

entity produces both separate financial statements and consolidated financial statements, a statement of cash flows will be required for each.

Prior to the adoption of IFRS 11 *Joint Arrangements*, an entity may have an interest in a joint venture that is accounted for using proportionate consolidation, but no subsidiaries. If the entity prepares individual financial statements (i.e. financial statements in which proportionate consolidation is applied), the statement of cash flows will include the investor's proportionate share of the cash flows of the joint venture.

### 3.1 Reporting cash flows on a net basis

Cash inflows should generally be reported separately from outflows. However, the Standard does permit the following cash flows to be reported on a net basis:

[IAS 7:22]

- receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity (such as the collection of rent on behalf of the owner of a property, funds held for customers by an investment entity, or the acceptance and repayment of demand deposits by a bank); and
- receipts and payments for items in which the turnover is quick, the amounts are large and the maturities are short (such as advances and repayments of principal amounts relating to credit card customers, purchases and sales of investments, and commercial paper or other short-term borrowings with a maturity period of three months or less).

For financial institutions, the following additional cash flows may be reported on a net basis:

[IAS 7:24]

- cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;
- the placement of deposits with and withdrawal of deposits from other financial institutions; and
- cash advances and loans made to customers and the repayment of those advances and loans.

### 3.2 Exclusion of non-cash transactions

As a general principle, only transactions that require the use of cash or cash equivalents should be included in a statement of cash flows. Note,

however, that when the indirect method of presenting cash flows from operating activities is used (as discussed at 5.1.2 below), this will result in certain non-cash items appearing in the statement of cash flows as adjustments to profit or loss for the period. Investing and financing activities that do not require the use of cash or cash equivalents are always excluded from a statement of cash flows. [IAS 7:43]

Examples of investing and financing transactions that do not result in cash flows and, consequently, are excluded from the statement of cash flows, include:

- the acquisition of an asset by way of a finance lease (but the payments for lease rentals are cash flows);
- the acquisition or disposal of assets (other than cash) in return for equity securities;
- exchanges of non-monetary assets such as property, plant and equipment, and inventories;
- the issue of bonus shares to holders of the entity's equity;
- the receipt of bonus shares from another entity in which the reporting entity holds an investment; and
- the conversion of debt securities into equity securities.

The inception of a finance lease contract is one of the most commonly encountered non-cash transactions. Such a transaction, although reflected in the statement of financial position by recognising an asset and a matching liability, should not be reflected in the statement of cash flows because the reporting entity neither pays nor receives cash. It is not appropriate to show a cash outflow in respect of an asset purchase and the drawdown of a loan. A sale and leaseback arrangement, however, *will* generate cash flows and, therefore, should be included in the statement of cash flows (see 5.3.1 below).

When transactions of a non-cash nature occur, the Standard requires that they be disclosed elsewhere in the financial statements in a way that provides all of the relevant information about those investing and financing activities. [IAS 7:43] This disclosure will normally be in narrative form in the notes.

### 3.3 Exclusion of movements between items that constitute cash or cash equivalents

Movements between items that constitute cash or cash equivalents are excluded from cash flows, because these components are part of the cash management of an entity rather than part of its operating, investing or financing activities. Cash management includes the investment of excess cash in cash equivalents. [IAS 7:9]

For example, when an entity uses cash to purchase a short-term investment meeting the definition of a cash equivalent, the purchase is not shown in the statement of cash flows.

## 4 Cash and cash equivalents

Cash flows are defined as inflows and outflows of cash and cash equivalents. [IAS 7:6]

### 4.1 Cash

Cash comprises cash on hand and demand deposits. [IAS 7:6]

#### 4.1.1 Demand deposits

The term 'demand deposits' is not defined in IAS 7, but the term may be taken to refer to deposits where the reporting entity can withdraw cash without giving any notice and without suffering any penalty. A seven-day call deposit would therefore not qualify as cash, because seven days notice of withdrawal is required. The deposit could, however, be reported as a cash equivalent.

