

The Optimization Path of Cash Flow Statement Presentation in China

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ABSTRACT

Cash flow is the lifeline of an enterprise. At present, there are deficiencies in China's current cash flow statement classification presentation. This article aims to explore the optimization path of China's cash flow statement presentation. First of all, the article analyzes the deficiencies of the current cash flow statement presentation, including the structure is not reasonable enough and the information disclosure is not comprehensive enough. Subsequently, it puts forward targeted optimization suggestions, including maintaining the internal consistency of the statements, strengthening the transparency and accuracy of information disclosure, and promoting convergence with IFRS. Optimizing the presentation of the statement of cash flows can help improve the readability and usefulness of the financial statements, provide investors, creditors, and other stakeholders with more comprehensive and accurate corporate financial information, and promote the healthy development of the capital market.

KEYWORDS

Cash Flow Statement; Categorical Presentation; Optimize the Path

1. INTRODUCTION

The significance of cash flow information in the operation of micro-entities and macroeconomic regulation and control has become more and more prominent, and in reality, such as “three years after the price war of small yellow car miserable exit from the market”, “New Oriental against the industry's cold stream of successful transformation” and other lessons to deepen our understanding of the importance of cash flow. The importance of cash flow. As a carrier of cash flow information, the cash flow statement can help investors make decisions by understanding the source of the increase in monetary funds brought about by the capital cycle of the enterprise [1]. The usefulness of the statement of cash flows should begin with an examination of the reasonableness of its presentation [2]. The first cash flow statement of China's enterprises was the Accounting System of the People's Republic of China for Sino-Foreign Equity Joint Ventures issued in 1985, which was called the Statement of Changes in Financial Position. It was used to standardize the way of disclosing the changes in the financial position of the enterprises. With the deepening of opening up to the outside world, China gradually aligned itself with international standards and promoted the reform of cash flow disclosure. The name was changed from the statement of financial position to the statement of cash flows. on January 1, 2007, China launched a new accounting standard, “Accounting Standard for Business Enterprises No. 31 - Statement of Cash Flows”, which is specifically designed to regulate the presentation of the statement of cash flows, stating that The cash flow statement should be divided into operating activities, investing activities and financing activities to present cash flow. Among them, operating activities refer to all transactions and events other than investment activities and financing activities of an enterprise; investment activities refer to the acquisition and construction of

long-term assets of an enterprise and investments not included in the scope of cash equivalents and their disposal activities; and financing activities refer to the activities that lead to changes in the size and composition of the enterprise's capital and debt.

2. ORIGINS AND EVOLUTION OF THE PRESENTATION OF THE STATEMENT OF CASH FLOWS

2.1. Origin of the Statement of Cash Flows

Traditionally there have been three main academic understandings of the basis for the generation of the statement of cash flows: first, the accounting theory [2]. The basis of accounting includes accrual and cash basis, enterprise accounting standards generally require the use of accrual basis, which means that the basis of accounting for the treatment of business is: regardless of whether the income incurred in the current period to receive cash should be listed as the income of the current period, regardless of whether the expenses incurred in the current period to pay cash should be listed as the current period of expenditures. But this can not disclose the actual situation of cash inflows and outflows of the enterprise in the current period, it is necessary to use the cash system to disclose all the business in the current period of cash inflows and outflows and its net information; Second is to supplement that, that is, the reason why the cash flow statement is produced to make up for the lack of information on the balance sheet, so that shareholders-based accounting statements use to obtain a certain period of cash inflows and outflows of various business activities and their Quantitative information on the changes in cash flows and outflows of operating activities during a given period[3]. Third, the role of the statement of cash flows is to disclose the reasons for the inflow and outflow of cash during a certain period, so that it can be used to analyze the enterprise's ability to obtain cash and the ability to pay, as well as the situation of investment and financing activities. No matter which point of view is that the cash flow statement should disclose the information of cash inflow and outflow in a certain period. Therefore, along with the change of time and economic development, how to standardize the presentation of enterprise cash flow information to achieve the purpose of effective disclosure of changes in the enterprise's monetary funds has been a topic of discussion in the academic community and relevant departments.

