NEWSLETTER NO. 55

CONSOLIDATED STATEMENT OF CASH FLOW - what is it?

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The final statement in your "new format" Annual Financial Report will be the Consolidated Statement of Cash Flow. This is the successor to the Consolidated Statement of Changes in Financial Position that is currently prepared by Canadian municipalities. Again, we will work through this by taking a sample statement prepared in the current format, and comparing it to how it might be presented in the new format.

Again, please note that this material is prepared to illustrate how the standards of the handbook might be implemented, with respect to an actual financial report. The presentation is not intended to indicate preferred formats, or to prescribe standardized note disclosure, as variations in format and wording will be required to meet the requirements of differing circumstances. The current and new reports do not purport to be best practice or best of breed, just a good example of what you are working towards.

In this statement, we are looking at the net changes during the year to cash and cash equivalents.

"***Cash*** *comprises cash on hand and demand deposits*" (PS 1200.096).

"*Cash equivalents* *are short-term highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of change in value. Cash equivalents are held for the making of short-term cash commitments rather than for investing or other purposes . An investment would normally qualify as a cash equivalent only when it has a short maturity, say three months or less from the date of acquisition.…*" (PS 1200.097)

There are two methods for reporting cash flows. A government may report cash flows from operating activities using either the direct method or the indirect method. Governments are encouraged to report such cash flows using the direct method. The direct method provides information that may be useful in estimating future cash flows and that is not available under the indirect method. Using the direct method, the major classes of gross cash receipts and gross cash payments relating to operating activities are disclosed (See PS 1200.103 and .104)

Both methods produce the net change in cash and cash equivalents that occurred during the fiscal year. The net balances are added to the previous year's cash reported in the Statement of Financial Position to come up with this year's balance for cash and cash equivalents, which can then be reconciled back to the Statement of Financial Position.

As is done in the Handbook, a copy of Irgendwo's Statement of Cash Flow is provided in both formats in the Appendix of this newsletter, the preferred format first.

The What

The Consolidated Statement of Cash Flow reports on that most liquid asset of all, cash and cash equivalents. It shows how your municipality financed its activities and met its cash requirements.

The direct method itemizes cash received by the municipality during the year by type or source, such as taxation, user fees, transfers, investments, etc. Operational uses of cash are similarly itemized by class or function, such as salaries, materials and supplies, contract fees, financing charges etc. This information on receipts and disbursements is not provided by the indirect method, unless provided elsewhere as a separate note. The direct method statement is constructed in a "bottom-up" manner, from adjusted Trial Balance balances.

The indirect method, by contrast, is a "top down" approach that uses the annual surplus (or deficit) from the Statement of Operations that is then adjusted for the effects of non-cash items included in the surplus/deficit and for any accruals of past or future operating cash receipts or payments. (PS 1200.105)

The municipality will use or receive cash as the result of various capital-related activities, through investing and through financing. Each one is sub-totaled, and added together to arrive at the net increase (decrease) in cash over the fiscal year. Once again, the previous year's year-end cash balance is added in to arrive at this year's year-end balance, which can be reconciled with the cash amount recorded in the Statement of Financial Position (line 11).

The Why

In terms of the financial reporting model, this statement furnishes the key indicators, the cash position of the municipality and the cash flow during the year. It helps users of municipal financial statements to assess the capacity of the municipality to generate cash and cash equivalents and of its needs for cash resources. This helps in evaluating a municipality's liquidity and assessing its future cash requirements, as well as providing accountability for its use of cash resources. Historical cash flow information may be useful as an indicator of the amount, timing and certainty of future cash flows.

This is why the statement reports in the context of the four major activities of operations, capital, investing and financing. Cash flow from operations is a key measure of the extent to which the municipality can generate sufficient cash flows to maintain its programs and services without recourse to external sources of financing. Capital activities are dealt with separately, because nearly all government capital assets provide future service potential rather than a return on investment, as is the case in the private sector. Investing and financing activities are engaged in by a municipality as and when appropriate, to maintain a reasonable level of cash on hand. Particularly with respect to capital, this statement should be read in conjunction with the Statement of Change in Net Financial Assets(or

Net Debt) and the Notes to the Financial Statements for a more complete picture of capital investment and utilization by the municipality.

