Part 5

Chapter 22
Statement of cash flows

Question	Key issues
22.1	Understanding the accounting for various items in the cash flow statement
22.2	Direct method, operating activities section
22.3	Direct method, calculation and explanation of ratios, preference share issue, debentures
22.4	Direct method, operating activities section, bad debts, deferred tax
22.5	Direct method, operating and financing activities sections
22.6	Direct method, understanding cash management, redemption of preference shares, capitalisation issue
22.7	Basic preparation on direct method
22.8	Basic preparation on direct method
22.9	Indirect method, tax and ratio analysis

Question 22.1

Discuss how the following items would be accounted for in a company's cash flow statement:

a) debenture discount written off

b) goodwill being impaired

c) deferred taxation included in the statement of comprehensive income tax charge

d) an under-provision of taxation in the previous year

e) share issue expenses of C2 000 incurred during the year of which C1 000 is written off against share premium.

Question 22.2

Hickory Limited manufactures clocks, which it sells to retailers around the country. The following balances were extracted from its financial statements for the years ended 31 July 20X5 and 20X6 respectively:

	20X6 C	20X5 C
Revenue	3 000 000	2 000 000
Cost of sales	2 000 000	1 300 000
Profit for the period	390 000	240 000
Plant and equipment	500 000	450 000
Accumulated depreciation - plant and equipment	50 000	45 000
Inventory	340 000	348 500
Accounts receivable	450 000	400 000
Provision for doubtful debts	25 000	18 000
Trade payables	250 000	235 000
Accrued expenses	15 000	-
Current tax payable	2 000	1 500

Additional information

- New plant costing C90 000 was purchased during the year. Plant with a carrying amount of C10 000 was sold during the year at a profit of C5 000.
- The tax rate is 40%. The depreciation expense equals the tax allowances granted by the taxation authorities.

Required:

a) Prepare the operating activities section of the cash flow statement for the year ended 31 July 20X6 using the direct method.

b) Prepare a reconciliation between profit before tax and cash generated from operations.

Comparatives are not required.

Question 22.3

Olbas Limited was incorporated in 20X0 with an authorised share capital of 1 000 000 ordinary shares of C 5 each and 500 000 10% non-redeemable preference shares with a par value of C0.50 each.

The statement of comprehensive income, statement of changes in equity and statement of financial position for 30 September 20X7 year are shown below:

OLBAS LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 SEPTEMBER 20X7

	C
Revenue	3 500 000
Cost of sales	(2 450 000)
Gross profit	1 050 000
Dividends income	3 200
Operating expenses	(339 950)
Finance cost	(136 268)
Profit before tax	576 982
Income tax expense	(177 888)
Profit for the period	399 094
Other comprehensive income	0
Total comprehensive income	399 094

OLBAS LIMITED
EXTRACT FROM STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR 30 SEPTEMBER 20X7

	Retained earnings
Balance 1/10/20X6	360 755
Total comprehensive income	399 094
Transfers to non-distributable reserve	(70 000)
Dividends - Ordinary	(225 000)
- Preference	(25 000)
Balance 30/9/20X7	439 849

OLBAS LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 30 SEPTEMBER 20X7

	20X7 C	20X6 C
ASSETS		
Non-current assets		
Land and buildings	1 750 000	2 200 000
Equipment at carrying amount	312 000	280 000
Equipment at cost	480 000	400 000
Accumulated depreciation: equipment	(168 000)	(120 000)
Vehicles at carrying amount	300 000	
Vehicles at cost	360 000	
Accumulated depreciation: vehicles	(60 000)	
Investments	370 000	250 000
Current assets	407 900	375 100
Inventory	146 000	131 200
Accounts receivable	135 350	147 200
Prepaid expenses	6 300	5 960
Tax Refundable		6 440
Bank	120 250	84 300
	3 139 900	3 105 100
EQUITY AND LIABILITIES		
Capital and reserves	2 007 549	1 585 755
Ordinary share capital	1 225 000	1 225 000
Preference share capital	250 000	
Share premium	22 700	
Non distributable reserve	70 000	
Retained earnings	439 849	360 755
Non-current liabilities	773 113	1 151 845
16% Mortgage bond	250 000	625 000
20% Debentures	523 113	526 845
Current liabilities	359 238	367 500
Accounts payable	96 350	142 500
Interest payable	100 000	100 000
Current tax payable	12 888	
Shareholders for dividends	150 000	125 000
	3 139 900	3 105 100

The following information is relevant:

- During the year ended 30 September 20X7 500 000 preference shares were issued at C0.55 per share. Share issue expenses of C2 300 were paid, these expenses were written off in such a way as to maintain maximum distributable reserves. The preference shares are not redeemable.

