CHAPTER- 6

CASH FLOW STATEMENT

- **Cash Flow** means incoming and outgoing of cash and cash equivalents.

- **Cash Flow Statements-** It is a statement that shows summary of transactions, which result either in incoming and/or outgoing of cash and cash equivalents during an accounting period.

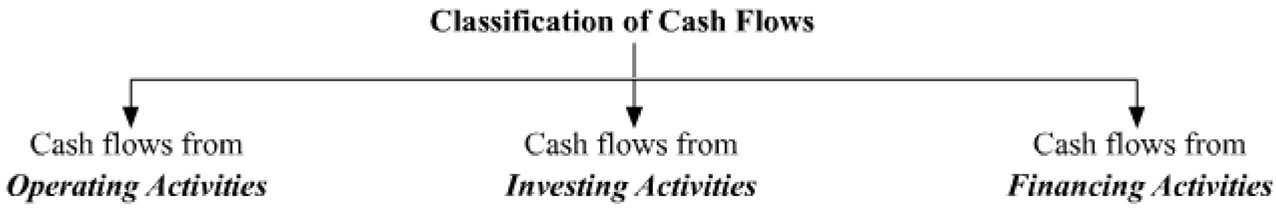
- **Objectives of Cash Flow Statements**
  - To ascertain gross inflows and outflows of cash and cash equivalents from various activities.
  - To analyse various reasons responsible for the change in the cash balances during an accounting period.
  - To ascertain the requirement and availability of cash in the near future.
  - To analyse and understand the liquidity and solvency of a company

- **Advantages of Cash Flow Statements**
  - It is useful for short term financial planning about inflows and outflow of cash.
  - It enhancers the comparability financial information of two or more enterprise having same financial structure and involved in same business.
  - It helps in analysing the reason for the change in cash and cash equivalent balances of a company.
  - It helps in efficient cash management by providing relevant information.
  - It helps to analyse and to study the trends of receipts and payments of cash from various activities, thereby helps in drafting various policy measures and plans.
  - It specifies the reason for changes in cash and cash equivalents.

- **Limitations of Cash Flow Statements**
  - It is prepared for the transactions that have already occurred.
  - It is used for analysing the cash transactions only, ignoring the non-cash transactions such as depreciation, etc.
  - It is prepared ignoring the basic accounting concepts such as, Matching Concept, Revenue Recognition Concept, Accrual Concept.
  - It cannot be substituted by the Income Statements and Balance sheet because it does not show the actual obligations, claim and net profit/net loss.

- **Classification of Cash Flows:**

  As per the Revised Accounting Standard-3 (AS-3), preparation of Cash Flow Statement for each period is mandatory. AS-3 also specifies the classification of all inflows and outflows basically under the following heads:
  - Cash Flow from Operating Activities
  - Cash Flow from Investing Activities
  - Cash Flow from Financing Activities



- **Method of Preparing Cash Flow Statement**
  As per the latest CBSE syllabus for the year 2012-13, only Indirect Method is followed for the preparation of Cash Flow Statement.

Cash Flow Statement of _______Ltd. (INDIRECT METHOD)
for the year ended……

	Particulars	Amount (Rs)	Amount (Rs)
A.	**Cash Flow from Operating Activities**		
	Profit as per Profit and Loss Appropriation Account	–	
	Add: Transfer to General Reserve	–	
	Transfer to Debenture Redemption Reserve and other Reserves	–	
	Proposed Dividend	–	
	Interim Dividend	–	
	Provision for taxation	–	
	Profit before taxation	–	
	Profit before taxation and Extra ordinary items (+/–)	–	
	Such as, Grant for Earthquake Victims, Insurance Claims for Loss by Fire, etc.		
	Add: Non-cash and Non-operating Expenses	–	
	Goodwill written-off (*if value of Goodwill decreases*)	–	
	Miscellaneous Expenditure written-off	–	
	Depreciation charged during the year	–	
	Loss on sale of Fixed Assets	–	
	Investments	–	
	Interest paid on Debentures and Loans	–	
	Other Non-Operating Expenses	–	
	Less: Non cash and Non-Operating incomes/Gain		
	Interest and Dividend Received on investment	( )	
	Profit on sale of Fixed Assets and Investment	( )	
	Rent Received	( )	
	Other Non-Operating Income	( )	
			–

	Operating profit before working capital changes		
	Add: Decrease in Current Assets (Except Cash in hand, Cash at bank, Marketable securities)	–	
	Increase in Current Liabilities (Except Bank Overdraft)	–	
	Less: Increase in Current Assets (Except Cash in hand, Cash at bank, Marketable securities)	( )	
	Decrease in Current Liabilities (Except Bank Overdraft)	( )	
	Cash Generated from Operations	–	
	Less: Income tax paid		( )
	Cash From (used in) Operations before Extraordinary Items		
	Receipts (or payments) of Extraordinary items (+/–)	–	–
	Net Cash from (used in) Operating Activities		
B	**Cash Flow From Investing Activities**		
	Add:		
	Proceeds from sale of Fixed Assets and Investment	–	
	Interest and Dividend received on Investment	–	
	Rent Received	–	
	Less:		
	Purchases of Fixed Assets and Investment in Cash	( )	
	Payment of expenses for acquiring fixed assets and investment	( )	
	Income from investment of Fixed Assets	( )	
	Cash From (used in) Investing Activities		–
C	**Cash Flow From Financing Activities**		
	Add:		
	Issue of shares and Debentures in Cash	–	
	Loan from bank and Financial Institution	–	
	Increase in Bank Overdraft	–	
	Less:		
	Redemption of Preference Shares and Debentures	( )	
	Repayment of Loan	( )	
	Interim Dividend paid	( )	
	Final Dividend paid	( )	
	Interest paid on Debentures and Loans	( )	
	Decrease in Bank Overdraft	( )	
	Cash From (used in) Financing Activities		
D	**Net Cash Increase (Decrease) in cash and Cash Equivalents (A + B + C)**		