The Implications

For the direct method, the municipality will be effectively reporting on operations on a straight cash basis, by disclosing the sources of cash received during the fiscal period, and the total of all disbursements by expenditure class or function. This may require careful analysis of the accounts of the municipality to extract the information required.

For the indirect method, many of the changes are the inclusion of information that we have already prepared for the Statement of Operations. While these were actually shown in the sample in Newsletter #53, to show how the differences were derived, they would not normally appear in a published Statement of Operations, but will appear here. Again, this statement amplifies some aspects of the earlier statements.

The Changes

As an appendix to this newsletter, there are 3 relevant financial statements:

Statement 4A -Consolidated Statement of Changes in Financial Position – published format;
Statement 4B1 - Consolidated Statement of Cash Flow – **preferred new format** (direct method); and
Statement 4B2 - Consolidated Statement of Cash Flow – new format (indirect method)

Statement 4A is what was published in Irgendwo's 2007 Annual Financial Report, and, again, the statement and its format would be familiar to any regular reader of Canadian municipal financial reports. This was actually the third financial statement following the auditor's letter.

Statement 4B1 is the new successor to the Consolidated Statement of Changes in Financial Position. The outward appearance of this statement is very similar to the old format, as in Statement 4A, because there is still the need to report on the major activities of a municipality as before, and the major sources and applications of cash have not changed.

However, the Operations section is quite different. As mentioned earlier in the section, "The What", this statement now discloses the amounts of cash received by class or type of revenue, and basically answers the questions – how much cash was received during the year? And of what was it in payment? Similarly, the statement discloses what payments were made during the year for Operations purposes, and answers the question – what were the payments made for – salaries? Materials and supplies? Contract obligations? - Etc.

The statement discloses the total receipts from operations during the year, and the total disbursements of cash for operational purposes during the year, to give the net cash provided by operations. Note that the three capital-related sources of cash are itemized, so that you can reconcile this statement back to the original published version. There are also a set of adjustments that help translated the published numbers into they would be in the new reporting model. Similarly for cash payments.

Please note that in a set of published statements, such adjustments would not be shown, as the amounts would be included in the revenue sources and functional area expense totals respectively.

To reiterate, they are itemized here to show how the figures in the new reporting model would relate back to the original published figures. You may find this example helpful when trying to restate your 2008 actuals for your 2009 financial report.

The biggest difference of all is that the new statement has a section on capital investment. In the published format, capital expenditures were included in the Consolidated Statement of Fund Activities (Statement 2A – see Newsletter #53), and reported by functional area on Schedule 2A, shown in the same newsletter. Under full accrual accounting, these outlays are for the purchase of non-financial assets, which will be expensed over time. The acquisition of tangible capital assets is a use of cash, which will reduce your net cash balance, but are not reported as an expense. Similarly, you dispose of TCAs and all proceeds received will be a source of cash, and the offset credit entry reported as a decrease in non-financial assets, not as revenue.

The annual surplus (deficit) will include the gain (loss) on disposition of TCAs. This is another non-cash transaction, so we must reduce (increase) our net cash balance by this amount. By doing this, the line Net Investment in TCAs becomes exactly that, total cost of new acquisitions less net book value of dispositions (line 51).

The sections on investing and financing activities are unchanged from the published format, as they are not impacted by the accounting change.

Note that the amounts shown on the net total line Net Increase (Decrease) in Cash is the same in both formats, as are the numbers on the bottom line, Cash, End of Year. This is another graphic example of the fact that the accounting change has not altered what has happened during the year by even a penny. What it has done is substantially change the reader's perspective on what has happened.

Statement 4B2 (the indirect method) differs from Statement 4B1 only in the Operations section. The rest is identical.

In this approach, the starting point is the Annual Surplus (or Deficit) from the Statement of Operations (line 66). This must be adjusted by the effects of all non-cash items included in the surplus/deficit, and for any accruals of past or future operating cash receipts or payments. First, we add in the net changes in the non-financial assets, Inventories for Internal Use and Prepaid Expenses, which we included in the Statement of Operations. The change in supplies on hand would increase or decrease the cost of operations, and would result in available cash being decreased or increased respectively. You are exchanging the financial asset cash for the non-financial asset, Inventory, or vice versa if your inventories are shrinking.

