

AASB 107 “CASH FLOW STATEMENTS”

INTRODUCTION

AASB 107 *Cash Flow Statements* is an Australian Equivalent International Financial Reporting Standard (AIFRS) applicable to financial years beginning on or after 1 January 2005. AASB 107 will replace the current Australian standard AAS 28 *Statement of Cash Flows*.

This Policy Summary outlines the main requirements of AASB 107 and also explains the key differences between the requirements in the existing AAS standard regarding cash flow statements and the new requirements of AASB 107.

AASB 107:

- defines cash and cash equivalents;
- identifies three different categories of cash flows to be presented in the statement of cash flows;
- requires a cash flow statement to be presented and included in the financial statements; and
- requires cash flows to be reported on a gross basis except in very limited circumstances.

AIFRS REQUIREMENTS

The objective of AASB 107 is to require the provision of information about changes in the cash and cash equivalents of an entity by means of a cash flow statement. Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents. This means that both cash and cash equivalents are included in the cash flow statement and both are defined below.

Definitions

AASB 107 defines cash as:

comprising cash on hand and demand deposits.

Further, AASB 107 defines cash equivalents as:

short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies

as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition.

Bank borrowings are generally considered to be financing activities. However, where bank overdrafts which are repayable on demand form an integral part of an entity's cash management they are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.

Classification

Cash flows are classified within one of three categories:

- cash from operating activities;
- cash from investing activities; and
- cash from financing activities.

Operating 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.

Examples of cash flows from operating activities are:

- cash receipts from the sale of goods and the rendering of services including:
 - government payment for output (GPO);
 - user charges;
- cash receipts from fees, commissions and other revenue;
- cash payments to suppliers for goods and services;
- cash payments to and on behalf of employees including:
 - employee payments;
 - superannuation payments;
- cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits; and
- cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities (for ACT agencies in the NTER).

Investing Activities

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. Examples of cash flows arising from investing activities are:

- cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalised development costs and self-constructed property, plant and equipment;

- 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 considered to be cash equivalents or those held for dealing or trading purposes);
- cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
- cash advances and loans made to other parties; and
- cash receipts from the repayment of advances and loans made to other parties.

When a contract is accounted for as a hedge of an identifiable position, the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

Financing Activities

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. Examples of cash flows arising from financing activities are:

- cash proceeds from capital contributions from government (not operation);
- cash payments/ distribution to government;
- cash proceeds from 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.

Measurement

Cash flows from operating activities are measured using the direct method in the statement of cash flows. The direct method requires major classes of cash receipts and cash payments to be reported in the cash flow statement on a gross basis. Cash flows from investing and financing activities must also be reported in the cash flow statement on a gross basis, with two exceptions. These two exceptions require cash flows relating to investing and financing activities be reported on a net basis where:

- cash receipts and payments are for items in which the turnover is quick, the amounts are large, and the maturities are short; or
- cash receipts and payments are on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity.

All ACT agencies (except CFU) should report their cash flows on a gross basis as the cash flows mentioned in the two situations above (relating to net cash flows) will not apply to ACT agencies' activities.

Disclosure

AASB 107 requires a reconciliation between cash flows arising from operating activities and the operating result to be disclosed in the financial report. AASB 107 also requires the disclosure of a reconciliation of the total cash amount in the cash flow statement with the equivalent items reported in the balance sheet.

Cash flows from interest and dividends received and paid shall each be disclosed separately.

CHANGES TO CURRENT PRACTICE

Significant Changes

There are no significant changes arising on transition to the new requirements in AASB 107 *Cash Flow Statements*.

Insignificant Changes

There are a number of insignificant changes proposed in AASB 107 *Cash Flow Statements* that may have an affect on agencies. These insignificant changes are outlined below.

Definition of Cash Equivalent

Existing AAS 28 currently defines cash equivalents as:

‘highly liquid investments with short periods to maturity which are readily convertible to cash on hand at the investor's option and are subject to an insignificant risk of changes in value, and borrowings which are integral to the cash management function and which are not subject to a term facility’.

Deposits at call are effectively the only investments that fall within the definition of cash equivalents as they are a highly liquid investment which is convertible to cash at the option of the investor.

AASB 107 has a slightly wider definition of cash equivalents. Cash equivalents are defined as:

‘short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.’

This definition does not make reference to the fact that the investment has to be readily convertible to cash at the option of the investor. This means that under the new definition, investments that are convertible to cash at the option of the issuer could meet the definition of cash equivalents.

In a practical sense, this change will not have a significant impact on ACT Government agencies as no other items that agencies have will fall within the new definition of cash that are not already within the current definition of cash.

Examples of Cash Flows

Both AASB 107 and existing AAS 28 provide examples of what constitutes cash flows from operating and investing activities. However, AASB 107 para 14 provides a number of additional examples of cash flow from operating activities and AASB 107 para 16 provides a number of additional examples of cash flows from investing activities. These examples are included in the above section titled 'Classification'.

This is a small change and will assist some agencies with identifying cash flows.

Cash Flows from Joint Venture

AASB 107 requires that the cash flows from an interest in a jointly controlled entity (that is equity accounted) be included in the cash flow of the entity. The cash flows included in an entity's cash flow statement include the investment made in the jointly controlled entity as well as the distributions and other payments or receipts. Existing AAS 28 does not provide commentary on this issue.

As only a limited number of ACT agencies have joint ventures this will not have a major impact on the ACT.

Payment by Lessee

AASB 107 para 17 identifies cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease as an example of financing activities. Existing AASB 28 is silent on this matter.

Currently, there is no line item in the model financial statements that is separately reflected in the cash flow statement for cash flows relating to the payment of finance leases. This will be updated in the model financial statements for 30 June 2006.