

Cash Flow Accounting

Presented by Israel Usidamen

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Brief profile of the facilitator



Israel Usidamen

- Practiced audit for about 8 years before joining the industry.
- Former Financial Controller at listed downstream oil and gas company
- Currently leads the Finance Dept of another midstream company O&G Company (not listed).
- Prize winner with **Institute of Chartered Accountants of Nigeria (ICAN).**
- Teaches financial and corporate reporting at Wyse Associates Limited.
- Co-Founder at Accounting Yard, a brand that seeks to bridge the gap between practical accounting and theoretical accounting.

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Who are we at Accounting Yard?

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What are your expectations?

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What are our rules?

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Understanding cash flow accounting fundamentally depends on your knowledge of the "Statement of Cash Flows (**SCF**)" under IAS 7

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The SCF Mechanism

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Bird's eye view of a Statement of Cash Flows.

Cash flow is about generating and spending money. Sources of cash flows are operating, investing and financing.

Statement of cash flow	
Operating cash flow	X
Investing cash flow	X
Financing cash flow	X
Total cash flow	**X**
Opening cash balance	X
Closing cash balance	**X**

Any or all these figures can end up being negative and it's not abnormal!

If either or both the opening and closing balances is negative, it implies that the business may have taken more overdraft than its positive cash balance.

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It all starts with an idea!



Ideas are the beginning points of all fortunes.
Napoleon Hill

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The Bottom-up Mechanism

Financing → **Secure the financing needed** to fund the idea, expansion, or strategic plan.

Investing → Once funds are drawn, proceed with acquiring the assets (usually long-term assets), though in some cases, **the strategy may call for selling certain assets instead**.

Operating → With the assets in place, put them to work to generate income, **turning assets into business profits**.

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The Top-down Mechanism

Operations should generate enough net cash flow to **fund expansion** and **reward providers of finance**.

← Operating

At this stage, the Company will not dispose of major assets indiscriminately, **as such actions may signal a shift in strategy**.

Some assets, by nature, may not be used in operations but can still generate inflows such as interest or dividends.

← Investing

- Repay debt.
- Reward equity with dividends.
- Raise more finance if expansion continues.

← Financing



Bringing the pieces together

1 Financing

Cash flows from:

- ✓ securing the required funds (debt and/or equity).
- ✓ refunding the money borrowed.
- ✓ Repayment of interest on the debt[1]
- ✓ Dividend paid[2]

2 Investing

Cash flows from:

- ✓ Acquiring new long-term assets
- ✓ Disposing old long-term assets.
- ✓ Interest and dividends received[3] (for assets that are not utilised directly in operations).

3 Operating

Cash flows from:

- ✓ Monies received from customers
- ✓ Cash paid to suppliers and employees
- ✓ Tax paid
- ✓ Interest paid[1]

[1] You're allowed to present interest paid as either financing or operating cash flow.