- The 20% debentures consist of 5 000 debentures of C100 each. On 1 October 20X5 Olbas Limited had issued the debentures at 106%. The debentures are all repayable on 30 September 20Y1 at par. Interest is payable on 1 October each year. The debenture premium is amortised using the effective interest rate method.

During the year the following transactions relating to non-current assets and investments took place:

- Land and buildings were sold for C520 000. No further sales or purchases were made and the profit on sale has been transferred to a non-distributable reserve.
- Investments, which cost C125 000 were sold at a profit of C12 450.
- Both these amounts are included in the 'profit before tax'.
- No equipment was sold during the year.
- Accounts receivable are reflected on the statement of financial position net of a provision for doubtful debts of C5 640 in 20X7 and C6 133 in 20X6.
- There are no components of other comprehensive income.
- The rate of normal tax is 35%.

Required:

a) Prepare the cash flow statement of Olbas Limited for the year ended 30 September 20X7 using the ***direct*** method in terms of IAS 7. *Notes to the cash flow statement **are** required.*

b) Prepare a reconciliation between the profit before tax and the cash generated from operations.

c) Calculate the following ratios

- Return on investment ratio (ROI/ROA), defining return as profit after tax but before finance charges
- Return on equity ratio (ROE)

Compare the return on investment and the return on equity and discuss whether the company is using gearing effectively.

Comparatives are not required.

Question 22.4

The financial director of Mt Grace Limited is in the process of preparing the cash flow statement for the year ended 30 June 20X5. She has prepared a set of working papers and notes, as set out below:

Sales for year = C5 200 000

	30/06/X5	30/06/X4
Accounts receivable	845 000	720 000
Provision for doubtful debts	71 500	34 000

Remember the TB shows a total debit in respect of bad debts of C55 500

	30/06/X5	30/06/X4
Accounts payable	510 000	340 000
Inventory	305 000	210 000

Profit before tax = ~~C720 000~~ ~~C590 000~~ C680 000

Don't forget to take into account the redeemable preference shares. They were issued at par of C200 000 on 1 July 20X2 and are subject to compulsory redemption by the company on 30 June 20X7 at a premium of 4%. The nominal interest rate is 12%. The dividends have been paid on 30 June each year. Note that the premium accrued is not deductible for tax purposes.

	30/06/X5	30/06/X4
Shareholders for ordinary dividend	35 000	30 000

We did not declare an interim dividend during the current year. The final dividend of C35 000 was declared on 25 June 20X5

I know that deferred tax is one of your hottest topics, but I have prepared the following schedule relating the plant and equipment that needs to be incorporated into the taxation calculation.

		Carrying amount	Tax base	Temporary difference	Deferred tax
01/07/X2	Cost	800 000	800 000		
30/06/X3	Depreciation / tax allowance	(100 000)	(320 000)		
30/06/X4	Depreciation / tax allowance	(100 000)	(160 000)		
		600 000	320 000	280 000	81 200
30/06/X5	Depreciation / tax allowance	(100 000)	(160 000)		
		500 000	160 000	340 000	98 600

	30/06/X5	30/06/X4
Tax Payable (Current tax)	125 175	190 000

Don't forget the current normal tax rate is 29%

There are no permanent or temporary differences other than those apparent from the above information.