Prepaid expenses are dealt with similarly. You paid the entire amount in this period, though you may spread the expense over several periods. Consequently, you have used the full amount of cash in this period, and will deduct the prepaid amount from cash to reflect that. On the other hand, if you are using up a prepaid expense in this period, you have recorded an expense for which there will be no cash outlay, so that your annual surplus figure for the year will understate the actual cash from operations.

Thus that decrease in prepaid expenses will be recorded as a source of funds, and added back into the net working capital from operations.

A major change in the Statement of Cash Flow is that you must also add back in the non-cash expense, Amortization Expense. Your annual surplus (deficit) is net dollars **AFTER** amortization expense, but you never paid out any amount to anyone for your quota of amortization. So after adding in the other uses and sources of cash, your net working capital will also include the amount of amortization charged in the year, as the cash equivalent is still on hand.

Similarly, any transfers or donations of tangible capital assets, whether out of your municipality or into your municipality, must be added in or subtracted, respectively. Like amortization, these are non-cash transactions, if no consideration was paid in return by the receiving party.

The net result of these items gives the net working capital from Operations, the same figure derived using the direct method. The rest of this statement is identical to the previous one.

Summary

This is a walk-through of the Consolidated Statement of Cash Flow, the last of the four financial statements required by the new financial reporting model. This Statement was covered in some detail at the MFOA/AMCTO Spring 2009 workshops, and the presentation materials can be found on-line at the MFOA/AMCTO PSAB Asset Management website.

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Our next newsletter will look at that new and different concept, the Accumulated Surplus. What does it mean? What does it include? How will you present your information, and report on it?

For more information and resources regarding tangible capital asset management, please go to PSAB Asset Management, or contact:

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Statement 4A - Consolidated Statement of Changes in Financial Position – published format

THE CORPORATION OF THE DISTRICT MUNICIPALITY OF IRGENDWO

Consolidated Statement of Changes in Financial Position

Year ended December 31, 2007

(in thousands of dollars)

	2007	2006
OPERATIONS		
Net revenues (expenditures)	**48,645**	(5,238)
Uses		
Increase in accounts receivable	**0**	(10,769)
Increase in other assets	**0**	(35)
Decrease in other deferred revenue	**0**	(845)
	0	(11,649)
Sources		
Decrease in accounts receivable	**17,393**	0
Decrease in other assets	**63**	0
Increase in accounts payable and accrued liabilities	**8,445**	28,847
Increase in deferred revenue	**14,655**	29,454
Increase in other deferred revenue	**1,273**	0
Increase in employee benefits and post employment liabilities	**6,901**	17,907
Increase in landfill closure and post closure liabilities	**772**	1,028
	49,502	77,236
Net increase in cash from operations	**98,147**	60,349
INVESTING		
Net increase in investment	**(86,246)**	(65,172)
FINANCING		
Debt issued for District purposes	**0**	14,650
District debenture principal repayments	**(13,708)**	(12,649)
Net (decrease) increase in cash from financing activities	**(13,708)**	2,001
NET DECREASE IN CASH	**(1,807)**	(2,822)
CASH, BEGINNING OF YEAR	**14,858**	17,680
CASH, END OF YEAR	**13,051**	14,858

The accompanying notes and schedules are an integral part of these financial statements.

Statement 4B1 - Consolidated Statement of Cash Flow – preferred new format (direct method

THE CORPORATION OF THE DISTRICT MUNICIPALITY OF IRGENDWO
Consolidated Statement of Cash Flow (Direct Method)

Year ended December 31, 2007

(in thousands of dollars)

	2007	2006
OPERATING		
Cash receipts:		
District taxes (including supplementary taxes)	**432,056**	407,771
User charges		
Water and sewer	**118,289**	108,264
Other	**105,863**	99,997
Fines	**5,900**	5,540
Government transfers		
Canada	**11,800**	11,838
Ontario - *operating related*	**163,286**	142,665
Other - *operating*	**20,586**	19,602
Interest earned on Reserve Funds	**9,881**	7,684
Government transfers - Ontario (capital related)	***3,945***	*21,352*
Contribution from developers	***67***	*276*
Other - capital	***14,261***	*13,431*
Adjustments required to translate published numbers		
Revenues received but deferred	***74,594***	*84,626*
Change in accounts receivable	***17,393***	*(10,769)*
Change in other deferred revenue	***1,273***	*(845)*
Less proceeds from sale of tangible capital assets	***(5,406)***	*(1,133)*
Change in other assets	***63***	*35*
Total - restated cash receipts	**973,851**	910,334
Cash payments:		
Salaries, wages and employee benefits	**385,546**	372,709
Operating materials and supplies	**99,779**	100,548
Contracted services	**89,927**	84,968
Rents and financial expensies	**15,555**	14,583
External transfers	**123,830**	116,909
Debenture interest	**11,705**	12,060