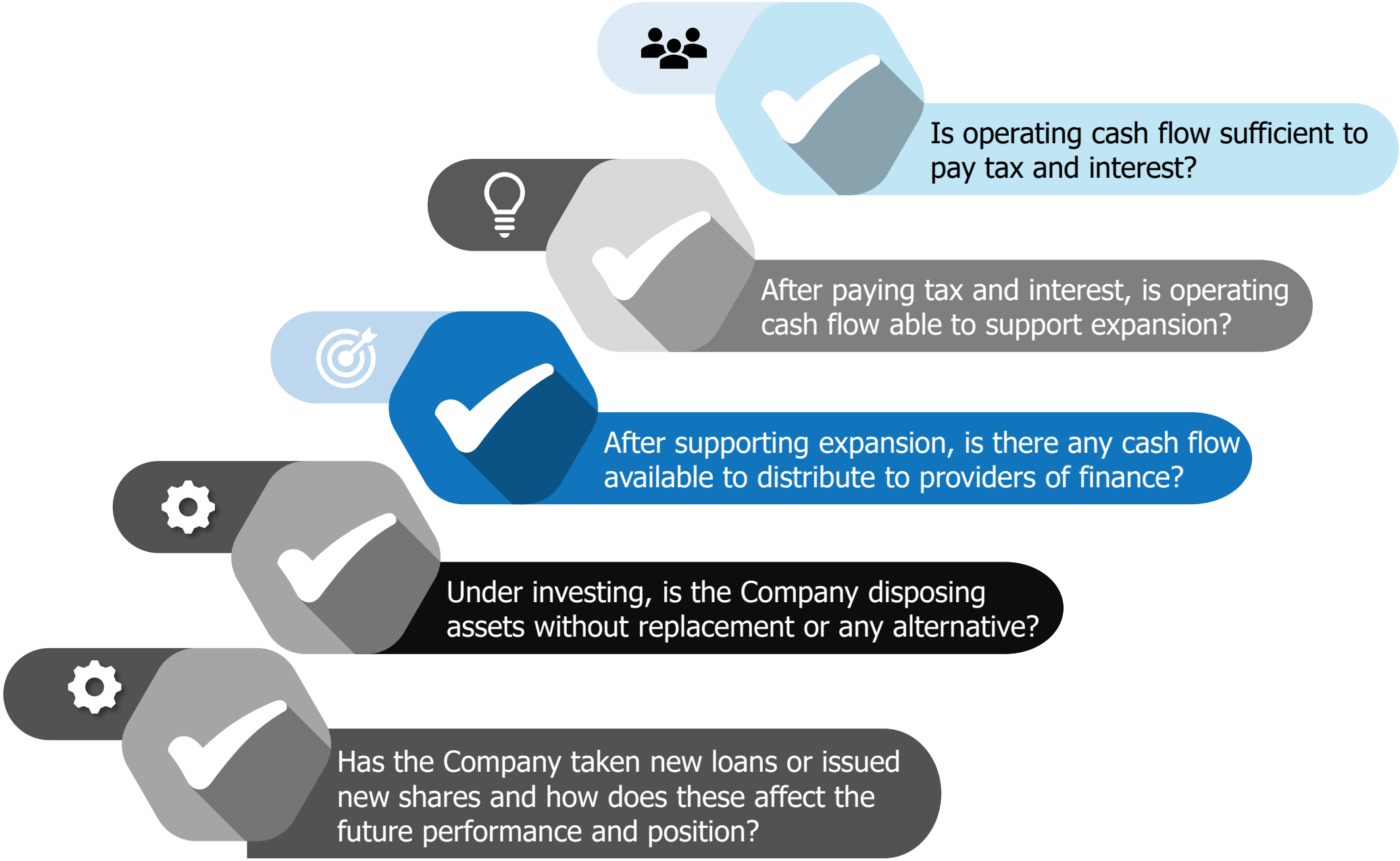
[2] You're allowed to present dividend paid as either financing or operating cash flow.

[3] Financial institutions typically present interest received under operating cash flow.

