FRS 1 CASH FLOW STATEMENTS: A SURVEY OF THE IMPLEMENTATION OF THE STANDARD TO IRISH PUBLISHED ACCOUNTS

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ABSTRACT

This paper addresses the historical background to the development of FRS 1 including a brief discussion of cash as an alternative to funds flow. The objective of FRS 1 is investigated together with a brief summary of the key contents of the standard as a prelude to a survey analysing the first Irish published accounts based on the new standard. The main part of the paper consists of a detailed survey on how Irish public companies, North and South, have interpreted the new statement. The problem areas of acquisitions, the use of the direct method for reporting operating cash flows and the definition of cash equivalents are also reviewed to see how Irish companies have coped with the change in the accounting rules. The paper concludes by recommending a number of possible changes that should be examined by the Accounting Standards Board (ASB) with a view to improving the utility of the statement.

HISTORICAL BACKGROUND

The emphasis of financial reporting in the early 1900s was largely based on an evaluation of the solvency of reporting entities and the balance sheet was the primary statement on which bankers judged whether or not there was sufficient security to grant loans. Over time, as emphasis switched to performance measurement, the profit and loss account gradually assumed greater importance and by the 1950s was recognised as the primary source of financial information for investors. Lee (1972) discovered a low level of concern by most investors in finding out information about the liquidity of entities, but by 1981 evidence was emerging of a growing interest in this type of data, particularly by institutional investors.

Financial reporting should be concerned with both the measurement of profitability and the ability of companies to turn those profits into cash. In the short term they rarely move in tandem, as both are based on different accounting principles (that is, the accruals and cash concepts respectively). A profitable company may fail for cash flow reasons and the mere rumour of a possible impending insolvency may cause shareholders considerable losses in the value of their shares. Concentration by users on a company's earnings alone is therefore insufficient in order to judge the solvency or otherwise of an entity. Users have been able to derive some incomplete information about liquidity from the balance sheet but, because of the limitations of that static document, it fails to provide the full story on how a company manages its cash resources or takes account of its changing business and financial risks.

A statement which can complement the profit and loss account and balance sheet and explain the full change in liquidity during an accounting period is therefore an important advance in financial reporting. SSAP 10 (*Statements of Source and Application of Funds*), introduced in 1975, attempted to bridge that gap in financial reporting, but it unfortunately was only partially successful.

Pressure, therefore, grew in the late 1980s for the replacement of funds flow by cash flow statements which could avoid the subjectivity associated with accruals-based judgements and opinions and would focus exclusively on the key resource (that is, cash) of most companies.

Financial Reporting Standard No. 1 *Cash Flow Statements* (FRS 1) superseded SSAP 10. FRS 1 was published by the Accounting Standards Board on 26 September 1991, and entities falling within its scope are required to prepare cash flow statements for accounting periods ending on or after 23 March 1992.

NEED FOR CHANGE

The deficiencies of SSAP 10 and the focus by management and creditors on the role of cash flows while running a business during a recession appear to have prompted the ASB to make the issue of a standard on cash flow statements a priority. Public attention had been drawn to deficiencies of financial reporting by some notable company failures and media comment thereon, and the ASB considered that the issue of a standard with the objective of highlighting significant components of cash flow would help the user to gain a better overview of the health of a business.

There appeared to be an inherent attraction in moving towards a statement based on cash flows, as cash budgets and monitoring of cash flows are a major part of business life and are generally well understood. Essentially cash flow is a simpler concept to understand than changes in working capital.

The impetus for change emerged in the United States after the publication of FASB's concepts statements. In particular, SFAC No. 5 (1984) emphasises the importance of cash flow 'to assess factors such as the entity's liquidity, financial adaptability, financial flexibility, profitability and risk'. FASB then decided to release a standard, SFAS 95 *Statement of Cash Flows* (1987). This started a worldwide trend, with New Zealand, Australia, France and later the United Kingdom and Ireland following suit.

OBJECTIVE OF PROVIDING CASH FLOW STATEMENTS

The benefit of including cash flow statements in the financial report is that the statements provide an opportunity for the reader to derive useful financial information on the cash flows generated by a company. The disclosure of the cash flows complements the accruals-based approach of the profit and loss account.