Similarly, if an entity has an account with its bank under which the entity has to give ninety days notice to the bank before it can withdraw money, the account does not meet the definition of cash because it is not a demand deposit. However, only ninety days notice is required and, therefore, it may meet the definition of a cash equivalent.

The term 'demand deposits' is not restricted to deposits with banks or financial institutions.

#### 4.1.2 Minimum average cash balances

Some entities have banking arrangements that require them to maintain a minimum average cash balance over a specified period instead of a constant minimum balance at the end of each day. It is therefore possible to have balances below the threshold for certain days as long as the average balance over the period is in excess of the minimum requirement. For such arrangements, it is necessary to consider whether the balance can be withdrawn on demand, in a way similar to demand deposits; i.e. whether the entity can withdraw the cash without giving any notice and without suffering any penalty. If these criteria are met, the cash balances will meet the definition of cash in IAS 7.

### 4.2 Cash equivalents

Cash equivalents are defined as short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. [IAS 7:6]

#### 4.2.1 Held to meet short-term cash commitments

The Standard explains that cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. [IAS 7:7] Therefore, in order to determine whether a particular investment qualifies for classification as a cash equivalent, it is necessary to look at the purpose for which it is held. Even though the investment may meet the definition set out in the previous paragraph, unless it is held for the purpose of meeting short-term cash commitments, it will not be classified as a cash equivalent.

For example, an entity purchases a two-year bond in the market when the bond only has two months remaining before its redemption date. The purchase is made for investment purposes. The bond does not qualify as a cash equivalent because, even though it meets the definition in IAS 7:6, it is not held for the purpose of meeting short-term cash commitments.

#### 4.2.2 Presumption of maturity of three months or less

The definition of cash equivalents includes the requirement that they be held for the 'short-term'. In order to qualify as such, the Standard states that the investment will *normally* have a maturity of three months or less

from the date of acquisition. [IAS 7:7] Therefore, the requirement for a three-month maturity is not part of the definition, but will nevertheless be a presumption except in very exceptional circumstances.

The Standard implicitly suggests that only in unusual cases will investments with more than three months to maturity nevertheless be free from significant risk of changes in value (arising, for example, from changes in interest rates). An entity purchasing a two-year bond in the market when the bond only has three months remaining before its redemption date could therefore classify the bond as a cash equivalent (assuming that there are no other factors causing it to be subject to a significant risk of change in value, and that the underlying purpose of holding the bond is to meet short-term cash commitments). However, the reference to three months or less 'from the date of acquisition' means that, if the entity instead purchased the same two-year bond when it had four months remaining before maturity, the entity could not classify the bond as a cash equivalent either at the date of purchase or once it has less than three months remaining to maturity (unless it could justify a departure from the three-month guideline, in which case the instrument would be classified as a cash equivalent throughout the entire four months).

The three-month limit may appear somewhat arbitrary, but the intention is to promote consistency between entities.

#### Example 4.2.2

##### Repurchase agreements as cash equivalents

An entity invests excess funds in short-term repurchase agreements with a term of two months. The underlying debt securities involved in the transaction have maturities in excess of three months. These repurchase agreements will be classified as cash equivalents provided that (1) there are no other factors that would subject the instruments to a significant risk of change in value, and (2) the underlying purpose for holding the repurchase agreements is to meet short-term cash commitments. The critical factor is the maturity of the repurchase agreements themselves, not the underlying debt securities.