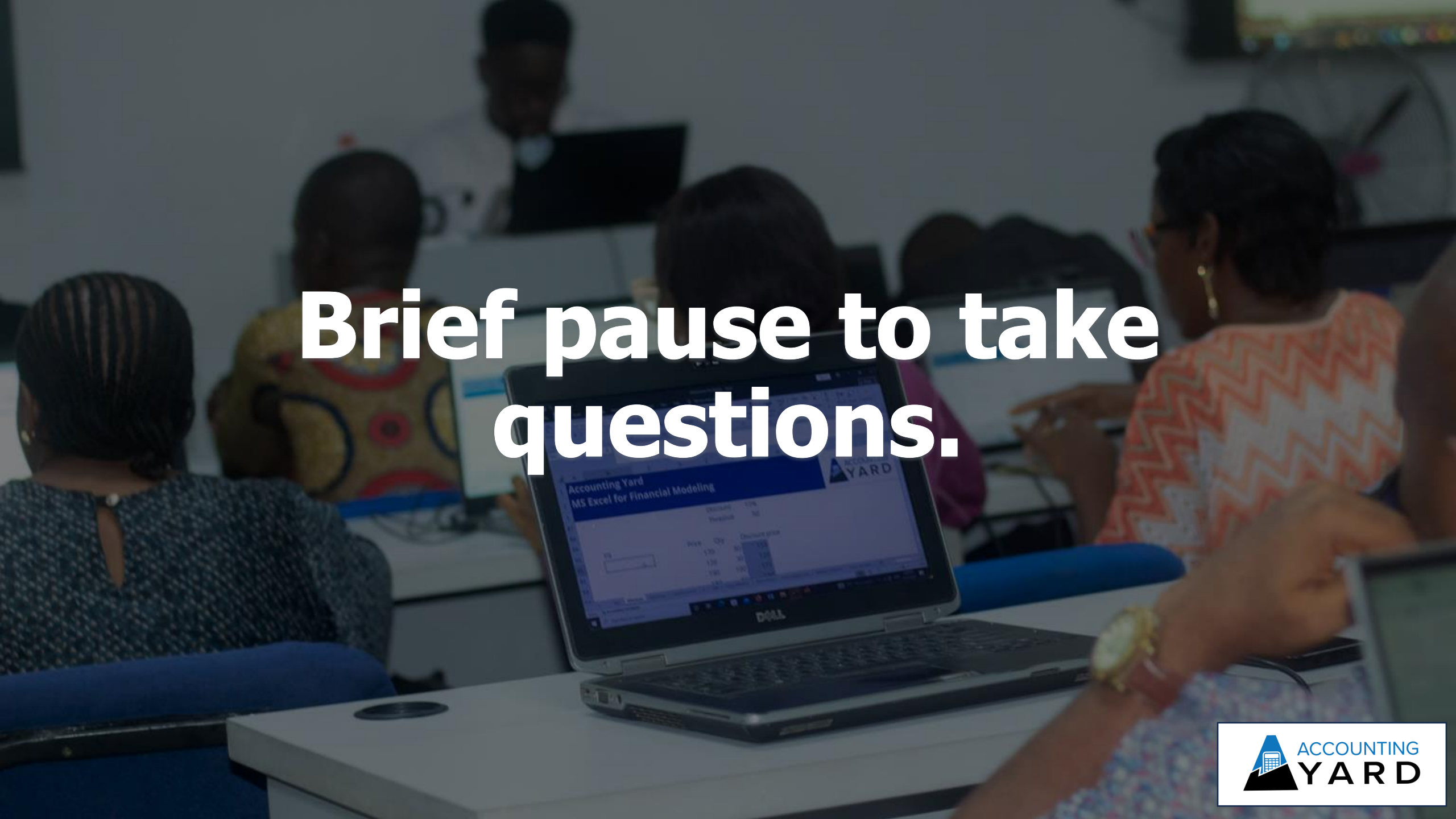
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Making sense of a SCF

Think about the future. The way the business is generating and spending money, how will it affect its future?



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Brief pause to take questions.
Accounting Yard
MS Excel for Financial Modeling
DELL
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Debrief on Section 1.

The concept of cash and cash equivalents



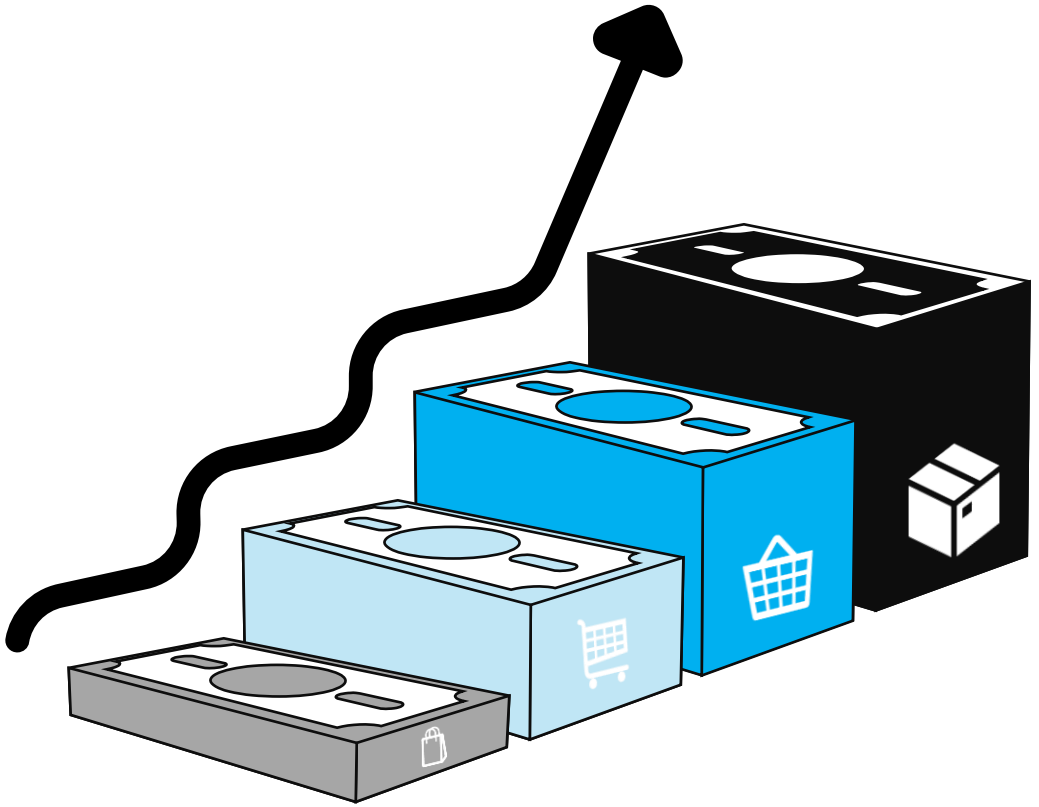
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What is cash? What is cash equivalent?