Cash flow as a concept is well understood by users, and cash flow statements should therefore give considerable value in providing information on the financial and liquidity management of the business. An objective of financial statements should be to provide information to help predict future cash flows, and the provision of cash flow statements in addition to the profit and loss account will improve the accuracy of cash flow forecasting. However, there is obviously a limit to the usefulness of any historic cost information in predicting the future.

FRS 1 — CASH FLOW STATEMENTS

One notable feature on the publication of FRS 1 is that it contains only genuine cash flows, major non-cash transactions featuring only in the notes to the statement. Previously the funds flow statement did contain non-cash flow movements. As ASB chairman David Tweedie said, 'Cash is a very difficult figure to fiddle' (Loveday, 1992).

FRS 1 requires cash flow statements to be prepared in a standard format.

The format identifies separately the cash flows from the three main activities — operating, investing and financing — to ensure consistency and comparability between companies.

There are also two additional headings in the cash flow statement, contrary to the approach of other countries:

- Returns on investment and servicing of finance
- Taxation.

The former heading has been kept separate in order that the presentation of net cash flow from operating activities is not affected by the capital structure of the reporting entity and the latter ensures that there is no arbitrary allocation of taxation cash flows to the main activities. There is still no international consensus as to the correct treatment of dividends, interest and taxation flows.

Investing activities include payments to acquire fixed assets less receipts from their eventual sale. Financing will incorporate, *inter alia*, the proceeds of the issue of shares and debentures less the redemption thereof. When the cash flows (excluding cash equivalents) under these headings are totalled, the final balance represents the increase or decrease in cash and cash equivalents.

DETAILS OF THE SURVEY

This paper sets out to investigate how Irish public and semi-State companies have coped with the implementation of FRS 1 and to indicate possible problems emerging for the ASB. The survey consists of an investigation of the first 59 companies from both Northern Ireland and the Republic of Ireland to implement FRS 1.

The survey indicates a very high rate of compliance with the standard headings (**Table 1**). In addition the survey (**Table 2**) also uncovers a similar high rate of disclosure of the notes to the statement except for the Analysis of Changes in Financing, which only 47% of companies provide.

OPERATING ACTIVITIES

The Indirect Method

FRS 1 gives the impression that the difference between the cash flow statement and an equivalent funds flow statement is essentially one of

Table 1: Compliance with FRS 1 standard headings

	Total	%
Net cash inflow from operating activities	59	100
Returns on investment and servicing of finance	57	97
Taxation paid	52	88
Investing activities	58	98
Net cash flow before financing	51	86
Financing activities	51	86
Net increase/(decrease) in cash and cash equivalents	54	92

Table 2: Production of notes to the cash flow statement

	Total	%
Reconciliation of operating profit to net cash flow	53	90
Analysis of changes in cash and cash equivalents	40	68
Analysis of balances of cash and cash equivalents	48	81
Analysis of changes in financing	28	47
Details of major non-cash transactions	2	3
Details of cash flow on acquisitions	11	19
Details of movement in net borrowings	8	14

Note: Six companies in addition provided a useful split between continuing and discontinued operations. Two companies failed to provide any notes

format under the indirect approach. The figures have been rearranged so that the statement focuses exclusively on cash. Operating profit/(loss), depreciation, profits/(losses) on sale of tangible assets and movements on stocks, debtors and creditors have been relegated to the notes accompanying the statement so that the statement itself only incorporates actual cash flows. Users are now provided, without having to make any adjustments, with the bare cash flows.

When the indirect method of preparing operating cash flow activities is adopted, the advantages of cash flow over funds flow statements could therefore be said to be mainly limited to the clarity and presentation of the information and the corresponding ease of interpretation for the user.

The Direct Method

The direct method of preparing operating cash flows has the attractive feature of including new information, showing operating cash receipts and payments, consisting of cash received from customers, cash payments to suppliers, cash payments to employees etc, in arriving at the net cash inflow from operating activities. In providing information on specific sources of cash receipts and payments, use of the direct method would allay criticism that the cash flow statement is just a revamped funds flow statement. The direct method, unlike the indirect approach, is a true cash flow statement.

Even if a company chooses to use the direct method, the FRS requires a note reconciling the reporting entity's operating profit to its net cash flow from operating activities. Therefore, the direct method is an optional additional disclosure, rather than an alternative to the indirect method.