2.2. Evolution of Domestic Cash Flow Statement Presentation

The first standardized cash flow statement for enterprises in China was the Accounting System for Sino-Foreign Enterprises of the People's Republic of China, issued in 1985, known as the Statement of Changes in Financial Position, which was used to standardize how enterprises disclosed changes in their financial position. At this time, the "cash flow statement" was prepared based on working capital, starting with profit on an accrual basis (profit before tax) and adjusted to: Cash profit on a "cash basis" [4]. The basic concept is to treat working capital as the financial solvency of an enterprise, to analyze the reasons for changes in financial solvency, and to show the results of changes in current assets and current liabilities due to these reasons. In 1992, the Accounting System for Foreign Invested Enterprises (FIEA) revised the original cash flow presentation, with the most significant change being the addition of specific items. In the same year, the Accounting System for Industrial Enterprises further improved the cash flow presentation to make it more suitable for industrial enterprises with domestic capital. The statement of changes in financial position prepared based on working capital was highly uncertain and could not accurately assess the true level of the enterprise. In 1998, China formally promulgated the "Accounting Standards for Business Enterprises--Statement of Cash Flows", which changed the past basis of working capital to cash, and began to establish the financial management system of "Cash is King". Cash is king" of financial management consciousness, at this time the enterprise's cash receipts and expenditures according to its characteristics are divided into 'operating activities', 'investment activities', and 'fund-raising

activities “. Subsequently, the 2006 revision of the “Accounting Standards for Business Enterprises - Cash Flow Statement” stipulates that the presentation of the main statement of cash flow of an enterprise is the direct method and that the classification of cash flow of an enterprise still follows the method of 1998.

3. THE CURRENT WAY OF CATEGORIZING CASH FLOWS IS CONTROVERSIAL

However, the categorized presentation of corporate cash flows, which has been in use in China for 26 years, is not perfect, and academics have long questioned its soundness. In 2008, the ISAB and FASB jointly issued a Discussion Paper on Preliminary Views on the Presentation of Financial Statements, in which longstanding user criticisms of financial statements were summarized [5]. The first of these is the different classifications of recognized transactions or events in the different statements. The different classification methods used in the presentation of the three statements make it difficult to obtain the related financial data, which makes it difficult for users of the statements to assess the profitability and quality of the reporting entity and affects the effective transmission of information. Currently, the following types of views exist in the academic community regarding how the statement of cash flows is categorized and presented.

The first group of views is that entrepreneurial and investment activities should be included in business activities [6]. With the development of capital markets, capital operation activities are becoming a common means for enterprises to increase their value. The origin of enterprise value appreciation is business and investment activities [7]. Based on the theory of capital movement, Wang Zhuquan proposed the classification of “operation, investment and financing activities”, of which operation and investment activities are categorized as business activities of enterprises [8]. This classification is due to the consistency of the direction of the movement of funds in the operating and investing activities of an enterprise, which are both outflows of funds [6]. The status of capital operating activities has been elevated under this approach, reflecting the emphasis on long-term investment and long-term development of the enterprise, and contributing to the realization of the objectives of liquidity and financial resilience of the enterprise.

The second view is that the categorization of cash flows in the statement of cash flows needs to be presented in a way that is consistent with the other two main statements to improve the relationship between the statements. The current presentation of financial statements in the balance sheet and income statement involving the word “investment” projects (such as long-term equity investments, investment properties, etc.) is the enterprise's foreign investment, while the cash flow statement “cash flow from investing activities” “The ‘investment’ in the cash flow statement includes both outward investment and inward investment activities such as the acquisition and disposal of fixed assets and intangible assets. As early as 2005, Alver, a professor of accounting at Tallinn University, pointed out that the treatment of items in the income statement should determine the classification of the cash flow statement [9]. Moreover, the concepts of “operating”, “investing” and “financing” activities in the statement of cash flows are not of the same caliber as those in the income statement and balance sheet. Specifically, the investment income in the income statement is limited to equity investment income and debt interest income, while the investment activities in the cash flow statement is a broad concept of investment, including investment activities in fixed assets, intangible assets, and other long-term assets [10]. The financial statements are prepared on different bases and lack internal logical consistency in terms of the business activities they reflect, for example, the cash flow statement is presented according to the categories of financing, operating, and investing activities, and the balance sheet is presented according to the liquidity of the assets and liabilities according to the length of the maturity date, the income statement is presented according to the direct source of income, and expenses are presented using the “functional approach”. Functional approach” for expenses [11]. Some scholars have also proposed solutions to the problem of inconsistent presentation

between statements, such as reclassification by nature and time to accurately convey information about the enterprise's cash flows [6].