Required:

Prepare the operating activities section of the cash flow statement of Mt Grace Limited for the year ended 30 June 20X5, using the direct method.
Notes are not required

Question 22.5

Shine Limited manufactures furniture oils products, which it sells to retailers around the country. The following balances were extracted from its financial statements for the years ended 30 June 20X3 and 20X4 respectively:

SHINE LIMITED
EXTRACT FROM STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE

	20X4	20X3
	C	C
10% Redeemable preference shares	-	64 716
Retained earnings	30 741	80 000
Trade payables	8 000	10 000
Administration expenses accrued	2 000	-
Current tax payable	12 925	10 000
Shareholders for dividends	-	2 000
Inventory	111 500	131 500
Accounts receivable	90 000	20 000
Distribution expenses prepaid	3 000	2 000
Deferred tax asset	22 500	20 000

SHINE LIMITED
EXTRACT FROM STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE

	20X4
	C
Profit before tax	53 216
Taxation	(19 475)
Profit for the period	33 741
Other comprehensive income	0
Total comprehensive income	33 741

Additional information

- The profit before tax is stated after taking into account the following expenses:

	C
Cost of sales	120 000
Profit on sale of plant	3 000
Bad debts	1 500
Depreciation	15 000
Finance costs	15 784

- Inventory is sold at a mark up of 110% on cost.
- Dividends were declared in the current year.
- 60 000 10% preference shares (par value of C1) were subject to a compulsory redemption at a premium of ? % on 30 June 20X4. The effective rate of interest on the preference shares was 11.255%. No additional ordinary or preference shares were issued during the year.

- The finance costs comprised interest on a mortgage loan and finance costs relating to the preference shares.

- Bad debts are written off as and when they are incurred.

Required:

Prepare the *operating activities* and *financing activities* sections only of the cash flow statement of Shine Limited for the year ended 30 June 20X4, using the direct method.

Include interest and dividend payments under operating activities.
Notes are not required.

Question 22.6

Meadowvale Manufacturers Limited commenced operations in June 20X1. Its summarised financial statements for the year ended 30 September 20X7 were as follows:

MEADOWVALE MANUFACTURERS LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 30 SEPTEMBER 20X7

	20X7	20X6
	C000s	**C000s**
ASSETS		
Non-current assets	3 024	2 795
Land and buildings	2 600	2 405
Plant and machinery	360	246
Goodwill	-	100
Unlisted investments	64	44
Current assets	2 849	1 363
Inventory	1 750	159
Accounts receivable	870	500
Listed investments	89	84
Bank	140	620
	5 873	4 158
EQUITY AND LIABILITIES		
Capital and reserves	3 477.2	3 018
Ordinary shares of C1 each	700	450
Share premium	68	72
400 000 10% redeemable preference shares of C1 each	400	500
Non-distributable reserve	164.2	120
Capital redemption reserve fund	25	50
Retained earnings	2 120	1 826
Non-current liabilities	975.8	180
Deferred tax	5.8	0
Long-term loan	970	180
Current liabilities	1 420	960
Accounts payable	670	310
Shareholders for dividend	150	180
Current tax payable	600	470
	5 873	4 158

MEADOWVALE MANUFACTURERS LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 SEPTEMBER 20X7

	C000s
Revenue from sales	5 000
Profit before tax	1 519
Income tax expense	(800)
Profit for the period	719
Other comprehensive income	
Revaluation of land and buildings	14.2
Total comprehensive income	733.2

MEADOWVALE MANUFACTURERS LIMITED
EXTRACT FROM STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR 30 SEPTEMBER 20X7

		NDR C000	Retained Earnings C000
Opening balance			1 826
Total comprehensive income		14.2	719
Transfers to	- Capital redemption reserve fund		(100)
	- Non-distributable reserve	30	(30)
Dividends	- Ordinary		(250)
	- Preference		(45)
Closing balance			2 120

Additional information

- Profit before tax was arrived at after taking the following into account:

  Bad debts - C5 000
  Depreciation on plant and machinery - C90 000
  Write down of listed investments - C7 000
  Interest paid - C92 000
  Impairment of goodwill - C100 000
  Dividends received - C18 000
  Profit on sale of land and buildings - C 50 000
  Profit on sale of plant and machinery - C 4 000
  Loss on trade in of plant and machinery - C 6 000

- On 31 March 20X7, 100 000 redeemable preference shares were redeemed at a premium of 4%. The preference shares are redeemable at the option of the company.
- On 30 April 20X7, the company made a capitalisation issue of ordinary shares, together with a fresh issue of ordinary shares at par.
- Land and buildings, with a carrying amount of C90 000, were sold at a profit of C50 000. The remaining buildings were re-valued during the year. There is no intention to sell the remaining land and buildings and the cost of land is not material. .
- There were no movements in the NDR other than those evident from the information provided. The balance at the end of 20X6 arose from transfers from retained earnings.