As **Table 3** shows, New Zealand requires, and Australia has proposals to require, the direct method of reporting operating flows, but the Accounting Standards Board in FRS 1 only encourages reporting entities to provide information based on the direct method where the benefits to the users of the information outweighs the cost of providing it. It is likely that virtually all entities reporting under FRS 1 will only adopt the indirect method. In the survey only one Irish company — Irish Continental Group Plc — was prepared to issue direct operating cash flow information (see **Example 1**). This is in line with a similar UK survey (*Company Reporting*, June 1992) and in the United States where in AICPA's 1991 survey of 600 companies, only 15 companies actually adopted the direct approach (2.5%).

Some companies will claim that their accounting systems do not easily produce the data required for the direct method, although it is arguable, if that is the case, whether the financial management of the company is as good as it should be. In other cases the indirect method may be used simply because it will cause fewer problems to the preparers. The requirement of FRS 1 to show cash flows net of any attributable Value Added Tax may also sway preparers to the indirect method. Cash flows from customers will almost certainly include VAT, as will cash payments to suppliers, and the extraction of VAT from cash flows would not be an easy exercise for most companies.

Table 3: Differences between the standards and exposure drafts issued by the United States, New Zealand, Australia and the IASC

Issue	UK	US	NZ*	AUS*	IASC
Effective date	period/end 23/3/92	period/end 15/7/88	period/beg. 1/1/88	ED only	ED only
Method of reporting operating flow	requires indirect, encourages direct	either, encourages direct	requires direct	requires direct	Either, encourages direct
Classes of cash flows	* O, I, F, R,	* O, I, F	* O, I, F	* O, I, F	* O, I, F
Classification of tax flows	Tax	Operating	Operating	Operating	Operating
Classification of interest & dividends received	Classified under returns on investments & servicing of finance	Operating	Investing	Operating	Consistent classification under operating, investing or financing
Classification of interest paid	Classified under returns on investments & servicing of finance	Operating	Financing	Financing	Consistent classification under operating, investing or financing
Classification of dividends paid		Financing	Financing	Financing	

** In New Zealand a revised standard (FRS 10) was promulgated in March 1992. In Australia, a statement of cash flows (AAS 28 and AASB 1026) is required after 30 June 1992.*

Source: Touche Ross, Cash Flow Statements, A Practical Guide, *1991*

Example 1: Irish Continental Group Plc
31 October 1991: Use of direct method

Operating Activities	1991 IR£'000	1990 IR£'000
Cash received from customers	32,121	30,258
Cash payments to suppliers	(19,706)	(17,492)
Cash paid to/on behalf of employees	(6,579)	(6,075)
Net cash inflow from continuing activities	5,836	6,691
Net cash outflow in respect of discontinued activities	—	(520)
	5,836	6,171

However, it must be questionable whether or not the indirect method offers useful information. The ASB argued on the release of FRS 1 that the indirect method provides users with valuable information about the 'quality of the profits' generated by companies. Independent Newspapers Plc's reconciliation of operating profit to net cash flow from operating activities is a typical example, disclosing some 13 reconciling items between the two figures (see **Example 2**). It can hardly be argued that this provides 'quality of profit' information to the average shareholder.

Table 4: Reconciliation of operating profit to net cash flows from operating activities

Analysis of Items Appearing in the Reconciliation

	Total	%
Depreciation	56	95
Profit/loss on disposal of tangible assets	40	68
Movement in debtors	56	95
Movement in creditors	55	93
Movement in stock	42	71
Foreign exchange differences	25	42
Capital grants release	18	31
Exceptional and extraordinary items	11	19
Share of associated companies profits/losses	10	17
Interest payable/receivable	11	19
Others	72	-

Example 2: Independent Newspapers Plc 27 December 1991: Use of indirect method

Note 1: Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities

	1991	**1990**
	IR£'000	**IR£'000**
Operating profit (note 7)	15,661	17,729
Depreciation charges	5,297	4,685
Profit on sale of tangible fixed assets	(116)	(564)
Amortisation of goodwill	278	267
Amortisation of goodwill in related companies	95	95
Amortisation of deferred expenditure	360	306
Decrease/(increase) in stocks	488	(897)
Decrease/(increase) in debtors	216	(70)
(Decrease) in creditors	(1,013)	(144)
Ex-gratia pensions paid	(347)	(266)
Decrease in restructuring provision	(1,546)	(854)
Exceptional items	(3,371)	-
Increase in medium term debtors	(1,103)	(1,863)
Effects of foreign exchange rate changes	(339)	(1,519)
	14,560	16,706

Table 4 summarises the main reconciling differences emerging from the survey. Five companies included the reconciliation on the face of the cash flow statements instead of in the note provided above. This would seem to be in contravention of FRS 1.

