How can you improve 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 flowed to and from an entity during a particular reporting period.

The Accounting Standards Board (the ASB) 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 are published in a Research Paper that is available on the ASB's website at [add link to the Research Paper].

The cash flow statements need improvement

From the review, it was noted that the quality of the presentation and compilation of the cash flow statement needs improvement.. Systemic issues have been identified that should be addressed to ensure that the quality of reporting is enhanced. These include:

- Insufficient time is allocated to prepare the cash flow statement – The cash flow statement is often the last component of the financial statements that is prepared before submission to the auditors for audit. It is challenging to complete the cash flow statement if insufficient resources are allocated to ensure the accurate and timely preparation of this statement.
- Lack of skill, capacity, and inadequate controls – A lack of skill and capacity within entities often leads to unnecessary mistakes in the preparation of the cash flow statement. The lack of adequate internal management processes and insufficient controls to ensure the accurate preparation may also contribute to unnecessary errors and/or mathematical mistakes.
- Not understanding the nature of an entity's activities – 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. Adjustments could also be made incorrectly.
- Over reliance on software programs and templates – When preparers rely on software programs and templates, without adequately reviewing the outputs, not all the appropriate adjustments are made when the cash flow statement is prepared.
- Uncertainty about the role of materiality – Entities do not consider a different materiality when they prepare the components of the financial statements, and/or present specific line items in the financial statements. Preparers should familiarise themselves with the role that materiality plays when preparing the cash flow statement.

What can be improved?

The review of GRAP 2 identified common areas of non-compliance, such as:

- Not presenting certain 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 these items from the face of the cash flow statement.
- 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 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 the information back to the information presented elsewhere in the financial statements.
- Incorrect presentation of items in the cash flow statement – 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 movements consist of both cash and 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 property, plant and equipment that was 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 when it should be presented 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 – 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 the amounts presented in the statement of financial performance or the notes to the financial statements.

  Reasons for these differences could be due to 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 the differences to make informed decisions.

Guidance to help entities prepare the cash flow statement

The National Treasury issued the Accounting Guideline on GRAP 2 on *Cash Flow Statements* that includes practical guidance and illustrative examples that entities can apply when preparing the cash flow statement.

Reference can also be made to the Frequently Asked Question 3.5 issued by the Secretariat of the ASB that explains what items should be included as 'cash and cash equivalents' (see FAQs on Standards of GRAP).