#### 4.2.3 Foreign currency investments

Provided that the definition of a cash equivalent is met, there is no reason why an investment acquired in a foreign currency could not be classified as a cash equivalent. Indeed, the Standard refers specifically to cash and cash equivalents held or due in a foreign currency. [IAS 7:28]

#### 4.2.4 Equity investments

Equity investments will not normally meet the definition of a cash equivalent because, even when they are readily convertible to cash, the amount of that cash is generally not known and the risk of changes in value is generally not insignificant, although there are exceptions. The example of an exception given in the Standard is that of preferred shares with a specific redemption date which, when acquired, are close to maturity. The majority of equity investments will not meet the definition, however, and therefore cannot be classified as cash equivalents. [IAS 7:7]

#### 4.2.5 Gold bullion

Gold (and similar traded commodities) will not qualify as cash equivalents for the same reason as equity investments (see above). In addition, the guidance on implementing IFRS 9 *Financial Instruments* confirms that gold bullion "is a commodity. Although bullion is highly liquid, there is no contractual right to receive cash or another financial asset inherent in bullion". [IFRS 9(2010):IG.B.1] For entities that have not yet adopted IFRS 9, this text is also reflected in the guidance on implementing IAS 39 *Financial Instruments: Recognition and Measurement*.

#### 4.2.6 Bank borrowings

The definition of cash equivalents makes no reference to the inclusion of bank borrowings. Bank borrowings are generally considered to be financing cash flows. However, the Standard acknowledges that bank overdrafts repayable on demand may form an integral part of an entity's cash management, in which case they should be included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to being overdrawn. [IAS 7:8]

IAS 7 does not therefore mandate the inclusion of bank overdrafts in cash equivalents in all circumstances. But it does require their inclusion when the bank overdraft forms an integral part of the entity's cash management. IAS 7:8 also emphasises that bank borrowings are generally considered to be financing activities. Therefore, the Standard does not allow for other short-term loans (e.g. short-term bank loans, advances from factors or similar credit arrangements, credit import loans, trust receipt loans) to be classified as cash equivalents, because they are financing in nature.

## 2.5 Shares listed but not intended to be traded

### Example 2.5

#### Shares listed but not intended to be traded

The shares of Company A are listed on the Luxembourg exchange. Company A has completed a listing for marketing purposes only because its investors (which are pension funds) are restricted by their governing laws to investing in listed entities. It is not expected that these shares will be traded.

Although these shares are not expected to be traded, the entity is within the scope of IAS 33 and EPS should be presented in accordance with that Standard. The notion of 'publicly traded' requires only an ability to trade the shares publicly, not the actual trading of shares.

## 3 Definitions

### 3.1 Ordinary share

IAS 33 defines an ordinary share as an equity instrument that is subordinate to all other classes of equity instruments. [IAS 33:5] An equity instrument is defined in IAS 32 *Financial Instruments: Presentation* as any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. [IAS 32:11] The Standard explains that ordinary shares participate in profit for the period only after other types of shares (such as preference shares) have participated. Ordinary shares of the same class have the same rights to receive dividends, but it is possible for an entity to have more than one class of ordinary shares. [IAS 33:6]

Entities will sometimes issue preference shares with many of the characteristics of ordinary shares. The terms of such preference shares will need to be evaluated carefully. If they share the characteristics of ordinary shares and have no preference attributed to them, such instruments should be considered as ordinary shares regardless of the legal name assigned to them (see 4.2.4 below).

### 3.2 Potential ordinary share

A potential ordinary share is defined as a financial instrument or other contract that may entitle its holder to ordinary shares. [IAS 33:5] Examples of potential ordinary shares include: [IAS 33:7]

- financial liabilities or equity instruments, including preference shares, that are convertible into ordinary shares;

- options and warrants (i.e. financial instruments issued by the entity that give the holder the right to purchase ordinary shares); and
- shares that would be issued upon the satisfaction of conditions resulting from contractual arrangements, such as the purchase of a business or other assets.

The concept of a potential ordinary share has evolved to meet the reporting needs of investors in entities that have issued certain types of convertible and other complex securities. The holders of these instruments can expect to participate in the appreciation in value of the ordinary shares resulting principally from the earnings and earnings potential of the issuing entity. The attractiveness of these instruments to investors is often based on the potential right to participate in increases in the earnings potential of the entity, rather than on fixed returns or other senior security characteristics. The value of instruments that are considered potential ordinary shares is derived largely from the value of the ordinary shares to which they relate. Changes in the value of such instruments tend to reflect changes in the value of the ordinary shares.