One welcome voluntary disclosure by some companies is the split between cash flow from continuing and that from discontinued operations in line with the new proposals in FRS 3 *Reporting Financial Performance* (see **Example 1: Irish Continental Group Plc**).

RETURNS ON INVESTMENT AND SERVICING OF FINANCE

This section of the statement has been designed to encapsulate all those flows relating to interest and dividends which alternatively would have to have been arbitrarily allocated to operating, financing and investing activities. **Table 5** summarises the main elements found in Irish published accounts. The expected headings of interest received/paid and dividends received/ paid occur frequently, but in addition approximately 25% of the survey include the interest element in the repayment of finance lease obligations. A few companies disclosed the dividends paid out to minority shareholders and received from associated companies/non-consolidated subsidiaries.

Table 5: Returns on investments and servicing of finance

	Total	%
Interest received	42	74
Interest paid (including 4 net)	48	84
Dividend paid	39	68
Interest element finance lease	13	23
Dividend paid to minority interest	8	14
Dividends received from associates/ non-consolidated subsidiaries	7	12
Exchange rate movements	3	5
Others	7	12
Produced	57	
None produced	2	

Although unique to the Irish/UK situation this section does not cause great problems in interpretation and it is better to have all the interest/ dividends in one section showing the overall cash flow cost of the company's particular financing structure rather than permitting companies to manipulate the statement by carrying out their own arbitrary allocation procedure which could be reversed or radically altered in the succeeding period.

Of the ten sundry disclosures, three related to foreign exchange differences and five to other forms of investment income. A typical example would be that of Fitzwilton Plc (shown in **Example 3**).

TAXATION PAID

This part of the cash flow statement has been set up to include all cash

Example 3: Fitzwilton Plc 31 December 1991
(Extract from cash flow statement)
Returns on investments and servicing of finance

	1991	1990
	IR£'000	**IR£'000**
Interest received	2,615	3,436
Interest paid	(8,220)	(8,634)
Interest element of finance lease payments	(25)	(43)
Dividends paid to company shareholders	(4,128)	(2,950)
Dividends paid to minority shareholders	—	(992)
Net cash outflow from returns on investments and servicing of finance	(9,758)	(9,183)

flows to and from the taxation authorities in relation to both revenue and capital profits. In practice this will normally include corporation tax paid and refunded, ACT paid, overseas tax on income and tax deposit certificates. It should not, however, include VAT. If any VAT is irrecoverable, it should be disclosed under the cash flow headings to which it relates. Normally the net payments/refunds should be allocated to operating activities (para 79, FRS 1).

Table 6 provides an analysis of headings adopted in Ireland. In 12 cases the heading 'tax paid' is adopted without any reference to the specific tax involved. However, in the majority of cases (39) the wording is clear,

Table 6: Taxation paid

	Total	**%**
Tax Paid	12	24
Corporation tax paid	39	76
Foreign tax paid	7	14
Other taxes	3	6
Companies disclosing	51	
Companies disclosing no tax payments	1	
No disclosure	7	

that is, 'corporation tax paid'. In addition, two companies disclosed specialised payments in terms of bank levies and duties on certain tax-based lending.

Those companies not disclosing tax information were largely found in the semi-State sector where taxation is not payable. The Bank of Ireland gives a fairly detailed analysis of its four components of tax payments (see **Example 4**).

Example 4: Bank of Ireland Plc 31 March 1992
(Extract from cash flow statement)

	1992	1991
Taxation:	**IR£m**	**IR£m**
Corporation tax paid	(8.8)	(13.8)
Overseas tax paid	(5.3)	(7.2)
Bank levy paid	(14.3)	(14.4)
Duty on certain tax based lending paid	(10.2)	(6.3)
Total tax paid	(38.6)	(41.7)

INVESTING ACTIVITIES

Cash flows under this heading normally relate to the acquisition or disposal of any asset held for investment purposes other than those included within the definition of a cash equivalent. They will include the cash flows associated with the purchase and sale of tangible fixed assets, of investments and of subsidiaries/associated companies. In addition, some companies have included capital and government grants receipts as cash inflows. FRS 1 does not offer any guidance on grant flows and, as a result, considerable variations in practice have arisen. Twelve companies have included grants as investment flows in the survey.