- The details of plant and machinery are:

	20X7	20X6
Cost	590 000	426 000
Accumulated depreciation	230 000	180 000
Carrying amount	360 000	246 000

- An item of plant, with a carrying amount of C140 000 was sold during the year at a profit of C4 000. A machine that had originally cost C60 000 and that had been depreciated by C25 000 was traded in at a loss of C6 000, in part payment of a new machine costing C100 000. The balance was paid in cash.
- In addition to the payment made in respect of the 20X6 tax liability, two provisional payments totalling C100 000 each were made during the year ended 30 September 20X7.
- There were no disposals of unlisted or listed investments during the year ended 30 September 20X7.

Required:

a) Prepare the cash flow statement and notes thereto, on the direct method, of Meadowvale Manufacturers Limited for the year ended 30 September 20X7, in conformity with IAS 7.

b) Prepare a reconciliation between profit before tax and cash generated from operations.

c) Comment on the cash management of the company on the basis of the cash flow statement you have prepared.

Comparatives are not required.

Question 22.7

The following financial statements relate to Spendee Limited:

SPENDEE LIMITED
DRAFT STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 20Y0

	20Y0 C	20X9 C
ASSETS		
Property, plant and equipment	400 000	300 000
Intangible assets	105 000	50 000
Inventory	70 000	50 000
Trade accounts receivable	20 000	30 000
Bank	0	900
	595 000	430 900
LIABILITIES AND EQUITY		
Share capital and reserves	372 100	260 900
Deferred taxation	45 000	37 000
Debentures	68 356	60 000
Trade accounts payable	52 000	42 000
Shareholders for dividends	5 000	12 000
Current tax payable	12 000	19 000
Bank overdraft	40 544	0
	595 000	430 900

SPENDEE LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE 20Y0

	20Y0	20X9
	C	C
Revenue	1 750 000	1 990 000
Cost of sales	(1 392 000)	(1 791 000)
Gross profit	358 000	199 000
Other income		
Profit on sale of plant	8 000	0
Other expenses	(240 000)	(92 000)
Finance cost	(20 000)	(20 000)
Profit before tax	106 000	87 000
Income tax expense	(39 800)	(24 100)
Profit for the period	66 200	62 900
Other comprehensive income	-	-
Total comprehensive income	66 200	62 900

SPENDEE LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 JUNE 20Y0

	Share capital	Share premium	Revaluation surplus	Retained earnings	Total
	C	C	C	C	C
Balance - 1 July 20X8	100 000	0	0	98 000	198 000
Profit for the period				62 900	62 900
Balance - 1 July 20X9	100 000	0	0	160 900	260 900
Profit for the period				66 200	66 200
Ordinary dividends				(30 000)	(30 000)
Revaluation surplus on land			15 000		15 000
Ordinary share issue	50 000	10 000			60 000
Balance - 30 June 20Y0	150 000	10 000	15 000	197 100	372 100

Additional information:

- Included in profit before tax are the following:

Depreciation of plant	C75 000
Depreciation of equipment	C1 644
Amortisation of development costs	?

- The company has been developing two new products (A and B) during the past few years. During the first three months of the current year, development costs incurred on product A totalled C50 000, (bringing the total development costs incurred on developing product A to C70 000). Development of product A ceased and commercial production began on 1 January 20Y0. Future economic benefits are expected to flow evenly from the sale of product A from the date on which commercial production commenced for a period of 10 years. Development costs are paid in the year that they are incurred. All development costs incurred have been capitalised.

- Plant with a carrying amount of C22 000 was sold at the beginning of the year. The company purchased extra plant during the year in order to expand the business. The revaluation surplus refers to land that was revalued on 1 July 20X9. No other purchases or sales of property, plant and equipment took place during the current year.

Required:

a) Prepare, in conformity with International Financial Reporting Standards, the cash flow statement of Spendee Limited for the year ended 30 June 20Y0, using the direct method.

b) Prepare a reconciliation between profit before tax and cash generated from operations.

Comparatives are not required.