### 3.2.1 Derivatives over own equity

If an entity enters into a derivative over its own ordinary shares that may entitle the holder to ordinary shares, that derivative is a potential ordinary share if the settlement terms of the derivative may result in the delivery of ordinary shares of the entity. The only exception applies to forward purchase contracts and written put options over own ordinary shares when the issuer regards the shares to be delivered under the forward contract or written put option as effectively purchased upon entering into the contract (see 4.2.2.8 below). In this case only, the ordinary shares subject to the contract are deemed as acquired, resulting in a reduction in the number of shares outstanding for both basic and diluted EPS.

If, however, the settlement terms of the derivative permit only net settlement in cash or other financial assets, and/or settlement by the exchange of gross amounts of cash or other financial assets, the instrument does not 'entitle its holder to ordinary shares' and is not a potential ordinary share.

If there is a settlement choice, either by the issuer or the holder, as to whether ordinary shares will be delivered under the contract, the arrangement is still a potential ordinary share because there is the

potential for delivery of ordinary shares under the contract. However, the detailed computation of diluted EPS differs according to whether the settlement alternatives are at the option of the holder or the issuer (see 5.5.5 below).

## 4 Calculation of basic earnings per share

The objective of basic EPS information is to provide a measure of the interests of each ordinary share of a parent entity in the performance of the entity over the reporting period. [IAS 33:11] Basic EPS amounts are required to be calculated for: [IAS 33:9]

- profit or loss attributable to ordinary equity holders of the parent entity; and
- if presented, profit or loss from continuing operations attributable to those equity holders.

Basic EPS is calculated as follows. [IAS 33:10]

$$\frac{\text{Profit (loss) attributable to ordinary equity holders of the parent entity}}{\text{Weighted average number of ordinary shares outstanding during the period}}$$

### 4.1 Earnings numerator

The starting point for the earnings numerator (for results both from continuing operations and for the entity as a whole) is the profit or loss after tax attributable to the equity holders of the parent entity (i.e. excluding the amount attributable to non-controlling interests). [IAS 33:12]

#### 4.1.1 Non-controlling interests

The profit or loss attributable to equity holders of the parent will be readily available, because it is required under IAS 1 *Presentation of Financial Statements* to be presented in the statement of comprehensive income (or, when applicable, the separate statement of profit or loss/income statement – see 2.4) separately from the profit or loss attributable to non-controlling interests. [IAS 1:83] When applicable, however, the profit for the period from continuing operations presented in the statement of comprehensive income (which is before the allocation to non-controlling interests) will need to be adjusted

for the non-controlling interests' share of those earnings in order to arrive at the amount attributable to equity holders of the parent.

#### 4.1.2 The impact of preference shares

The profit or loss attributable to the equity holders of the parent entity will already be after deduction of dividends and other profit or loss effects relating to preference shares *classified as liabilities*. [IAS 33:13] For the purposes of calculating basic EPS, the profit or loss attributable to the equity holders of the parent entity is further adjusted for the following after-tax amounts relating to preference shares *classified as equity*: [IAS 33:12]

- preference dividends;
- differences arising on the settlement of such preference shares; and
- other similar effects of such preferences shares.

##### 4.1.2.1 Preference dividends

The after-tax amount of preference dividends to be deducted in determining the profit or loss attributable to ordinary equity holders of the parent entity is: [IAS 33:14]

- for non-cumulative preference shares classified as equity, the after-tax amount of preference dividends declared in respect of the period; and
- for cumulative preference shares classified as equity, the full after-tax amount of the required preference dividends for the period (whether or not declared). This does not include amounts paid or declared on cumulative preference shares in the current period in respect of previous periods.

For non-cumulative preference shares, dividends 'declared in respect of the period' are any dividends on the preference shares that are recognised as a liability during the current period, plus any dividends paid during the period that were not accrued at the end of the prior period. They do not include dividends declared after the end of the period that, in accordance with IAS 10 *Events after the Reporting Period*, are not recognised as a liability, or dividends accrued at the end of the prior period whether or not actually paid in the current period.

