**Source C for Question 3**

PI plc prepares a statement of cash flows in accordance with IAS 7 each year. It provided the following information.

| | at 31 August 2025 | at 31 August 2024 |
|---|---|---|
| | $ | $ |
| Retained earnings | 64 000 | 92 000 |
| General reserve | 80 000 | 50 000 |
| Debenture interest owing | 6 000 | 3 000 |

Debenture interest paid during the year was $12 000, and interest on the bank overdraft was $2000. **No** dividends were paid.

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**3 Read Source C in the insert.**

**(a)** Explain why a statement of cash flows usually starts with profit.

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**(b)** Calculate the profit from operations for the year ended 31 August 2025.

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**Additional information**

The directors are now considering taking a number of different actions to take effect in the year ending 31 August 2026.

**(c)** Complete the following table to explain the effect **each** action would have on the statement of cash flows.

As part of the explanation, indicate the section or sections of the statement of cash flows which would be affected.

If an action does **not** affect the statement of cash flows, explain why it does **not** affect it.

| |
|---|
| **Action:** Increasing selling prices, sales volume being unaffected<br>Explanation .....<br>.....<br>.....<br>.....<br>..... |
| **Action:** Making a bonus issue of shares<br>Explanation .....<br>.....<br>.....<br>.....<br>..... |
| **Action:** Paying a dividend<br>Explanation .....<br>.....<br>.....<br>.....<br>..... |

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**Action:** Doubling the quantity of raw materials kept in the manufacturing facility

Explanation .....

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**Action:** Selling a building, resulting in a profit on disposal

Explanation .....

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**Action:** Revaluing the remaining building, debiting both the asset account and the provision for depreciation account

Explanation .....

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[12]

**(d)** Suggest **two** methods of funding which would **not** be included in the cash flow from financing activities.

1 .....

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[2]

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**(e)** State why it is important that the financial statements of PI plc are prepared with professional competence and due care.

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**(f)** State the **main** difference between the responsibilities of the directors and the responsibilities of the auditor regarding the financial statements.

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..... [2]

[Total: 25]

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| Question | Answer | Marks |
|---|---|---|
| 3(a) | **Explain why a statement of cash flows usually starts with profit.**<br><br>Because the statement reconciles profit with changes in cash and cash equivalents **(1)** to explain reasons why they differ **(1)**<br><br>**Accept other valid responses.** | **2** |
| 3(b) | **Calculate the profit from operations for the year ended 31 August 2025.**<br><br>$<br>decrease in retained earnings (28 000) **(1)**<br>transfer to general reserve 30 000 **(1)**<br>finance costs **W1** 17 000 **(2)**<br>profit from operations 19 000 **(1)OF**<br><br>**W1** (12 000 + 6 000 – 3 000) **(1)** + 2 000 **(1)** | **5** |

| Question | Answer | Marks |
|---|---|---|
| 3(c) | **Complete the following table to explain the effect each action would have on the statement of cash flows.**<br><br>**As part of the explanation indicate the section(s) of the statement of cash flows which would be affected.**<br><br>**If an action does not affect the statement of cash flows explain why it does not affect it.** | **12** |

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|---|
| Increasing selling prices, sales volume being unaffected:<br>This would cause net cash from operating activities to increase **(1)** as it increases profit from operations **(1)**. |
| Making a bonus issue of shares<br>This would not affect the statement of cash flows **(1)** as it does not involve a movement of funds/is funded from reserves rather than cash **(1).** |
| Paying a dividend<br>This would decrease the cash from financing activities **(1)** as it involves an outflow/application of funds **(1).** |
| Doubling the quantity of raw materials kept in the manufacturing facility<br>This would decrease the net cash from operating activities **(1)** as it involves an outflow/application of funds **(1).** |
| Selling a building, resulting in a profit on disposal<br>The sale proceeds would increase the cash from investing activities **(1)** as it involves inflow of funds **(1).**<br>Profit on disposal reduces cash from operating activities **(1)** as the profit element is included in cash inflow in investing activities **(1).** |
| Revaluing the remaining building, debiting both the asset account and the provision for depreciation account<br>This would not affect the statement of cash flows **(1)** as it does not involve a movement of funds/credits the revaluation reserve rather than cash **(1).** |

| | | |
|---|---|---|
| | **Accept other valid responses.** | |
| 3(d) | **Suggest <u>two</u> methods of funding which would <u>not</u> be included in the cash flow from financing activities.**<br><br>Bank overdraft **(1)**<br><br>Trade credit **(1)**<br><br>Payment by instalments **(1)**<br><br>Rental / leasing as an alternative to purchase **(1)**<br><br>**Max 2**<br>**Accept other valid responses.** | **2** |

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| Question | Answer | Marks |
|---|---|---|
| 3(e) | **State why it is important that the financial statements of PI plc are prepared with professional competence and due care.**<br><br>So that they give a fair presentation / true and fair view **(1)**<br><br>To comply with International Accounting Standards / company legislation **(1)** facilitate comparisons / aid decision making **(1)** and to avoid the auditors making a qualified report **(1).**<br><br>**Max 2**<br>**Accept other valid responses.** | **2** |
| 3(f) | **State the main difference between the responsibilities of the directors and the responsibilities of the auditor regarding the financial statements.**<br><br>The directors are responsible for the preparation of the financial statements **(1)** and the auditor is responsible for reporting on them **(1).**<br><br>**Accept other valid responses.** | **2** |

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