Table 7 gives an analysis of the components of investing activities. Heiton Holdings Plc (in **Example 5**) provides a typical example.

Some of the more unusual features are NIE's inflow of customers' contributions in respect of fixed assets and Printech Plc's net cash outflows in respect of due diligence. The former represents deferred payments by customers towards the purchase of fixed assets, while no explanation has been provided for the latter.

Table 7: Investing activities

	Total	%
Purchase of tangible fixed assets	55	95
Proceeds on the sale of tangible fixed assets	50	86
Purchase of investments	19	33
Proceeds on the sale of investments	16	28
Acquisitions/disposals of subsidiaries	24	41
Purchase of investments in associated companies	15	26
Capital and government grants received	12	21
Purchase/sale of minority interests	8	14
Others	46	–
Disclosures	58	
No disclosures	1	

Example 5: Heiton Holdings Plc 30 April 1992 (Extract from cash flow statement)

	Notes	1992 IR£'000	1991 IR£'000
Investing Activities		(1,568)	(749)
Purchase of tangible fixed assets		246	223
Disposal of tangible fixed assets		821	(138)
Divestment of UK activities	21		
Related company dividends received out of profits previously accounted for on equity basis		—	944
Merger and acquisition costs of related companies and subsidiaries		(155)	(76)
		(656)	204

Extract from notes to the accounts

Note 21: Divestment of UK activities

	1992 IR£'000	1991 IR£'000
Extraordinary loss	(185)	(1,057)
Depreciation	33	—
Attributable taxation (credit)	(140)	—
Goodwill written-off	—	257
Stocks	708	—
Debtors	1,921	—
Creditors	(2,637)	662
Proceeds of disposal of fixed assets	121	—
	821	(138)

The survey did not pick up any particular problems apart from some unusual analysis — for example, Burmin Exploration and Developments Plc's inclusion of a share issue as an investing flow rather than what appears to be one of a financing nature. No explanation is offered by the company for this particular presentation.

FINANCING ACTIVITIES

Financing cash flows represent receipts from or repayments to both external providers of finance and shareholders. Receipts will include those from the issue of shares, loans, capital instruments, bonds etc and outflows include repayments of loans, the capital element of finance lease payments, redemption or repurchase of loans/shares and expenses of the issue of loans and debentures.

Government grants received have been included under financing activities by seven companies as financing (**Table 8**). This emphasises the need for clarification as to the most appropriate heading into which these inflows should be set. The most frequent financing items were proceeds from share issues (31) and repayment of borrowings (36). Independent Newspapers provide a good example of these flows (**Example 6**).

There are a number of unusual examples, such as capital reorganisation costs (Dwyer Plc) and reduction in deferred payments (Kerry Products Plc), but it can be concluded that no real problems in practice were found in the survey and the majority of the flows are self-explanatory.

INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS

One of the major problems on implementation of FRS 1 was seen to be the interpretation of the definition given in FRS 1 of 'cash equivalents'. FRS 1 gives the following definition:

> 'Short-term, highly liquid investments which are readily convertible into known amounts of cash without notice and which were within three months of maturity when acquired; less advances from banks repayable within three months from the date of the advance. Cash equivalents include investments and advances denominated in foreign currencies provided that they fulfil the above criteria' (FRS 1, para 3).

Investments must be within three months of maturity *when acquired* and

Table 8 Financing activities

	Total	%
Proceeds on the issue of shares	31	61
Proceeds on the receipt of loans/debentures	23	45
Capital element of finance leases	20	39
Repayment of borrowings/loan and preference stock	36	71
Capital and other government grants received	7	14
Issue expenses	5	10
Others	6	12
Disclosures	51	
No disclosures	8	

Example 6: Independent Newspapers Plc 27 December 1991

	Notes	1991 IR£'000	1990 IR£'000
Issue of ordinary share capital		(223)	(148)
Issue of shares to minority		–	(45)
Issue of convertible bonds	27	(30,000)	–
Redemption of bonds and loan stock	27	7	6
Repayment of long term loans		37,651	9,131
Capital element of finance lease			
Rental payments		1,767	1,387
Costs of bond issue	26	836	–
Net cash outflow from financing		10,038	10,331

also they must be readily convertible into known amounts of cash *without notice*. Thus, a deposit for an unspecified period or requiring seven days' notice would fall outside the strict interpretation of a cash equivalent. Undoubtedly the three months rule is an arbitrary cut-off point, but it is one which should ensure consistency across reporting entities and leave less room for company directors to exercise any flexibility.