**Example 4.1.2.1****Liquidating dividends on preference shares**

Company X issued one share of Series A Non-Voting Convertible Preference Shares for CU1,000,000. The liquidation preference on this preference share is CU1,000,000, plus a 12 per cent cumulative dividend from the issue date. Company X also issued one share of Series B Non-Voting Convertible Preference Shares for CU2,000,000. The shareholder of the Series B Preference Share is entitled to a non-cumulative dividend at the rate of five per cent per annum on the liquidation preference. The liquidation preference is CU2,000,000, plus a 12 per cent cumulative dividend from the issue date. All payments on both preference shares are at the discretion of Company X and, therefore, they are both presented as equity.

In calculating 'profit or loss attributable to ordinary shareholders' for EPS purposes, Company X should not deduct the 12 per cent cumulative liquidating dividends for either the Series A or Series B shares. Although cumulative, the liquidating dividends are intended to provide a preference to the Series A and Series B preference shareholders in the event of a liquidation of Company X and, therefore, should not be adjusted in determining profit or loss attributable to ordinary shareholders until a liquidating event occurs.

**4.1.2.2 Differences arising on the settlement of preference shares**

Differences may arise on the settlement of preference shares in the following circumstances:

- when the preference shares are repurchased under a tender offer, and the fair value of the consideration paid to the preference shareholders differs from their carrying amount. Any excess of the fair value of the consideration over the carrying amount represents a return to the holders of the preference shares and is adjusted against retained earnings in the period of repurchase. This amount is deducted in calculating the earnings numerator for basic EPS. [IAS 33:16] Any excess of the carrying amount of the shares over the fair value of the consideration is added in calculating the earnings numerator for basic EPS; [IAS 33:18] and
- on early conversion of convertible preference shares, as a result of favourable changes to the original conversion terms or the payment of additional consideration. The excess of the fair value of the ordinary shares or other consideration paid over the fair value of the ordinary shares issuable under the original conversion terms is a return to the preference shareholders, and is deducted in calculating the earnings numerator for basic EPS. [IAS 33:17]

Some entities issue classes of shares characterised as 'tracking' or 'targeted' shares to measure the performance of a specific business unit or activity of the entity (see 7.1.1 below for further description). The terms of tracking shares often allow the entity, at its option, to exchange or redeem one class of tracking shares for another class of tracking shares, such that the entity would have one less class of ordinary shares outstanding. The terms of this feature generally require a premium to be paid to the class being redeemed as a result of the transaction. In the period of redemption, profit or loss attributable to ordinary shareholders (whose shares are being used for the redemption) should be reduced by the premium over market price paid to redeem the tracking shares. The holders of the tracking shares being redeemed have received a benefit that constitutes an additional contractual return to them. **Example 4.1.2.2A** illustrates the treatment of this premium for the purpose of calculating EPS.

**Example 4.1.2.2A****Premium paid on redemption of tracking shares**

Company X has two classes of ordinary shares outstanding that separately track the results of operations of two different businesses, Company A and Company B. Company X decides to redeem all of its outstanding Company B tracking shares in exchange for Company A tracking shares. The terms of the Company B shares being redeemed provide Company X with the right to redeem the Company B tracking shares, at its discretion, by issuing its Company A tracking shares with a market price equal to a 15 per cent premium over the market price of the Company B tracking shares at the time of redemption. As such, the fair value of Company A tracking shares to be exchanged for the Company B tracking shares will exceed the fair value of the Company B tracking shares by 15 per cent on the date the redemption is announced.

When calculating basic EPS for the period in which the Company B tracking shares are redeemed, the profit or loss attributable to the Company A tracking shareholders should be reduced by the amount of the 15 per cent premium.