Question 22.8

The following statement of financial position and statement of comprehensive income have been prepared for Big Foot Limited for the year ended 31 December 20X8:

BIG FOOT LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER

	Note	20X8	20X7
		C	C
ASSETS			
Non-current assets		762 964	510 000
Land and buildings		320 000	300 000
Plant and machinery		312 964	110 000
Development costs		130 000	100 000
Current assets		361 072	284 000
Inventories		120 000	80 000
Trade receivables		110 000	45 000
Bank		131 072	159 000
		1 124 036	794 000
EQUITY AND LIABILITIES			
Capital and reserves		493 000	450 000
Ordinary shares of C1 par value		472 000	440 000
Share premium		8 000	0
Retained earnings		13 000	10 000
Non-current liabilities		542 036	281 000
Long-term loans		527 036	260 000
Deferred taxation		15 000	21 000
Current liabilities		89 000	63 000
Trade and other payables		55 000	20 000
Current tax payable		12 000	5 000
Interest payable		4 500	9 000
Shareholders for dividends		17 500	29 000
		1 124 036	794 000

BIG FOOT LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X8

	20X8
	C
Revenue	654 000
Cost of sales	(294 000)
Gross profit	360 000
Other income	
Profit on sale of plant and machinery	20 000
Other expenses	(347 000)
Finance costs	(17 000)
Profit before tax	16 000
Income tax expense	(3 000)
Profit for the period	13 000
Other comprehensive income	-
Total comprehensive income	13 000

Additional information:

- Included in other expenses are the following items:

Depreciation on plant and machinery	C20 222
Impairment of plant and machinery	C10 648
Amortisation of development costs (see below)	C?

- Part of the office building was extended during the year. There were no other purchases or sales during the year. Land and buildings are not depreciated. Half of the cost of the extensions were financed via a mortgage bond, (see note on Long-term loans). The balance of the cost was paid for in cash.

- Plant and machinery with a carrying value of C15 866 was sold during the year.

- Development costs relate to 2 products: Splodgets and Goodies. The development of Goodies only began during the current year, whilst the development of Splodgets had begun at the beginning of the prior year.

  - Splodgets: The company incurred a further C20 000 on developing the 'Splodget' during the current year, all of which was capitalised. Development of the 'Splodget' was completed and commercial production commenced on 1 July 20X8. Big Foot believes that sales of Splodgets will continue for a total of 24 months, (i.e. no sales are expected after June 20Y0).

  - Goodies: Development of Goodies began during the current year with all costs incurred being capitalised. Commercial production of the Goodies is expected to commence in July 20Y1.

- The company issued 32 000 ordinary shares at C1.25 each.

- Ordinary dividends of C10 000 were declared during the year.

- C80 000 was repaid to Sub-standard Bank, the provider of the long-term loan. A portion of the balance at 31 December 20X8 relates to a mortgage bond from Sub-standard Bank that was raised during the year in order to cover half of the cost of the additions to the office building, (see note above).

- Assume that all transactions are for cash unless otherwise indicated.

Required:

Prepare the cash flow statement of Big Foot Limited for the year ended 31 December 20X8, using the direct method, in conformity with International Financial Reporting Standards

Comparatives are not required.

Question 22.9

Sauron Steel Limited is a company that manufactures and wholesales pure aluminium steel rings and rods used in the construction industry. The main income of Sauron Steel Limited is derived from the sale of their indestructible rings and accounts for approximately 90% of revenue. The company has been in operation for three years and has a 31 December year-end. The following are extracts of the financial statements for the year ended 31 December 20X2.

SAURON STEEL LIMITED
EXTRACT FROM THE STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X2

	C
Profit before tax	80 000
Income tax expense	(21 000)
Profit for the period	59 000
Other comprehensive income	
Revaluation of plant	105 000
Total comprehensive income	164 000

SAURON STEEL LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20X2

	Share capital C	Share premium C	Revaluation surplus C	Retained earnings C	Total C
Balance at 1 January 20X1	700 000	10 000	-	25 000	735 000
Profit for the period	-	-	-	262 000	262 000
Balance at 31 December 20X1	700 000	10 000	-	287 000	997 000
100 000 Shares issued at C1.10	100 000	10 000	-	-	110 000
Share issue expenses	-	(5 000)	-	-	(5 000)
Total comprehensive income	-	-	105 000	59 000	164 000
Dividends – Interim	-	-	-	(10 000)	(10 000)
Dividends – Final	-	-	-	(10 000)	(10 000)
	800 000	15 000	105 000	326 000	1 246 000