It has been suggested by some leading technical partners in the accounting profession that the spirit of the standard should be followed and not necessarily the strict letter of the rules. This would accord with the substance of the transaction and be in line with current accounting theory and practice. This would enable certain deposits over three months to be included as cash equivalents (Patient, Faris and Holgate, 1992). Undoubtedly this has caused problems in the United States, and David Tweedie has promised to review this point at some future date. The Financial Reporting Review Panel in the United Kingdom are very strict, however, in their interpretation of cash equivalents and two companies to date have been publicly admonished (Control Techniques Plc and BM Group Plc).

From the survey of Irish companies, it was hard to see whether Irish companies were finding problems in interpreting the standard definition. However, a number of companies have disclosed all their cash, overdrafts and loans as cash equivalents if repayable within one year, which would not be in accordance with FRS 1 (for example, CRH Plc and Irish

Example 7: CRH Plc, 31 December 1991
Note 27: Analysis of the balance of cash and cash equivalents as shown in the balance sheet

	1991	1990	Change in year
	IR£'000	IR£'000	IR£'000
Cash at bank and in hand	385,512	361,965	23,547
Bank loans and overdrafts	(80,520)	(104,428)	23,908
Loans repayable within one year	21,664	10,230	11,434
	326,656	267,767	58,889
Non-cash equivalents	(28,607)	(26,705)	(1,902)
Cash equivalents	298,049	241,062	56,987

Continental Group Plc). CRH Plc attempts to get around this problem by deducting non-cash equivalents from the total (see **Example 7**).

Other organisations have included temporary loans (such as CIE and Fitzwilton Plc) or short-term investments in their definitions (such as Gypsum Industries Plc) but no details are disclosed about the precise life of any of these items in any of the companies surveyed.

Paragraph 56 of FRS 1 indicates that movements in the net cash/debt position should be given an 'appropriate degree of prominence', but it has not specified the form of presentation for individual entities. In practice, most companies in Ireland have adopted Notes 2 and 3 from the illustrative examples, that is, 'Analysis of Changes in Cash and Cash Equivalents during the Year' and an 'Analysis of the Balances of Cash and Cash Equivalents during the Year'. **Table 9** reveals that 68% of companies provided the former statement, with 100% showing opening balances, the net cash flow for the period and the closing balances. However, 19 (48%) also revealed the extent of foreign exchange differences.

Table 9: Analysis of changes in cash and cash equivalents

	Total	%
Opening balances	40	100
Net cash flow for the period	40	100
Exchange differences	19	48
Closing balances	40	100
Total produced	40	
Not produced	19	

The details of the latter statement are disclosed in **Table 10** and give details about the composition of items included as cash and cash equivalents. As expected, cash at bank and in hand and bank overdrafts represent the bulk of the entries. However, bills of exchange and short-term investments are represented in a substantial minority of company statements.

Table 10: Analysis of balances of cash and cash equivalents as shown in the balance sheets

	Total	%
Cash at bank and in hand	47	98
Bank overdrafts and loans	41	85
Short term investments	11	23
Bills of exchange	3	6
Others	8	—
Produced	48	
Not produced	11	

Fitzwilton Plc provides a good example of the necessary disclosure of an 'Analysis of Balances of Cash and Cash Equivalents' (see **Example 8**).

Example 8: Fitzwilton Plc 31 December 1991
Note 32: Analysis of balances of cash and cash equivalents as shown in the balance sheet

	1991	1990	Change in year
	IR£'000	IR£'000	IR£'000
Cash at bank and in hand	27,873	33,984	(6,111)
Short term liquid financial instruments	—	3,500	(3,500)
Bank advances and loans	(16,637)	(17,538)	901
Bills of exchange payable	(145)	(119)	(26)
	11,091	19,827	(8,736)

A number of Irish companies have decided to amalgamate the two notes, 2 and 3, together into one statement. This does seem to be logical as the information in both is the same. The Analysis of Changes in Cash and Cash Equivalents During the Year merely shows the movement for that period while the Analysis of Balances of Cash and Cash Equivalents breaks down that same movement into its component parts.

