



Accounting and Reporting Policy

FRS 102

Staff Education Note 1

Cash flow statements

Disclaimer

This Education Note has been prepared by FRC staff for the convenience of users of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. It aims to illustrate certain requirements of FRS 102, but should not be relied upon as a definitive statement on the application of the standard. The illustrative material is not a substitute for reading the detailed requirements of FRS 102.

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Introduction

In this Staff Education Note, an illustrative cash flow statement is shown first under FRS 1 *Cash flow statements (revised 1996)* and then restated to comply with Section 7 *Statement of Cash Flows* of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

In contrast to FRS 1, a cash flow statement prepared under FRS 102:

- reconciles the movement in cash and cash equivalents, not just cash;
- groups cash flows into fewer headings (ie cash flows from operating, investing and financing activities);
- reconciles profit to cash flows from operating activities starting from profit for the year rather than operating profit; and
- has fewer supporting notes.

This Staff Education Note has been prepared to illustrate the format of the cash flow statement prepared in accordance with FRS 102 and assumes that there are no other changes arising from the application of FRS 102. In a full set of financial statements, comparatives would be provided.

There are no requirements in the Regulations¹ in respect of cash flow statements.

This Staff Education Note is written to highlight key areas of consideration when transitioning to FRS 102 and is not designed to be exhaustive.

Illustrative Cash Flow Statement
FRS 1 Cash flow statements (revised 1996)

Cash flow statement²

for the year ended 31 December 20X1

	Note	20X1 CU'000
Net cash inflow from operating activities	A	6,889
Returns on investments and servicing of finance		
Interest received		3,011
Interest paid		(12)
Net cash inflow from returns on investments and servicing of finance		<hr/> 2,999
Taxation		(2,922)
Capital expenditure		
Payments to acquire intangible fixed assets		(71)
Payments to acquire tangible fixed assets		(1,496)
Receipts from sales of tangible fixed assets		42
Capital expenditure		<hr/> (1,525)
		5,441
Equity dividends paid		(2,417)
Net cash inflow before use of liquid resources and financing		<hr/> 3,024
Management of liquid resources		
Purchase of treasury bills		(650)
Sale of treasury bills		200
Net cash outflow from management of liquid resources		<hr/> (450)
Financing		
Issue of ordinary share capital		211
Repurchase of debenture loan		(149)
Expenses paid in connection with share issue		(5)
Financing		<hr/> 57
Increase in cash	B, C	<hr/> <hr/> 2,631

Illustrative Cash Flow Statement**FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland****Cash flow statement³**

for the year ended 31 December 20X1

	Note	20X1 CU'000
Cash flows from operating activities⁴		
Profit for the financial year ⁵		6,099
Adjustments for:		
Depreciation of property, plant and equipment		869
Amortisation of intangible assets		50
Profit on disposal of property, plant and equipment		(20)
Interest paid ⁶		12
Interest received ⁶		(3,011)
Taxation ⁷		2,922
Decrease/(increase) in trade and other receivables		(72)
Decrease/(increase) in inventories		(194)
Increase/(decrease) in trade payables		234
Cash from operations⁸		6,889
Interest paid ⁶		(12)
Income taxes paid		(2,922)
Net cash generated from operating activities		3,955
Cash flows from investing activities		
Proceeds from sale of equipment		42
Purchases of property, plant and equipment		(1,496)
Purchases of intangible assets		(71)
Interest received ⁶		3,011
Net cash from investing activities		1,486
Cash flows from financing activities		
Issue of ordinary share capital		206
Repayment of borrowings		(149)
Dividends paid ⁹		(2,417)
Net cash used in financing activities		(2,360)
Net increase/(decrease) in cash and cash equivalents		3,081
Cash and cash equivalents at beginning of year ¹⁰	A	(1,492)
Cash and cash equivalents at end of year¹¹	A	1,589

Illustrative extracts from the notes to the financial statements

FRS 1 Cash flow statements (revised 1996)

Notes to the financial statements

for the year ended 31 December 20X1

A. Reconciliation of operating profit to net cash inflow from operating activities

	20X1 CU'000
Operating profit	6,022
Depreciation	869
Amortisation	50
Profit on disposal of tangible assets	(20)
Increase in stock	(194)
Increase in debtors	(72)
Increase in creditors	234
Net cash inflow from operating activities	6,889