**Example 4.1.2.2B****Premium paid by a parent to redeem preference shares issued by a subsidiary**

Company P, a publicly traded entity, has a wholly-owned subsidiary, Company S. Company S has preference shares outstanding held by parties outside the group that are classified as equity. The preference shares are redeemable at the option of Company S (with Company P's consent) in

whole or in part, at varying dates, at CU100 per share plus accumulated and unpaid distributions to the date fixed for redemption. Consistent with the view that the subsidiary's preference shares represent a non-controlling interest in the parent's consolidated financial statements, dividends or accretions to a redemption price should be classified as income allocated to non-controlling interests in the consolidated statement of comprehensive income of the parent.

Company P decides to acquire Company S's preference shares. The premium paid by Company P to the third-party preference shareholders on the acquisition of Company S's preference shares is not recognised in the consolidated statement of comprehensive income because this represents a transaction with shareholders. Accordingly, the consolidated entity does not recognise in its statement of comprehensive income any gain or loss from the acquisition.

The premium paid to redeem Company S's preference shares should be deducted in computing profit or loss attributable to ordinary shareholders in the calculation of EPS in Company P's consolidated financial statements. The premium represents a return on investment to the holders of the preference shares and is not available to ordinary shareholders, similar to preference share dividends and accretion charges. Because dividends and accretion charges on preference shares of a subsidiary are treated as income allocated to non-controlling interests, premiums paid to redeem Company S's preference shares also should be deducted in computing profit or loss attributable to ordinary shareholders in the calculation of earnings per share in Company P's consolidated financial statements.

#### 4.1.2.3 Other effects of preference shares

The results for the period will also be adjusted for other appropriations recognised in respect of preference shares classified as equity. For example, preference shares may provide for a low initial dividend to compensate the entity for selling the shares at a discount, or an above-market dividend in later periods to compensate investors for purchasing the shares at a premium. (These are sometimes called increasing rate preference shares.) When such shares are classified as equity, the discount or premium on issue is amortised to retained earnings using the effective interest method and treated as a preference dividend for the purposes of calculating basic earnings per share. [IAS 33:15]

The following example, reproduced from Example 1 of the illustrative examples accompanying IAS 33, illustrates the required adjustments in respect of increasing rate preference shares.

#### Example 4.1.2.3

##### Increasing rate preference shares [IAS 33 Illustrative examples: Example 1]

Entity D issued non-convertible, non-redeemable class A cumulative preference shares of CU100 par value on 1 January 20X1. The class A preference shares are entitled to a cumulative annual dividend of CU7 per share starting in 20X4.

At the time of issue, the market rate dividend yield on the class A preference shares was 7 per cent a year. Thus, Entity D could have expected to receive proceeds of approximately CU100 per class A preference share if the dividend rate of CU7 per share had been in effect at the date of issue.

In consideration of the dividend payment terms, however, the class A preference shares were issued at CU81.63 per share, i.e. at a discount of CU18.37 per share. The issue price can be calculated by taking the present value of CU100, discounted at 7 per cent over a three-year period.

Because the shares are classified as equity, the original issue discount is amortised to retained earnings using the effective interest method and treated as a preference dividend for earnings per share purposes. To calculate basic earnings per share, the following imputed dividend per class A preference share is deducted to determine the profit or loss attributable to ordinary equity holders of the parent entity:

Year	Carrying amount of class A preference shares on 1 January	Imputed dividend <sup>a</sup>	Carrying amount of class A preference shares 31 December <sup>b</sup>	Dividend paid
	CU	CU	CU	CU
20X1	81.63	5.71	87.34	-
20X2	87.34	6.12	93.46	-
20X3	93.46	6.54	100.00	-
Thereafter	100.00	7.00	107.00	(7.00)

(a) At 7%

(b) This is before dividend payment.

#### 4.1.2.4 Contingent dividends on preference shares

##### Example 4.1.2.4

##### Contingent dividends on preference shares

Company X, a publicly traded entity, issued to Company Y convertible preference shares that earn a seven per cent dividend per year although payment is at the discretion of Company X. Conversion is at Company Y's option. Company X may elect to redeem the preference shares at any time.