COLLEGE OF ACCOUNTING

FINANCIAL REPORTING | ADVANCED

Video Transcription: Cash Flow for Groups

UCT College of Accounting

Hi, my name is Taryn, and the purpose of this video is to better equip you to be able to identify and present, the cash in/outflows, as a result of a transaction on a Group Statement of Cash Flows (Group SCF).

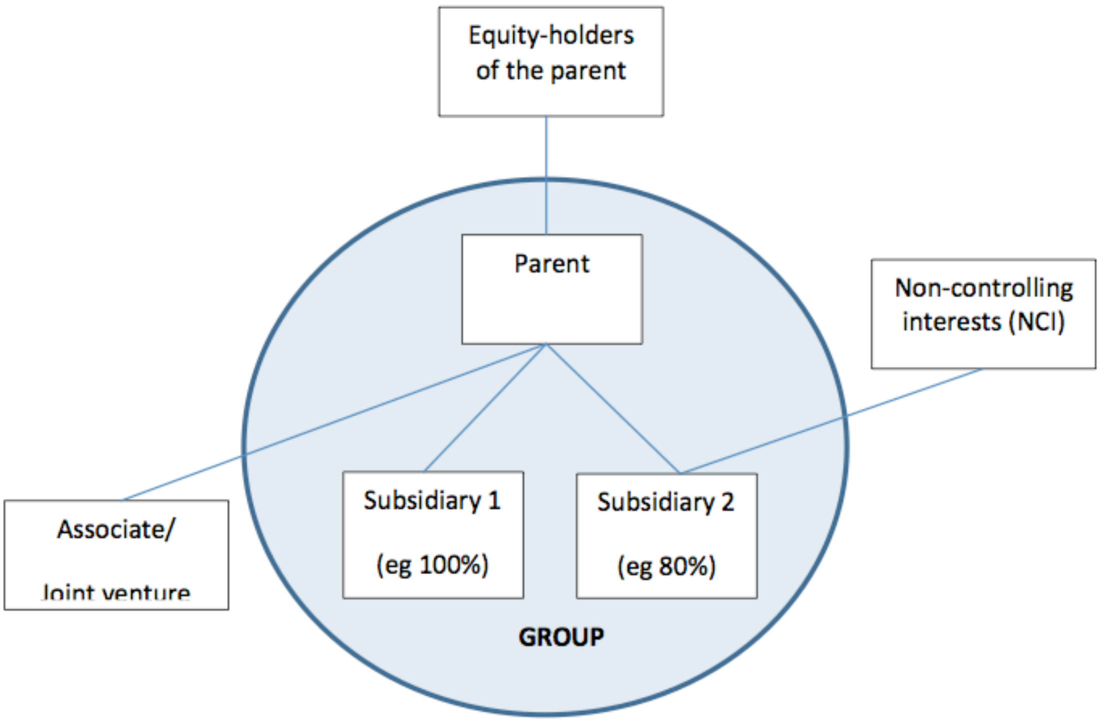
As with any Statement of Cash Flows, the key considerations are:

- **Is there a cash flow?** If a transaction or event does not give rise to a cash flow it will not be reported in the Statement of Cash Flows.
- **How should the cash flow be presented?** The options are either as an operating, investing or financing cash flow.

Before viewing the rest of this video, ensure you have a good understanding of the purpose of a Statement of Cash Flows, the main sections in the statement, the definitions of cash and cash equivalents, as well as a good grasp of how to prepare such a statement for a particular entity.

What is a Group?

- Remember that a Group is defined as a parent and its subsidiaries, which can be diagrammatically represented as follows:



- The circle depicts the boundary of the Group, and is useful because any cash flows that occur between the individual entities within the group (that is, within the circle) are not cash inflows or outflows of the group and are therefore not reported in the Group Statement of Cash Flows. They are not relevant in understanding the cash flows of the Group as a whole; as such, transactions do not result in a change in the Group's cash. We are interested in the cash that flows into or out of the circle (that is, cash flows to or from external parties), as these will be reflected in the Group statement of Cash Flows, as either operating, investing or financing cash flows.

- It is important to note that, although equity-accounting an associate/joint venture results in the inclusion of that entity's results in the Group accounts, the associate/joint venture sits outside of the Group boundary as it is not controlled by the Group (and by definition is not part of the Group).
- Similarly, Non-Controlling Interests (or NCI) are not part of the group. They are part-owners of an entity in the Group, but are not part of the Group themselves.

With this picture in mind, and remembering that we are interested in identifying cash that flows into or out of the Group, let's consider a few examples of typical transactions.

1. Dividends Paid

- Dividends may be declared and paid by any entity to the holders of the entity's equity.
- If a parent pays dividends to its equity holders that cash will leave the Group, and should therefore appear as 'dividends paid' on the Group SCF.
- If a subsidiary pays dividends to its equity holders, that cash remains in the Group to the extent that it is paid to the parent. Therefore the dividend paid by the subsidiary to its parent should never appear on the Group SCF. But cash will leave the Group to the extent that a subsidiary pays cash to the NCI, and so this amount will appear on the Group SCF as part of 'dividends paid'.
- If an associate or joint venture pays dividends, that cash will flow out of the associate, and some of it will flow into the Group. This cash flow will therefore not appear as dividends paid (as the associate's cash was never part of the Group), but the portion received by the parent (or investor) will be presented as part of 'dividends received' in the Group SCF.
- In summary then, 'dividends paid' on the Group SCF will include dividends paid in cash by the parent and by a subsidiary to its NCI; and 'dividends received' will include dividends received by the Group from any associates or joint ventures.