SAURON STEEL LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 20X2

	20X2 C	20X1 C
Non current assets		
Land and buildings	1 000 000	950 000
Plant – at valuation (20X1 – at cost)	650 000	600 000
Plant-accumulated depreciation	(65 000)	(100 000)
Machinery-cost	240 000	120 000
Machinery-accumulated depreciation	(35 000)	(20 000)
Furniture and fittings - cost	50 000	50 000
Furniture and fittings - accumulated depreciation	(15 000)	(10 000)
Investments in listed companies	150 000	90 000
Current assets		
Inventories	55 000	300 000
Accounts receivable	120 000	30 000
Cash and cash equivalents	66 375	55 000
	2 216 375	2 065 000
Share capital and reserves		
Share capital	800 000	700 000
Share premium	15 000	10 000
Revaluation reserve	105 000	0
Retained earnings	326 500	287 000
Non current liabilities		
Long term loan	800 000	800 000
Deferred tax	96 000	36 000
Current liabilities		
Accounts payable	74 375	225 000
Current tax payable	0	7 000
	2 216 375	2 065 000

The profit before tax includes dividends received, depreciation and interest paid. The tax expense has been correctly calculated and includes the current *normal* tax, deferred tax and the adjustment to the prior year's tax provision.

Additional information:

- Land and buildings are not depreciated. The tax authority does not allow any deductions on the land and buildings. There were no disposals of buildings during the year.
- The plant was purchased on 1 January 20X0 for C600 000 and the useful life of the plant was estimated on that date as 12 years. The tax authority considers that the useful life is only six years and allows a wear and tear deduction accordingly.

The plant was re-valued on 1 January 20X2 by an independent valuator. The revaluation is accounted for on the net replacement cost basis and the entity ***does not*** transfer the realised portion of the revaluation surplus to retained earnings. The useful life of the plant remained the same after the revaluation. There were no additions or disposals to plant in the year.

- There were no disposals of machinery during the year, but the entity assembled new machinery for the expansion of operations. This new machinery became available for use as intended by management on 30 June 20X2. The machinery assembled utilised C100 000 of the entity's own inventories while management paid C20 000 for external inventories and assembly costs. Machinery is depreciated over 12 years, while the tax authority allows wear and tear based on a six year useful life, apportioned for part periods.

- Furniture and fittings are depreciated at 10% per annum which is equal to its wear and tear allowance. Furniture with a carrying amount of C30 000 was exchanged for furniture of a slightly darker colour with the same fair value.

- The deferred tax balance of C36 000 as at 31 December 20X1 comprises deferred tax on plant of C30 000 and deferred tax on machinery of C6 000.

- The amount owing to the tax authorities in respect of the 20X1 year was paid in May 20X2, after taking into account the assessment from the tax authorities. The assessed tax for the 20X1 year according to the assessment amounts to C60 000. The company had made provisional payments of C55 000 in that year and had provided C62 000 in respect of current *normal* tax.

- Two provisional payments were made in August and December 20X2 equal to the amount provided for current *normal* tax.

- The company has never paid dividends prior to 20X2. The company declared and paid an interim dividend of C10 000 on 30 June 20X2 and a final dividend of C10 000 on 30 December 20X2. A dividend of C5 000 was received in March 20X2.

- Authorised share capital consists of 1 000 000 ordinary shares of C1 each.

- The share issue expenses have been paid in full.

- The long term loan is payable in 20Y0 and interest is payable at 15% per annum. The interest for the year has been paid.

- The company pays tax at 30%. Except for what is apparent above, no other temporary or permanent differences exist.

Required:

a) Prepare the *taxation expense* and the *deferred taxation* notes to the financial statements of Sauron Steel Limited for the year ended 31 December 20X2.

b) Prepare the cash flow statement of Sauron Steel Limited for the year ended 31 December 20X2 according to IAS 7 *Cash Flow Statements and* using the ***indirect method***.

c) Calculate the interest cover of Sauron Steel Limited for the year ended 31 December 20X2 and comment on whether you think it is adequate, explaining what the ratio measures.

Accounting policies are not required.

Comparatives are not required.

Notes to the cash flow statement are not required.