ANALYSIS OF CHANGES IN FINANCING DURING THE YEAR

The fourth note in the illustrative examples to FRS 1 requires a reconciliation of the movement in the items shown in the financing section of the cash flow statement with the related items in the opening and closing balance sheets.

This necessitates the introduction of a wide variety of non-cash flow transactions within the section, as well as the setting up of finance leases as liabilities. Fourteen instances of non-cash movements were recorded and of these, nine companies disclosed the existence of foreign currency differences and seven the inception of finance leases (**Table 11**). Scrip

Table 11: Analysis of changes in financing during the year

	Total	%
Share capital (including share premium)	21	72
Debentures/loan stock	20	70
Finance loans	13	45
Bank loans	3	10
Minority interest	1	3
Non-cash	14	48
Inception of finance leases	7	24
Scrip issues	3	10
Issue expenses	2	7
Loan write-offs	1	1
Foreign exchange movements	9	31
Capital element of finance leases	2	7
Other	7	24
Produced	29	
Not produced	0	

issues and the expenses of issuing shares/loans were also noted in a small minority of instances.

The production of the note itself was not disclosed by many companies, with only 29 (47%) providing the information. The Barlo Group Plc (see **Example 9**) provided an excellent example.

Generally this has been a useful note since it links the cash flow from financing per the cash flow statement with the full movement in finance for the year, including any non-cash transactions. It provides a bridge between the cash flow statement and the opening and closing balance sheets. However, companies may well feel that the merits of such a statement are outweighed by the additional costs of providing it.

MAJOR NON-CASH TRANSACTIONS

Paragraph 43 of the FRS requires companies to disclose those material transactions not involving the movement of cash or cash equivalents in the notes if their disclosure would be necessary for an understanding of

Example 9: Barlo Group Plc 31 March 1992
Note 33: Analysis of changes in financing during the year

	Lease Finance IR£'000	Long Term Loan IR£'000	Share Premium IR£'000	Share Capital IR£'000
At 31 March 1991			5,550	5,692
- in creditors due within one year	28	167		
- in creditors due after more than one year	35	250		
Cash flow items:	63	417	5,550	5,692
Payments of capital finance leases	(57)	—	—	—
New loan taken out in year	—	700	—	—
Payment of long term loans	—	(412)	—	—
New shares issued	—	—	615	285
Non cash items:				
New finance leases	67	—	—	—
Exchange difference	—	(5)	—	—
At 31 March 1992	73	700	6,165	5,977
- in creditors due within one year	40	12		
- in creditors due after more than one year	33	688		
	73	700		

the underlying transactions. The illustrative examples at the back of FRS 1 in Note 5 provide details of possible likely contents. Only two companies in the survey provided such a note (Powerscreen International

Example 10: Kingspan Group Plc 31 December 1991
Note 27: Major non-cash transactions

During the year the group entered into finance lease arrangements in respect of assets with a total capital value at the inception of the lease of £188,000 (1990: £502,000).

Plc and the Kingspan Group Plc). Both companies disclosed the fact that they were entering into finance leases but in addition Powerscreen noted the discharge of consideration for an acquired subsidiary to be by way of a share for share exchange. Powerscreen provided its information as a footnote to the main statement whereas Kingspan (**Example 10**) provided the information in a separate note as per the illustrative example of FRS 1.

ACQUISITIONS/DISPOSALS

SSAP 10 permitted two options of reflecting acquisitions or disposals of subsidiary undertakings: either as a separate item of purchase cost or disposal proceeds; or by reflecting the effects of acquiring/disposing of a subsidiary on the separate assets and liabilities of the group. FRS 1 now only permits an amended version of the former method.

FRS 1 requires the amount of cash and cash equivalents paid in respect of acquisitions, and received in respect of disposals, to be included as respective single amounts net of any cash and cash equivalents existing in the subsidiary. The respective net inflow/outflow should be included under 'Investing Activities'. The non-cash element of the purchase consideration must not be included on the face of the statement (for example, share for share exchange).

A note is also required of the effects of acquisitions and disposals, sufficient to show the amount of cash and cash equivalents transferred, and the amount of cash and cash equivalents included in the cash consideration. Disclosure of acquisitions/disposals was found in 24 companies in the survey under the 'Investing Activities' title and of these 11 disclosed a separate note, as required by FRS 1. CRH Plc (**Example 11**) provides a very clear detailed note.