However, due to the highly abstract nature of capital movements and the diversity and complexity of capital movements resulting from the diversity and complexity of the enterprise's economic operations, it is very difficult to analyze the capital movements arising from economic operations, and it is not easy to follow the principle of taking the substance as the basis for classification, taking into account the actual business context in which the project occurs, and then analyzing it by the specific circumstances and categorizing it into the corresponding cash flows. Therefore, the method of reclassification according to the nature of the cash flows from the acquisition and disposal of fixed assets and intangible assets into the operating activities makes it difficult to truly distinguish the substance of economic activities. For example, some scholars have pointed out that the purchase and construction of non-monetary assets does not in itself form a gain, but rather these non-monetary assets are used to form a gain. This revenue is a component of the company's profit and must be included in the cash inflow from operating activities. According to this logic, the cash flow corresponding to the principal portion recovered from the sale or use of non-monetary assets still belongs to investing activities. In the annual reports of listed companies, common cases of unreasonable classification of cash flows include: cash flows generated from fund transactions with related enterprises are classified as operating activities; all fund receipts and payments related to the deposit or maturity of time certificates of deposit are classified as operating activities; settlement of bills payable and receipt and payment of deposits related to the purchase of inventory or long-term fixed assets are classified as financing activities; cash flows generated from discounting of bank acceptance bills which have been derecognized are classified as investing activities; cash flows generated from the sale or use of non-monetary assets are still classified as investing activities. Cash obtained from the discounting of derecognized bank acceptances is classified as financing activities; government grants received in connection with assets and rebates of withholding tax fees are classified as investing activities; and subsidies received for IPO filing and other subsidies are classified as financing activities, etc.

The third group of views argues that the categorical presentation of statements needs to reflect information at the strategic level of the firm. Wernerfelt (1984) proposes a resource-based view of the firm as a collection of resources and argues that a firm's strategy should be formulated in terms of the firm's resources [12]. Therefore, a cash flow statement reflecting information on the flow of funds should be able to reflect the flow of funds of the enterprise in its strategic activities [13]. The nature of funds is liquidity, and flow management should be the center of gravity of funds management, the role of the cash flow statement should not be a supplement to the balance sheet and income statement but should provide specific information on the changes of different types of funds flow in the enterprise, to reflect the direction of different funds in the enterprise. Should be based on the original basis of the cash flow statement of cash flow from operating activities and then specifically categorized, from which to extract the "operating activities EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization)", "operating activities working capital savings", "Net investment in operating long-term assets" to reflect the effectiveness of the management of corporate capital flows, the effectiveness of capital stock management and the strategic planning of the enterprise's product management, respectively. However, I believe that this presentation is useful for enriching the value of the statement of cash flows, and I have not explored whether the current categorized presentation is reasonable[13].

4. OBSERVATIONS ON THE IMPROVEMENT OF THE CATEGORIZED PRESENTATION OF CHINA'S STATEMENT OF CASH FLOWS

From the point of view of individual statements, the balance sheet reflects the status of assets, liabilities, and equity as a static point in time, the income statement is a dynamic point in time of the

results of the operation, and the cash flow statement is a process of monetary operation in the course of the operation of the enterprise, each of the three statements has its responsibility to show the operation of an enterprise's entire business chain from different perspectives, and together reflect the results of a complete value chain of an enterprise. The three statements have their responsibilities. Therefore, these three statements are inevitably closely linked and inseparable.