THE CORPORATION OF THE DISTRICT MUNICIPALITY OF IRGENDWO

Consolidated Statement of Cash Flow (continued)

Year ended December 31, 2007

(in thousands of dollars)

	2007	2006
Cash payments (continued):		
Adjustments required to translate published numbers		
Increase in accounts payable and accrued liabilities	***(8,445)***	*(28,847)*
Increase in employee benefits and post employment liabilities	***(6,901)***	*(17,907)*
Increase in landfill closure and post closure liabilities	***(772)***	*(1,028)*
Amortization expense	*These are non-cash expenses that were not included in the original published numbers shown above*	
Increase in prepaid expenses		
Decrease in inventories of supplies		
Capital expenditures" expensed	***1,443***	*1,380*
Total - restated cash payments	**711,667**	655,375
Working capital from Operations	**262,184**	254,959
CAPITAL		
Acquisition of tangible capital assets	**(169,443)**	(195,743)
Proceeds on disposal of tangible capital assets	**5,406**	1,133
Net investment in tangible capital assets	**(164,037)**	(194,610)
INVESTING		
Net increase in investment	**(86,246)**	(65,172)
FINANCING		
Debt issued for District purposes	**0**	14,650
District debenture principal repayments	**(13,708)**	(12,649)
Net (decrease) increase in cash from financing activities	**(13,708)**	2,001
NET INCREASE (DECREASE) IN CASH	**(1,807)**	(2,822)
CASH, BEGINNING OF YEAR	**14,858**	17,680
CASH, END OF YEAR	**13,051**	14,858

The accompanying notes and schedules are an integral part of these financial statements.

Statement 4B2 - Consolidated Statement of Cash Flow – new format (indirect method

THE CORPORATION OF THE DISTRICT MUNICIPALITY OF IRGENDWO
Consolidated Statement of Cash Flow

Year ended December 31, 2007
(in thousands of dollars)

	2007	2006
OPERATING		
Annual surplus (deficit)	**84,575**	63,856
Uses		
Increase in accounts receivable	**0**	(10,769)
Increase in other assets	**0**	(35)
Decrease in other deferred revenue	**0**	(845)
Increase in prepaid expenses	**(987)**	0
	(987)	(11,649)
Sources		
Decrease in accounts receivable	**17,393**	0
Decrease in other assets	**63**	0
Increase in accounts payable and accrued liabilities	**8,445**	28,847
Increase in deferred revenue	**14,655**	29,454
Increase in other deferred revenue	**1,273**	0
Increase in employee benefits and post employment liabilities	**6,901**	17,907
Increase in landfill closure and post closure liabilities	**772**	1,028
Decrease in inventories of supplies	**269**	0
	49,771	77,236
Non-cash charges to operations		
Amortization	**125,681**	122,718
Transfers of capital assets	**5,816**	800
Working capital from Operations	**264,856**	252,961

Statement 4B - Consolidated Statement of Cash Flow – new format (continued)

THE CORPORATION OF THE DISTRICT MUNICIPALITY OF IRGENDWO

Consolidated Statement of Cash Flow (continued)

Year ended December 31, 2007

(in thousands of dollars)

	2007	2006
Working capital from Operations (borught forward)	**262,184**	254,959
CAPITAL		
Acquisition of tangible capital assets	**(169,443)**	(195,743)
Proceeds on disposal of tangible capital assets	**5,406**	1,133
Net investment in tangible capital assets	**(164,037)**	(194,610)
INVESTING		
Net increase in investment	**(86,246)**	(65,172)
FINANCING		
Debt issued for District purposes	**0**	14,650
District debenture principal repayments	**(13,708)**	(12,649)
Net (decrease) increase in cash from financing activities	**(13,708)**	2,001
NET INCREASE (DECREASE) IN CASH	**(1,807)**	(2,822)
CASH, BEGINNING OF YEAR	**14,858**	17,680
CASH, END OF YEAR	**13,051**	14,858

The accompanying notes and schedules are an integral part of these financial statements.