COMMON MISCONCEPTION

Student: But I thought we eliminate the dividend received as part of a Pro-forma Journal Entry (PFJE) when equity accounting an associate. How can it then appear in the Group SCF?

Answer: there is a PFJE to move this dividend as follows:

Dr Dividend income (P/L)
Cr Investment in Associate (SFP)
However, this entry does not affect 'cash/bank' in anyway. The parent (investor) would have first recorded the dividend received as follows:

Dr Bank
Cr Dividend income (P/L)
This clearly shows an increase in the parent/investors bank account, and since 100% of the parent's cash inflow is included in the Group accounts (and 0% of the associate's cash outflow), this increase in cash must be reflected in the Group SCF.

This example has helped demonstrate some basic principles relating to a Group SCF:

- The Group SCF will include 100% of all the cash in and outflows of the parent and its subsidiaries with external parties. However the cash effects of inter-group transactions between a parent and its subsidiaries will never appear on the Group SCF;
- Cash transactions between the Group and the NCI, will appear on the Group SCF, as cash has either entered or left the Group as a result of these transactions;
- Cash transactions between the Group and an associate/joint venture will appear on the Group SCF, including loans advanced to or received from the associate, and acquisitions of investments in associates.

2. Cash flows that relate to a parent gaining or losing control in a subsidiary

- When cash is paid by the parent to obtain control over an entity (thereby making it a subsidiary), this is an investing cash flow as the group has acquired a business (as represented by the net assets of the subsidiary).
- These net assets include the cash balances of the subsidiary.
- The total cash outflow for the group, as a result of such a transaction, is therefore the net of the cash paid by the parent and the acquired cash in the subsidiary.

The reason we need to include the cash that is in the subsidiary at the acquisition date as an inflow on the Group SCF, can be explained diagrammatically as follows:

Cash flows from operating activities Cash flows from investing activities Cash flows from financing activities	Xxx Xxx Xxx	(3) These lines will show 100% of the subsidiary's **post-acquisition** cash in/outflows, as a result of its own operating, investing and financing activities.
Net cash in/(out)flows for the period	xxx	
Cash and cash equivalents at the beginning of the year	Xxx	(2) This line will include zero cash relating to the subsidiary, because the parent did not control the subsidiary at the beginning of the year.
Cash and cash equivalents at the end of the year	xxx	(1) This line will include the subsidiary's cash at the end of the year
(4) In order to balance this SCF, the cash that existed in the subsidiary at the acquisition date must be included as an inflow during the year.		

- This inflow is set off against the cash paid to acquire the subsidiary, and the net number is presented as a cash flow for the 'acquisition of the subsidiary' under 'investing activities', as follows:

Cash flows from operating activities	Xxx	
Cash flows from investing activities	Xxx	
Acquisition of subsidiary	(Xxx)	
Cash flows from Financing activities	Xxx	
Net cash in/(out)flows for the period	Xxx	
Cash and cash equivalents at the beginning of the year	Xxx	
Cash and cash equivalents at the end of the year	Xxx	

- When cash is received by the parent for selling all, or some of its investment in a subsidiary such that control is lost, that cash inflow is also presented as an investing activity cash flow but is once again net of the cash in the subsidiary, over which control has now been lost.

3. What about foreign bank accounts?

- Where there are foreign bank accounts, held directly by a parent or via a foreign subsidiary, the foreign bank balance would be included on the Group Financial Statement at the closing rate, at the reporting date.
- However the cash flows would have been translated to the functional currency at the spot rate on the date of the cash flow (or at an average rate where this is used as a proxy rate for the transaction).

Cash flows from operating activities	Xxx	(3) These lines will include the cash movement translated at the spot rate on the date of the transaction
Cash flows from investing activities	Xxx	
Cash flows from Financing activities	Xxx	
Net cash in/(out)flows for the period	xxx	
Cash and cash equivalents at the beginning of the year	Xxx	(2) This line will include last year's foreign cash balance translated at last year's closing rate
Cash and cash equivalents at the end of the year	xxx	(1)This line will include the foreign cash balance translated at this year's closing rate
(4) In order to balance this SCF, an adjustment is required for the differential between all these rates, as indicated as follows:		

Cash flows from operating activities	Xxx	
Cash flows from investing activities	Xxx	
Cash flows from Financing activities	Xxx	
Net cash in/(out)flows for the period	xxx	
Cash and cash equivalents at the beginning of the year	Xxx	
Adjustment for foreign exchange	Xxx	
Cash and cash equivalents at the end of the year	xxx	

- Therefore, do not forget about this line item when presenting a SCF that includes the translated movements and balances of cash (and cash equivalents) in a foreign currency.

Conclusion

- As Jack Welsh, the long-standing Chairman and CEO of General Electric, is quoted as saying: "Number one, cash is king!" Many others would agree.
- Remember that in order to determine the cash flow implications for any transaction, your first consideration is: has there been a cash flow for the reporting entity? And if so, where should this cash flow be presented?
- Why don't you see whether you can apply these considerations and principles to the following three scenarios? What would the implications be for the Group Statement of Cash Flows if:
  1. The parent was also a joint operator that had an interest in a joint operation?
  2. The parent entered into a finance lease agreement with one of its partially owned subsidiaries?
  3. The parent disposed of a portion of its holding in a subsidiary by selling shares to the other shareholders, and retained control?

I do hope that you have found the considerations that I have discussed, useful. The SCF is a highly relevant source of information for many users of financial statements.