Only the net cash outflows of £2,267,000 are recorded in the cash flow statement as 'Acquisition of subsidiary companies'. The FRS has undoubtedly cleared up some of the misunderstandings about disclosing the effects of acquisitions/disposals by insisting on only actual cash movements being recorded inside the cash flow statement itself and relegating non-cash movements to the notes.

CONCLUSIONS

The paper set out to examine how FRS 1 was being implemented in

Example 11: CRH Plc 31 December 1991
Note 22: Purchase of subsidiary companies net assets acquired at fair value

	1991 IR£'000	1990 IR£'000
Tangible fixed assets	1,070	32,777
Tangible financial assets	3	—
Stocks	200	17,216
Debtors	1,300	19,948
Taxation	15	(3)
Creditors	(784)	(19,138)
Capital grants	—	(143)
Minority shareholders' interest	300	(187)
Loans and finance leases	—	(1,387)
	2,124	49,083
Goodwill	848	34,259
	2,972	83,342
Satisfied by		
Cash payment	2,039	78,543
Cash acquired	(183)	(1,484)
Bank overdrafts acquired	411	2,959
Net cash outflows	2,267	80,018
Deferred acquisition consideration	705	3,324
	2,972	83,342

practice. It tries to achieve this by carrying out an in-depth survey of the first 59 Irish published accounts to adopt FRS 1.

In general, the move away from the more accruals-based funds flow statement is to be welcomed and undoubtedly the statement is now prepared in a more user-friendly and understandable manner. In addition, the presentation of cash flow in a standardised format has aided comparison across companies.

However, there are a number of specific problems raised by the survey. The first is the failure of companies to take up the voluntary disclosure of direct operating cash flow information. This method undoubtedly provides a more complete explanation of the total cash flow effects on the business. Evidence from the United States would suggest that in order for it to become the normal accounting practice it would need to be implemented on a compulsory basis and not simply as an alternative to the indirect approach. Certainly, at present, it does not appear to be logical to force companies to provide indirect flow information in addition to direct, if they were to formally adopt the direct approach. It is also out of line with international practice. As an initial step, a move should be made to harmonise the accounting practice with that proposed by the IASC and the United States: that is, companies should be permitted to adopt either the direct or indirect approach.

The ASB's unique attempt to isolate interest and tax cash flows from other activities is to be welcomed as it does lead to greater consistency between companies. Another topic that could be similarly treated is the current inconsistent approach of companies in dealing with government and other grants which appear at present in both investing and financing activities.

Apart from the problem of grants, the survey revealed clear and reasonably consistent cash flow disclosure of investing and financing activities, and there does not seem to be any need for further refinement in these sections of the statement.

Although the new definition of cash equivalents has been criticised by a number of financial directors since its inception, the strict cut-off rule does mean that there is consistency of accounting treatment across companies. There was some evidence from the survey that companies were adopting a liberal interpretation of the definition. There is always the opportunity for those entities who are unhappy with the definition to make their case known in the accompanying narrative to the financial statements. Consistency is better than flexibility, which could too easily lead to a more creative form of cash flow statement.

One superfluous note is the perceived requirement to issue both Notes 2 and 3 (per the illustrative example) on the balances of cash and cash equivalents. The breakdown and the movement could just as easily be contained within the one note. Several companies in the survey have already adopted this technique.

The fourth note, dealing with the changes in financing is a welcome additional disclosure by companies as it ties in both the cash and non-cash movements within the financing structure of the business. However, at present only a minority of Irish companies have disclosed the note. This note should be encouraged as it forms a useful bridge between the cash flow statement and the financing section of the balance sheet. Perhaps this could be enforced by the Financial Reporting Review Panel in the United Kingdom and by whatever monitoring force will eventually be put into position in the Republic of Ireland.

The accounting treatment for acquisition/disposal cash flows is much clearer under FRS 1 and only includes 'real' cash flows in the statement. Much of the information previously recorded as inflows/outflows is now correctly analysed as a non-cash movement (for example, share for share exchange).

Overall, the introduction of FRS 1 can be judged to be a success, albeit qualified, in its objective of improving the information provided on cash flow reporting. The survey results would suggest that FRS 1 represents an evolutionary but by no means a revolutionary change in financial reporting. The ASB has promised to review the standard after a two-year transitional period and it is hoped that some of the problems that have emerged in Irish company reporting can be satisfactorily addressed in a revised version.

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