

## The Statement of Cash Flows in the Romanian Accounting Practice

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According to the Romanian legislation in force, medium and large entities as well as public-interest entities present the statement of cash flows as part of the financial statements set. This paper aims to map out the way in which cash flows are prepared by the two methods know in the practice - direct and indirect.

Keywords: cash flow statement, operating activities, financing activities, investing activities.

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### 1. Introduction

As a tool for assessing an entity's performance, the cash flow statement has grown over the last 20 to 30 years, with the awareness of the information limits of the results account. Cases of entities have been identified that, although they have made profit, have not been able to dispose of sufficient liquidity to pay various debts such as corporate income tax, staff salaries or dividends to shareholders, etc. In these situations, although there was a good management of profit-generating income and expenses, management has mismanaged treasury flows, failing to acquire liquidity as needed for payment. Thus, current or potential shareholders are becoming increasingly interested in information about the entity's ability to pay future dividends than the current profit.

Informations concerning the cash flows of an entity are useful to provide sufficient elements for assessing the entity's ability to generate cash and cash equivalents to users of financial statements. When used in conjunction with the rest of the financial statements, the cash flow statement provides information that allows users to evaluate changes in an entity's net assets, its financial structure (including its liquidity and solvency), and the entity's ability to influence value and timing of treasury flows. In addition, past information on cash flows is often used as indicators of value, time placement and certainty of future cash flows.

Regardless of the nature of the entity's activities and whether the cash can be considered as the product of the entity (as may be the case for a financial institution) they need cash to carry out their activities, pay their obligations and maintain their profitability. And although the presentation of the cash flow situation is necessary for all entities, the Romanian regulator [1] considers useful only the elaboration of the situation of cash – flows by medium and large entities as well as those of public interest.

### 2. Literature review

The Statement of cash flows presents the receipts and payments made by an entity over the course of one year, the scene construction being based on the concepts of treasury (cash and cash equivalents) and the flows of Treasury (cash-flows). Through the entity's Treasury we understand the set of liquidity and liquidity equivalents available to the entity. *Liquidities (cash) are delimited in cash and demand deposits*. Cash equivalents represent short-term placements with a high degree of liquidity that can easily be converted into amounts of money. In the category of liquidity equivalents, we refer to term deposits, deposit certificates and treasury bills issued by

the government, all with a maturity of up to three months, all those financial resources held to meet short-term commitments and not for investments or other purposes.

Structurally, the cash flow statement reports flows/cash flows of **operating, investing and financing activities**.

The amount of cash flows arising from operating activities is a key indicator of the extent to which the entity's activities generated sufficient cash flows to repay the loans, to maintain the entity's ability to operate, to pay dividends and to make new investments without resorting to external sources of funding. These cash flows generally arise from the entity's main income-generating activities. Typically, operating cash flows arise principally from transactions and other events that result in determining the profit or loss.

*Examples of cash flows from operating activities may be* (art. 455 of THE OMFP No. 1.802/2014):

- ✓ cash receipts from the sale of goods and the provision of services;
- ✓ cash receipts from royalties, fees, commissions and other income;
- ✓ cash payments geared towards suppliers of goods and service providers;
- ✓ cash payments made to and on behalf of employees;
- ✓ cash payments or profits tax refunds, unless they may be specifically linked to investment and financing activities;
- ✓ cash receipts/cash payments of an insurance premium and claims insurance, annuities and other benefits related to insurance policies;
- ✓ cash receipts and payments from contracts concluded for placement or trading.

Some transactions, such as selling a component of an installation, can generate a recognized gain or loss in the result of the current period. Cash flows related to this type of transaction are cash flows from investment activities. However, cash payments for the generation/acquisition of assets held for lease to others are cash flows from operating activities. Cash receipts from the rental and subsequent sale of these assets are also cash flows from operating activities (art No. 454 paragraph 2 OMFP No. 1.802/2014). In addition, both paid interest and received interest/dividends can be classified as operating cash flows because they are included in the profit or loss determining process.