Not everything you have in the bank is cash!

Cash

- Some money in the bank may be restricted and not available for working capital purposes. Such monies are excluded from the "cash balance".
- Only monies that are available (without restriction) **for day-to-day business operations** are considered as part of cash. Others are referred to as "Restricted cash"
- For example, **Debt Service Reserve Account (DSRA),** maintained as buffer in case a borrower defaults is not typically presented as cash.



Cash equivalent

- Highly liquid short-term investment (say 3-months maturity).
- Subject to insignificant risk of changes in value.
- Earmarked and available for working capital purposes.

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Try-outs

Discuss if the below should be classified and presented as cash and cash equivalents

Try-out 1
Entity A is a property company. During the year it has secured CU5m of finance, which is ring-fenced for use only for a specific development. The funds are held in a designated bank deposit account to be used only for the purposes of the specific development project, which is expected to take 3 years to complete. Withdrawals from the account can only be made with the approval of the lender when specified milestones are met. At the year end, CU1m of the fund has been used on the development and CU4m remains in the designated account.

Try-out 2
Entity A has a wholly owned subsidiary Entity B, which holds bank accounts with domestic banks. Entity B can use the money freely within its local jurisdiction and classifies the amounts as cash and cash equivalents in accordance with IAS 7, but government restrictions prevent it from remitting cash abroad to Entity A or to any fellow subsidiary outside the local jurisdiction.

Try-out 3
Can cryptocurrency be classified as part of cash and cash equivalents? Give brief reasons for your answer.

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Try-outs – Cont'd

Try-out 4

Entity A recently sold surplus plant and machinery for cash proceeds of CU250,000. Management decide to deposit the funds with the bank in two term deposit accounts as follows:

a) CU175,000 into a 12 month term account, earning 4.5% interest. The cash can be withdrawn by giving 7 days' notice but the entity will incur a penalty, being the loss of all interest earned.

b) CU75,000 into a 12 month term account earning 3.5% interest. The cash can be withdrawn by giving 7 days' notice. Interest will be paid for the period of the deposit but only at the rate of 3%, which is equivalent to the bank's stated rate for short-term deposits.

Management are confident that they will not need to withdraw the cash from the higher-rate deposit within the term, but want to keep easy access to the remaining CU75,000 to cover any working capital shortfalls that might arise.

Try-out 5

Entity A holds units in two money market funds that are redeemable on demand at net asset value:

a) high-returns fund – the fund aims to achieve superior returns and may invest in longer-term (up to 2 years) sovereign and corporate bonds to do so, including some bonds with higher credit risk. During the year, entity A invested CU80,000 in this fund and recorded a related fair value gain of CU9,300 in profit or loss. Two weeks after the reporting date, entity A converted the investment into CU87,900 cash (ie CU1,400 less than the yearend value).

b) short-term fund – the fund holds a low risk portfolio of short-maturity, low credit risk investments designed to achieve a stable level of income while maintaining the value of each unit at close to nominal value. The entity uses this fund to 'park' surplus cash and invested CU100,000 in this fund at the beginning of the year. The entity will convert this into cash whenever needed to satisfy any working capital shortfalls or other cash needs.