B. Analysis of changes in net debt

	At 1 Jan 20X1 CU'000	Cash flows CU'000	Other changes CU'000	At 31 Dec 20X1 CU'000
Cash in hand, at bank	42	847		889
Overdrafts	(1,784)	1,784		
		2,631		
Debt due within one year	(149)	149	(230)	(230)
Debt due after one year	(1,262)		230	(1,032)
Current asset investments	250	450		700
Total	(2,903)	3,230	-	327

C. Reconciliation of net cash flow to movement in net debt¹²

	20X1 CU'000
Increase in cash in the period	2,631
Cash to repurchase debenture	149
Cash used to increase liquid resources	450
Change in net debt	3,230
Net debt at 1 January	(2,903)
Net funds at 31 December	327

Illustrative extracts from the notes to the financial statements
FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

Notes to the financial statements
 for the year ended 31 December 20X1

A. Components of cash and cash equivalents¹³

	20X1	20X2
	CU'000	CU'000
Cash	42	889
Overdraft	(1,784)	
Cash equivalents	250	700
	(1,492)	1,589

The Financial Reporting Lab of the FRC carried out a project on net debt reconciliations. This noted that a majority of investors use a net debt reconciliation or reconciliation of net cash flows to net debt when one is presented. It encouraged companies to consider how this might be relevant to their own circumstances and if so enhance their reporting to meet investor needs.

Other similarities and differences

Exemptions

FRS 1	FRS 102
<p>Subsidiary undertakings where 90 per cent or more of the voting rights are controlled within the group are exempt from having to prepare a cash flow statement, provided that consolidated financial statements in which the subsidiary undertakings are included are publicly available.</p> <p>(FRS 1 paragraph 5)</p>	<p>A qualifying entity may take advantage of certain disclosure exemptions (including the preparation of a cash flow statement) provided that:</p> <ul style="list-style-type: none"> (a) Its shareholders have been notified in writing about, and do not object to, the use of the disclosure exemptions... (b) It otherwise applies the recognition, measurement and disclosure requirements of this FRS. (c) It discloses in the notes to its financial statements: <ul style="list-style-type: none"> (i) a brief narrative summary of the disclosure exemptions adopted; and (ii) the name of the parent of the group in whose consolidated financial statements its financial statements are consolidated, and from where those financial statements may be obtained. <p>(FRS 102 paragraph 1.11 and 1.12)</p> <p>A qualifying entity is a member of a group where the parent of that group prepares publicly available consolidated financial statements which are intended to give a true and fair view (of the assets, liabilities, financial position and profit or loss) and that member is included in the consolidation.</p> <p>(FRS 102 Glossary)</p>

Under FRS 102, if certain conditions are met and an entity elects to take advantage of the reduced disclosures for subsidiaries (and ultimate parents), it is possible for any subsidiary and any parent company to opt out of preparing a cash flow statement. This is in contrast to FRS 1, where only 90% subsidiaries are exempt from preparing a cash flow statement. This represents a change when applying FRS 102.

Acquisitions and disposals

FRS 1	FRS 102
<p>Individual categories of inflows and outflows should be disclosed separately, where material.</p> <p>(FRS 1 paragraph 7)</p> <p>Cash outflows from acquisitions and disposals include payments to acquire investments in subsidiary undertakings, showing separately any balances of cash and overdrafts acquired.</p> <p>(FRS 1 paragraph 24(a))</p>	<p>An entity shall present separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities. The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units shall be presented separately and classified as investing activities.</p> <p>(FRS 102 paragraph 7.10)</p>

Therefore, FRS 102 does not explicitly require the disclosure of the cash or overdrafts acquired as part of an acquisition. However, if the cash or overdraft acquired was material it may be regarded as a major class of gross cash receipts or payments and separate presentation would be required.