Separate presentation of cash flows from investing activities shows the extent to which the expenses incurred served to obtain resources intended to generate future revenues and cash flows. *Examples of cash flows from investing activities may be* (Article 456 of OMFP No 1.802 / 2014):

- ✓ cash payments for the purchase of tangible, intangible and other fixed assets. Such payments shall include those which relate to the capitalised development costs and the construction, in its own direction, of tangible assets;
- ✓ cash receipts from the sale of tangible, intangible and other immobilised assets;
- ✓ cash payments for the acquisition of equity or debt instruments of other entities and interests in joint ventures (other than payments for instruments considered to be cash equivalents or for those held for placement or trading);
- ✓ cash receipts from the sale of equity or debt instruments of other entities and from the sale of interests in joint ventures (other than receipts for instruments deemed to be equivalent to cash and for those kept for placement or trading);
- ✓ cash advances and loans granted to other parties (other than advances and loans granted by a financial institution);
- ✓ cash receipts from repayment of advances and loans granted to other parties (other than advances and loans of a financial institution).

Separate presentation of cash flows generated from financing activities is important because it is useful to predict the entity's financing requirements for future cash flows.

*Examples of cash flows from the activities of funding can be* (art. 457 of OMFP No. 1.802/2014):

- ✓ cash receipts generated from the issue of shares or other equity instruments;

- ✓ cash payments made to owners to acquire or redeem the entity's shares;
- ✓ cash receipts from the issue of debt securities, loans, trade effects, bonds, mortgages and other short or long-term loans;
- ✓ cash refunds of borrowed amounts;
- ✓ cash payments made by the lessee to reduce the existing debt under a finance lease.

Also, paid interest and received interest/dividends can be classified as treasury flows from financing and from investments because they represent costs of attracting sources of financing or return on investment (art. 459, para. 2 OMFP No. 1.802/2014).

In addition, although the unrealized gains and losses arising from exchange rate fluctuations are not cash flows, the effect of exchange rate fluctuations on cash and cash equivalents held or denominated in foreign currencies is reported in the cash flow statement to reconcile cash and cash equivalents at the beginning and end of the period. This value is presented separately from cash flows arising from operating, investing and financing activities and includes, where appropriate, the differences that would have arisen if those cash flows were reported at the end-of-period exchange rate (art. 458 OMFP no 1.802/2014).

### 3. Reporting of cash flows from operating activities

The Romanian regulations in force have taken over the requirements of IAS 7 "Statement of cash Flows" for the presentation of cash flows from operating activities, but using with preference the direct method. The present paper presented booth the methods: direct and indirect. If, according to the direct method, the flows are derived from the main classes of gross cash payments and receipts, in the indirect method [2] the profit or loss is adjusted with the effects of non-monetary transactions, deferrals or commitments of payments or cash receipts from exploitation, past or future, and items of income or expense associated with cash flows from investing or financing.

We present below in Tables no. 1 and 2 the structure of treasury flows according to the indirect and direct method.

*Table No. 1 Statement of cash flows according to the indirect method*

Specification	Amounts
<b>Gross profit before tax</b>	
<i>Eliminating non-treasury revenue and expenses:</i>	
+ Expenses with depreciation of fixed assets	
+ Current assets value adjustments expenditures	
- Provisions income	
<i>Non-operating income and expenses elimination:</i>	
+ Tangible assets sale losses	
- Tangible assets sale gains	
+ Funding related interest expense	
- Investments interest income	
<b>= Operating result before the change in working capital requirement</b>	
- Stock change	
- Receivables variation	
- Operating upfront expenditure variation	
+ Operating debts variation	
-Paid profit tax	
<b>= Net cash from operating activities (I)</b>	
+ Proceeds from tangible assets sales	
- Provider payments for property, plant or equipment	
- Long-term loans payments	
+ Repayment Receipts from long-term loans	

+ Interest receipts on loans granted	
<b>= Investment activity net cash (II)</b>	
-Cash payments from capital contributions reimbursement	
+ Short term credit receipts	
- Interest payments	
<b>= Financing activity net cash (III)</b>	
<b>IV Net increase in cash (I+II+III)</b>	
<b>V Cash at the beginning of the period</b>	
<b>VI Cash at the end-period (+/- IV+V)</b>	