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Cash is not Profit!!!!

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Cash Flow vs. Profit

Profit (in N'm) Income statement	
Revenue	1,000
Cost of sales	(600)
Gross profit	**400**
Operating expenses	(150)
Depreciation & amortisation	(50)
Operating profit	**200**
Interest expense	(20)
Tax expense	(40)
Profit for the period	**140**



Profit is based on income earned by the Company and expenses incurred by the Company, regardless of whether cash has been received or paid.

Cash – Direct Method (in N'm) Actual cash flows	
Operating activities	
Receipts from customers	940
Payments to suppliers	(590)
Payments to employees	(150)
Interest paid	(20)
Tax paid	(35)
Net cash – operating	**145**
Investing activities	
Purchase of PP&E	(80)
Sale of equipment	10
Net cash – investing	**(70)**
Financing activities	
Proceeds from borrowings	60
Dividends paid	(25)
Net cash – financing	**35**
Net change in cash	**110**



Cash flow is actual movement of cash (inflow and outflow).

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Practice – Cash vs. profit

Scenario

Imagine this:

- 1 January – The balance of cash in your hand was N500k while you had N210m cash in the bank.
- 3 January – You won a contract to deliver building materials to a client at a Contract Price of N250m.
- 4 January – You got a 50% advance of N125m
- 5 January – You purchased a vehicle to support the process worth N10m. You made a part payment of N7m immediately.
- 5 to 11 January – You successfully delivered all the materials to the client but you had to pay your vendor N200m to purchase the materials.

Question

1. Assuming no other transaction took place asides the above, how much profit do you have as at 11 January?

2. How much is your cash balance as at 11 January?

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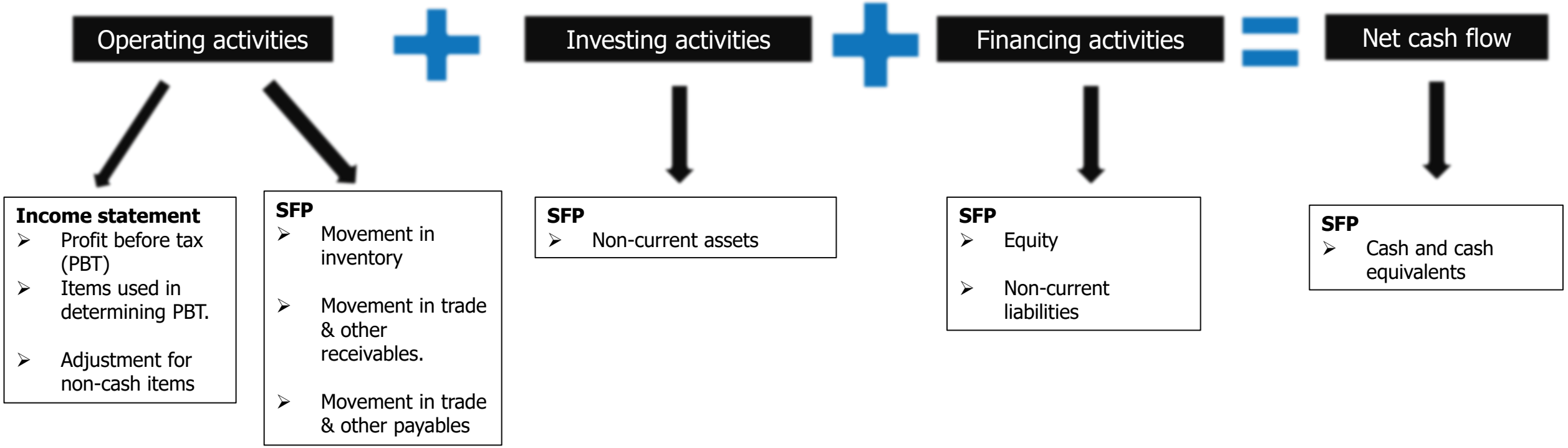
Sources of Cash Flow: Deeper Dive



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Statement of cash flows relationship with SFP and Income Statement

SCF cannot be prepared without the SFP and Income Statement. Both Statements feed the SCF.