Foreign currency cash flows

FRS 1 / SSAP 20	FRS 102
<p>Where a portion of a reporting entity's business is undertaken by a foreign entity, the cash flows of that entity are to be included in the cash flow statement on the basis used for translating the results of those activities in the profit and loss account of the reporting entity.</p> <p>(FRS 1 paragraph 41)</p> <p>The profit and loss account of a foreign enterprise accounted for under the closing rate/net investment method should be translated at the closing rate or at an average rate for the period.</p> <p>(SSAP 20 paragraph 54)</p>	<p>... to reconcile cash and cash equivalents at the beginning and the end of the period, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency must be presented in the statement of cash flows. ... The entity shall present the resulting unrealised gain or loss separately from cash flows from operating, investing and financing activities.</p> <p>(FRS 102 paragraph 7.13)</p> <p>An entity shall translate cash flows of a foreign subsidiary at the exchange rate between the entity's functional currency and the foreign currency at the date of the cash flow or at an exchange rate that approximates the actual rate (for example, a weighted average exchange rate for the period).</p> <p>(FRS 102 paragraph 7.12)</p>

In accordance with FRS 1, the value changes recognised by translating cash held or due in a foreign currency at the balance sheet date are not required to be presented separately in the cash flow statement. However, such value changes are not cash flows as defined by FRS 102 and FRS 102 requires the separate presentation of foreign exchange differences relating to cash and cash equivalents. This will be a change when applying FRS 102.

In relation to profit and loss items, FRS 1 allows a choice between translating at the closing rate or an average rate for the period, in contrast to FRS 102 which allows a choice between

the rate at the transaction rate or an average rate for the period. This represents a change when applying FRS 102.

Endnotes

- ¹ Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410).
- ² The individual categories of inflows and outflows under the standard headings should be disclosed separately in the cash flow statement, as shown here, or in the notes to the financial statements.
- ³ FRS 102 uses the term 'Statement of Cash Flows'. No title for this statement is specified in the Regulations, therefore any title that adequately describes the statement is permitted (FRS 102 paragraph 3.22 permits any titles as long as they are not misleading).
- ⁴ FRS 102 paragraph 7.7 permits entities to present cash flows from operating activities using either the indirect method or the direct method. This Education Note illustrates the indirect method, which is the method commonly applied in the UK. The reconciliation of profit or loss to cash from operations can be shown either on the face of the cash flow statement or in the notes. FRS 1 also permits operating cash flows to be presented using either the direct method or the indirect method (FRS 1 paragraph 7).
- ⁵ If the indirect method is chosen, FRS 102 paragraph 7.7(a) requires the profit or loss to be adjusted for the effects of non-cash transactions. FRS 102 Section 7 does not specify which measure of profit or loss should be used, but the glossary defines profit or loss as "The total of income less expenses, excluding the components of other comprehensive income". As a result, the measure of profit or loss to be used should be 'profit or loss for the financial year'.
- ⁶ For simplicity, the interest charge and income in this example are assumed to be the same as the cash flows. FRS 102 paragraph 7.15 gives a choice for interest paid and received to be included in operating cash flows or in financing and investing respectively. Here the choice has been taken to include interest paid in operating cash flows and interest received in investing cash flows.
- ⁷ For simplicity, the taxation charge in this example is assumed to be the same as the cash flows.
- ⁸ The 'cash from operations' subtotal is discretionary and is used here in part to illustrate the similarity between the two cash flow statements.
- ⁹ FRS 102 paragraph 7.16 gives a choice for dividends paid to be included either in cash flows arising from operating activities or financing activities.
- ¹⁰ Overdrafts have been included within this opening figure as the overdraft is repayable on demand and forms an integral part of the entity's cash management (see paragraph 7.2 of FRS 102).
- ¹¹ It is assumed that the 'current asset investments' shown as liquid resources in the first example have a short maturity of three months or less from the date of acquisition, are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value, and hence in the FRS 102 cash flow statement are included as part of cash and cash equivalents.
- ¹² This reconciliation shall be given either adjoining the cash flow statement or in a note as it is here (FRS 1 paragraph 33).
- ¹³ FRS 102 paragraph 7.20 requires an entity to present the components of cash and cash equivalents. It also requires a reconciliation of cash and cash equivalents as presented in the cash flow statement to the equivalent items presented in the statement of financial position (balance sheet). In addition, paragraph 7.21 of FRS 102 requires the disclosure of cash held by the entity but which is not available for use. It has been assumed that this is not the case in this example.