Table No. 2 Situation of operating cash flows according to the direct method

Specification	Amounts
Customer receipts	
+ Fees, commissions receipts	
+ Operating subsidies receipts	
-Services and stock suppliers payments	
- Employee payments	
-Social contributions payments	
-VAT payments	
-Operating lease rents payments	
-Corporate tax payments	
<b>= Operational activity cash</b>	

#### 4. Cash flow statement elaboration by direct and indirect method

In order to reflect the cash flow situation according to the direct method, we consider the following case study for ALFA enterprise, which during the year N showed in the accounts the following receipts and payments (in lei):

Customer receipts	3.680.000
VAT payments	344.000
Operating subsidies proceeds	280.000
Employee payments	1.520.000
Payments from the repayment of bank loans	656.000
Fees and commissions receipts	80.000
Receipts from issue of shares	1.760.000
Financial lease rents payments	344.000
Short-term financial investments sale proceeds	72.000
Financial fixed assets sale proceeds	104.000
Interest payments	320.000
Dividend payments	128.000
Corporate tax payments	264.000
Receipts from new bond issues	336.000
Received bank credits receipts	688.000
Social contribution payments	240.000
Proceeds from tangible assets sale	480.000
Interest receipts	224.000
Asset provider payments	720.000
Dividend Receipts	600.000
Operating lease rents payments	160.000

Investment grants receipts	880.000
Acquisition of short-term financial investment payments	64.000
Inventory and service providers payments	480.000

At the beginning of the year the cash and cash equivalents amounted to 960,000 lei and at the end of the year they amounted to 5,096,000 lei. The effect of foreign currency exchange rate variations was + 192,000 lei. It is required to prepare the cash flow statement according to OMFP no. 1.802/2014, knowing that direct method is used to determine net operating flow.

*Table No. 3 Statement of cash flows according to the direct method*

<b>Statement of Cash Flows</b>	
<b>Treasury cash flows from operating activities (direct method)</b>	
Receipts from customers	3.680.000
Fees and commissions receipts	+ 80.000
Operating subsidies receipts	+ 280.000
Inventory and service providers payments	- 480.000
Employee payments	- 1.520.000
Social contribution payments	-240.000
VAT payments	-344.000
Operating lease rents payments	-160.000
Corporate tax payments	-264.000
<b>I. Net cash from operating activities</b>	<b>+ 1.032.000</b>
<b>Treasury cash flows from investment activities</b>	
Proceeds from tangible assets sale	+ 480.000
Short-term financial investments sale proceeds	+ 72.000
Financial fixed assets sale proceeds	+ 104.000
Interest receipts	+ 224.000
Dividend receipts	+ 600.000
Investment grants receipts	+ 880.000
Payments to asset providers	-720.000
Short-term financial investments sale proceeds	- 64.000
<b>II. Net cash from investing activities</b>	<b>+ 1.576.000</b>
<b>Treasury flows from financing activities</b>	
Receipts from share issues	+ 1.760.000
Receipts from new bond issues	+ 336.000
Receipts from bank credits received	+ 688.000
Payments from bank loans repayments	- 656.000
Interest payments	-320.000
Dividend payments	-128.000
Financial lease rents payments	-344.000
<b>III. Net cash from financing activities</b>	<b>+ 1.336.000</b>
<b>IV. Net increase in treasury and treasury equivalents (I+II+III)</b>	<b>+ 3.944.000</b>
<b>V. Treasury and treasury equivalents at the beginning of the period</b>	<b>+ 960.000</b>
<b>VI. Foreign currency exchange rate variations effect</b>	<b>+ 192.000</b>
<b>VII. Treasury and treasury equivalents at the end of the period (+/-IV+V+/-VI)</b>	<b>+ 5.096.000</b>

In order to develop the cash flow situation of the BETA entity, at the 31.12.N the following information is known, in RON:

Gross profit	4.320.000
Customers receipts	720.000
Depreciation of fixed assets expenses	160.000
Paid corporate tax	192.000
Cash payments from capital contributions reimbursement	320.000
Stocks at the end of the year	240.000
Provisions income	128.000
Tangible assets sale losses	256.000
Operating payables at the end of the year (excluding corporate income tax)	2.640.000
Long-term loans payments	640.000
Early operating income at the beginning of the year	160.000
Received short-term loans receipts	400.000
Proceeds from the tangible assets sale	152.000
Stocks at the beginning of the year	480.000
Upfront expenses at the end of the year	128.000
Receipts from repayment of long-term loans	80.000
Operating claims at the end of the year	2.240.000
Payments to asset providers	528.000
Interest income from investments	136.000
Upfront expenses at the beginning of the year	40.000
Operating claims at the beginning of the year	1.360.000
Proceeds from tangible assets sale	528.000
Funding related interest expense	160.000
Operating liabilities at the beginning of the year (excluding corporate tax)	3.680.000
Interest payments	160.000
Turnover	1.600.000
Operation revenues at the end of the year	184.000
Current assets value adjustments expenditures	8.000
Corporate tax expense	400.000
Interest receipts on granted loans	136.000
Employee payments	960.000

Treasury and treasury equivalents at the beginning of the year were 640,000 lei and at the end of the year 1,936,000 lei. It is required to prepare the cash flow statement under IAS 7, knowing that indirect method is used to determine net operating flow.

*Table No. 4 Statement of cash flows according to the indirect method*

<b>Statement of Cash Flows</b>	
<b>Treasury flows from operating activities (indirect method)</b>	
Profit before tax (gross profit)	4.320.000
<b>Elimination of revenue and expenses with no effect on the treasury:</b>	
+ Expenses with fixed assets depreciation	+ 160.000
+ Current assets value adjustments expenditures	+ 8.000



- Provisions income	-128.000
<b>Elimination of non-related exploitation income and expenses</b>	
+ Tangible assets sale losses	+ 256.000
- Proceeds from the tangible assets sale	-528.000
+ Funding related interest expense	+ 160.000
- Investments interest income	-136.000
<b>Operating result before deducting the change in operating capital requirement</b>	<b>+ 4.112.000</b>
(-)Stock change 240.000 – 480.000 = -240.000	+ 240.000
(-)Receivables variation 2.240.000 – 1.360.000 = 880.000	-880.000
(-)Variation in upfront operating expenses 128.000 – 40.000 = 88.000	-88.000
(+)Change in operating liabilities (excluding corporate tax) 2.640.000 – 3.680.000 = -1.040.000	-1.040.000
(+)Variation of operation upfront revenue 184.000 – 160.000 = 24.000	+ 24.000
(-) Paid corporate tax	-192.000
<b>I. Net cash from operating activities</b>	<b>+ 2.176.000</b>
<b>Treasury flows from investment activities</b>	
Tangible assets sale proceeds	+ 152.000
Asset providers payments	-528.000
Payments from long-term loans	-640.000
Receipts from the of long-term loans repayment	+ 80.000
Interest receipts on granted loans	+ 136.00
<b>II. Net cash from investing activities</b>	<b>-800.000</b>
<b>Treasury flows from financing activities</b>	
Cash payments from capital contributions reimbursement	-320.000
Receipts from received short term credits	+ 400.000
Interest payments	-160.000
<b>III. Net cash from financing activities</b>	<b>-80.000</b>
<b>IV. Net increase in treasury and treasury equivalents (I+II+III)</b>	<b>+ 1.296.000</b>
<b>V. Treasury and treasury equivalents at the beginning of the period</b>	<b>+ 640.000</b>
<b>VI. Treasury and treasury equivalents at the end of the period (+/-IV+V)</b>	<b>+ 1.936.000</b>

## 5. Conclusions

The cash flow statement provides a snapshot of the entity's financial structure, showing important information about operating cash, investments and financing that cannot be obtained either from the balance sheet or the profit and loss account. The structure of the cash flow table also provides additional information to users of financial statements to assess an entity's assets, liabilities and equity changes.

The paper has proposed a graded completion of the cash flow statement structure, the reporting of operating cash flows, and the direct and indirect cash flow statement to familiarize professional accountants and account users with this component of the annual financial statements.

## References

- [1,] IAS 7 The cash – flow statements, Annual Improvements to IFRS Standards 2015 – 2017 Cycle;
- [2] OMFP no. 1802/2014 for the approval of the Accounting Regulations on the individual annual financial statements and the consolidated annual financial statements, Official Gazette no. 963/2014.