Class discussion

- Why is operating cash flow so important?
- Why do businesses prefer the indirect method even when the direct method is encouraged by accounting standards?
- What do you think about this extracted from a Company's SCF?

  Operating cash flow: N40bn Negative
  Investing cash flow: N52bn positive
  Financing cash flow: N14.2bn Negative
- A company's cash balance grew from N2bn in 2022 to N42bn in 2023, is this a good thing? What do you have to say about this?
- If a business keep borrowing every year, what's the likely impact of this on the future?
- If cash flow from operations is not sufficient to support expansion, what's the likely impact of that?
- Company A received CU100m from the government as COVID-19 palliative, what type of cash flow is this?
- Accounting Yard sold one of its television for N1m, what type of cash flow is this?
- Additional profit of N10m was generated during the year, what kind of cash flow is this?

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Practice – Classifying cash flows

Classify each of the following items as **Operating, Investing or Financing**. Where IAS 7 permits a choice, state both options and justify your preference.

a. Cash paid to acquire a 5-year machine

b. Dividends received from a 12% equity investment

c. Proceeds from issuing new ordinary shares

d. Cash received from customers for goods sold

e. Repayment of the principal portion of a bank loan

f. Interest paid on a long-term borrowing

g. Cash paid for income tax

h. Proceeds from sale of an obsolete delivery van

i. Cash dividends paid to shareholders

j. Cash advance to a supplier for a future inventory order

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SCF Preparation:

Introducing the "CAMPS" Framework



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Presentation methods for operating cash flows.

Indirect method reconciles profitability to liquidity while direct method (DM) shows the source of the cash flows. DM is encouraged by the accounting standard).

Statement of cash flows (Indirect method)	
Operating activities	
Profit/(Loss) before tax	X
Adjustments:	
Depreciation & amortisation	X
Allowance for doubtful debts	X
Any other non-cash item	X
Cash flow before working capital	X
Movement in working capital	
Changes in inventory	X
Changes in trade & other receivables	X
Changes in trade & other payables	X
Cash flow from operations	**X**
Interest paid	(X)
Tax paid	(X)
Net cash flow from operations	**X**

Statement of cash flows (Direct method)	
Operating activities	
Cash received from customers	X
Cash paid to suppliers and employees	(X)
Tax paid	(X)
Interest paid	(X)
Net cash flow from operations	**X**

Both amounts are typically expected to be same (as long as same inputs were used to derive them).

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Facilitator should project the SCF in **KPMG's** 2024 Illustrative Financial Statements (FS)

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Basic items to check before you commence your SCF

- ✓ Check if the statement of financial position (SFP) balances.

- ✓ Ensure the notes adequately explain the differences between the opening and closing balances of the required SFP account items. As you work through the SCF, you may uncover gaps or ambiguities in the clarity of the notes.

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Foundational Principle – CAMPS Framework

Repeat after the Facilitator:

"The completeness & accuracy of my SCF[1] is driven by how much I can correctly drill down into the movement in SFP[2] items."

[1] Statement of cash flows

[2] Statement of financial position

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Step 1:

Calculate the differences between prior year (PY) and current year (CY) balances **for each item in the SFP**.

- For assets: PY minus CY
- For liabilities: CY minus PY

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Step 2:

Obtain the **breakdown** for each of the differences by making use of the notes to the financial statements.

For instance, to explain changes in the PPE balance, the notes would typically show that some assets were purchased, others disposed of, and depreciation was charged during the year.

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Step 3:

Classify each of the items in the breakdown into any of the **CAMPS**:

- **C**ash outflow or a cash inflow
- **A**djustment for non-cash item that was used in deriving profit (NOT OCI)
- **M**ovement in working capital
- **P**rofit or loss
- **S**pecific disclosure requirements - interest paid/received, dividend paid/received, income tax paid

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Step 4:

Once an item is traced to CAMPS, it must be **correctly** classified as operating, investing, or financing activity.

Quick Clue – items under "AMP" are always taken to the operating activity.