4.1. Cash Flow Statement and Balance Sheet

Users of accounting statements, mainly shareholders, cannot recover all of the monetary funds initially invested in the company after a cycle in the form of monetary funds. As the capital cycle continues, the assets at the beginning of any period will generally not be the same as the amount of money funds invested, and the ending balance will not be the full recovery of money funds after the capital cycle. Therefore, the disclosure of changes in the amount of increases or decrease in money funds through the balance sheet alone does not reflect the total amount of inflows and outflows of money funds and the changes in the amount of increases or decreases in money funds resulting from all the business activities of the company during a given period. Therefore, the reasons for the formation of the cash flow statement can be summarized in two points: first, to explain the reasons for the changes in the opening and closing balances of money funds in the balance sheet, to realize the conversion from the cash basis to the accrual basis; second, to explain the total amount of inflows and outflows of money funds of all business activities of the company during a certain period, especially the total amount of inputs and recoupments of money funds of the company and its structure.

4.2. Cash Flow Statement and Income Statement

As far as the income statement and the cash flow statement are concerned, both of them, as a depiction of the dynamic process of the movement of funds, belong to the same category of dynamic statements, and the difference between the two should only be reflected in the reflective dimension and measurement method, and consistency needs to be maintained in terms of the reflective object and its categorization. In 2019, the IASB proposed in the “General Presentation and Disclosure (Exposure Draft)” to include the profit or loss of operations as the starting point for determining cash flows from operating activities under the indirect method and to clarify the method of categorizing interest and dividends. starting point for determining cash flows from operating activities, separate presentation of cash flows from integrated and non-integrated associates and joint ventures, and clarification of how interest and dividends are categorized. Although no conclusion has been reached so far, it can be seen that there is a general trend to promote the presentation of the income statement according to the classification of economic activities.

4.3. Possible Improvements in the Categorized Presentation of the Statement of Cash Flows

To improve the internal consistency between the statements, we need to reform the cash flow statement at least along the lines of the income statement reform, so that the income statement is logically consistent with the cash flow statement. To make the cash flow statement logically consistent with the income statement in terms of classification of economic activities, the cash flow statement should set up a cash flow from operating activities item by the first viewpoint mentioned above, and subdivide cash flow from investing activities and cash flow from operating activities into cash flow from operating activities.

However, the breakdown is prone to the shortcomings of the second viewpoint mentioned above, that is, it is difficult to truly distinguish the nature of the enterprise's business activities. I do not believe that the cash flows that occur at the beginning and end of the business of operating activities or investing activities should be included in the activity based on the theory of money movement in

general. For example, the taking of deposits and the issuance of bonds by commercial banks are both financing activities in nature, rather than operating activities on the asset side of commercial banks. The operating activities of commercial banks are mainly related to the day-to-day use of cash assets acquired by commercial banks through various financing methods, the issuance of loans and their payment of loan-related operating costs, recovery of loans and income from loan interest, but not related to the source of cash used for the issuance of loans, and should be directly related to the absorption of deposits, withdrawal of deposits and payment of interest on deposits should be reclassified and reclassified to the cash flow from the current cash flow from operating activities. should be adjusted out of the current cash flow from operating activities and reclassified to cash flow from financing activities [14]. According to this logic, I believe that the documents related to the regulation of financial statements should take into account the complexity of the business activities of enterprises, and analyze in detail the various kinds of cash flows generated by the daily activities of various industries and expressly indicate what kinds of activities should be included in the scope of activities. The non-routine activities of the enterprise are difficult to be classified as operating activities and financing activities of the cash flow, can be categorized separately as other activities of the cash flow. In addition, the state should also strengthen the training of finance practitioners to enhance their ability to analyze the substance of cash flows from business activities, and should not rely on formulas or templates without considering the substance of the business, but should start from the reality of the business and restore the real business background.

5. CONCLUSIONS

With the development of the times, the complexity of economic business is advancing day by day. As a carrier of information about the operation of an enterprise, the statement should accurately reflect the substance and situation of the enterprise's business, to help investors better identify the operating conditions of the enterprise. This is inseparable from the efforts of accounting standard setters and practitioners, requiring us to grasp the principles of the standard, but also to combine them with the business substance, so that statement users can further understand the content of cash flow, and improve the quality of accounting information disclosure in the statement.

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