons for these differences could be as a result of interest receivable or finance costs payable, differences between the effective and contractual interest rates applied or because interest could be capitalised to assets. However, without an explanation as to why these differences exist, users will not be able to understand these differences to make informed decisions.

Some preparers are still unsure about the role that materiality plays when they prepare the cash flow statement. For example, should a similar materiality amount be used in preparing all the components of the cash flow statement, or could materiality differ between, for example the cash flow statement and the statements of financial position and performance. Preparers will find the Guideline on *The Application of Materiality to Financial Statements* useful in addressing these uncertainties.

Management need to make informed decisions about the allocation of resources and users require a proper understanding of the timing and certainty of cash flows. It is therefore important that entities have appropriate internal processes and controls in place, and that they plan ahead to dedicate more time to the accurate completion of the cash flow statement to improve decision-making.