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Step 5:

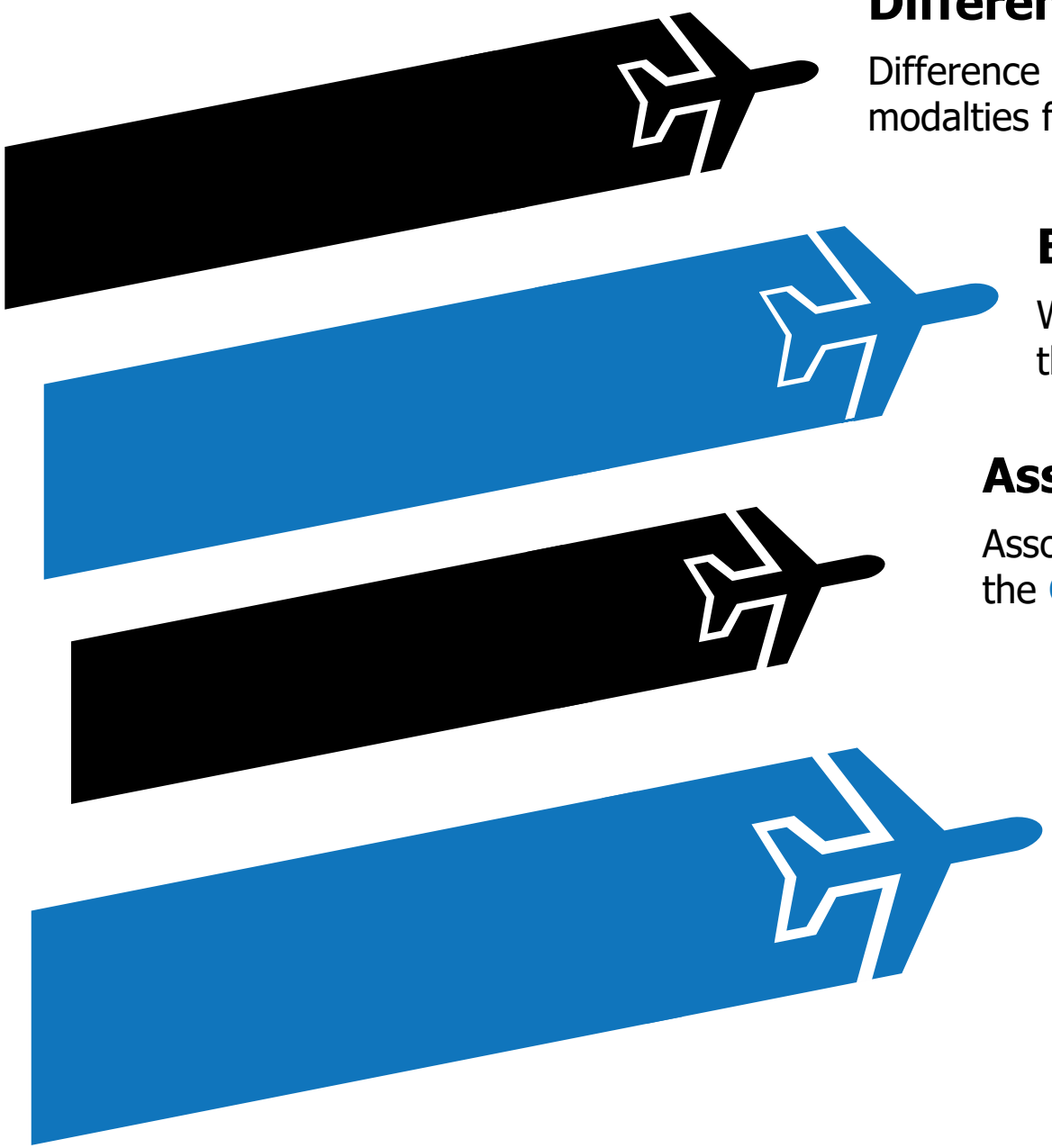
Finishing touch

Carefully go through the income statement items to ensure you have captured:

1) All non-cash items
2) All items that require separate disclosures (interest, dividend paid etc.)

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Let's summarise it!



Differences

Difference between current and prior year balances. Consider the specific modalties for assets, liabilities and equity

Breakdown of differences

What's causing the differences? The notes to the FS will answer this question.

Associate each items in the breakdown to CAMPS

Associate items to the CAMPS. Some items may not fall into any of the **CAMPS**, hence, they will not be presented in the SCF

Classify item in CAMPS to the operating, investing or financing

Once an item falls into the **CAMPS**, classify it appropriately.

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Thank you!

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