E	*Add*: Cash and Cash Equivalents in the beginning Cash in Hand Cash at Bank Marketable Securities	 – – –	
	Cash and Cash Equivalents at the end (D + E) Cash in Hand Cash at Bank Marketable Securities	 ( ) ( ) ( )	

IMPORTANT ADJUSTMENTS

❖ **FIXED ASSETS AND DEPRECIATION**

Generally, there are following two ways of presenting the balances of Fixed Assets in a Balance Sheet.

- When the Fixed Assets are shown at their diminishing values (or Written-down Values)
- When the Fixed Assets are shown at their original costs

❖ **When the Fixed Assets are shown at their diminishing values (or Written-down Values)**

In this case, when the fixed assets are shown at their written-down values, then there is no need to prepare Provision for Depreciation Account (or Accumulated Depreciation Account).

Case: 1

When the balances (i.e. opening and closing balances) of Fixed Assets are given in the Balance Sheet and Depreciation charged during the year is given in the adjustment.

Example:

Balance Sheet

Liabilities	**Previous Year Rs**	**Current Year Rs**	**Assets**	**Previous Year Rs**	**Current Year Rs**
			Machinery (Net)	2,00,000	1,80,000

Adjustment: Depreciation of Rs 60,000 charged during the year.

Solution:

Machinery Account (at Written-down Values)

Dr. **Cr.**

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Balance b/d	2,00,000	Depreciation	**60,000**
Bank (*Balancing Figure- Purchases of Machinery*)	**40,000**	Balance c/d	1,80,000
	2,40,000		2,40,000

Treatment

Investing	**Operating**
(–) Rs **40,000** as Purchases of Machinery	(+) Rs **60,000** as Depreciation charged during the year

Case 2

When the balances (i.e. opening and closing balances) of Fixed Assets are given in the Balance Sheet and Depreciation charged during the year along with ***sale of part of fixed assets*** is given in the adjustment.

Example:

Balance Sheet

Liabilities	**Previous Year Rs**	**Current Year Rs**	**Assets**	**Previous Year Rs**	**Current Year Rs**
			Machinery (Net)	2,00,000	1,80,000

Adjustments:

1. Depreciation of Rs 60,000 charged during the year.
2. A part of Machinery costing Rs 30,000 (accumulated depreciation Rs 4,000) was sold for Rs 23,000.

Solution:

Machinery Account (at Written-down Values)

Dr. **Cr.**

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Balance b/d	2,00,000	Depreciation	60,000
		Cash- Sale of Machinery	**23,000**
Bank (*Balancing Figure- Purchases of Machinery*)	**66,000**	Loss on Sale of Machinery (30,000 – 4,000 – 23,000)	**3,000**
		Balance c/d	1,80,000
	2,66,000		2,66,000

Treatment

Investing	Operating
(–) Rs **66,000** as Purchase of Machinery (+) Rs **23,000** as Sale of Machinery	(+) Rs **60,000** as Depreciation charged during the year (+) Rs **3,000** as Loss on Sale of Machinery

- **When the Fixed Assets are shown at their Original Costs**
  In this case, the fixed assets are shown at their original costs in the Balance Sheet, hence there is a need to maintain a separate account for Provision for Depreciation (or Accumulated Depreciation). In this method, either Depreciation charged during the year will be given or Accumulated Depreciation on the part of the machinery sold will be given. If Depreciation charged during the year is given, then Accumulated Depreciation on the part of machinery will be the balancing figure and vice-versa.

Case 1
When the balances (opening and closing balances) of Fixed Assets and the balances (opening and closing balances) of Provision for Depreciation (or Accumulated Depreciation) are given in the Balance Sheet and ***<u>depreciation on a part of fixed assets sold</u>*** is given in the adjustment.

Example:

Balance Sheet

Liabilities	Previous Year Rs	Current Year Rs	Assets	Previous Year Rs	Current Year Rs
Accumulated Depreciation	20,000	70,000	Machinery (On Cost)	2,00,000	2,80,000

Adjustments:
1. A part of Machinery costing Rs 30,000 (accumulated depreciation Rs 4,000) was sold for Rs 23,000.

Solution:

Machinery Account (On Cost)

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Balance b/d	2,00,000	Depreciation A/c (on part) Ψ	**4,000**
		Cash- Sale of Machinery°	**23,000**
Cash (*Balancing Figure- Purchase of Machinery*) ♠	**110,000**	Loss on Sale of Machinery* (30,000 – 4,000 – 23,000)	**3,000**
		Balance c/d	2,80,000
	3,10,000		3,10,000

Accumulated Depreciation Account (Provision for Depreciation Account)

Dr. **Cr.**

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Fixed Assets (Dep. on part of Fixed Assets) Ψ	**4,000**	Balance b/d	20,000
Balance c/d	70,000	Depreciation charged during the year (*Balancing Figure*) ♦	**54,000**
	74,000		74,000

Treatment

Investing	**Operating**
♠ (–) Rs **1,10,000** as Purchase of Machinery ° (+) Rs **23,000** as Sale of Machinery	♦ (+) Rs **54,000** as Depreciation charged during the year * (+) Rs **3,000** as Loss on Sale of Machinery

Case 2:

When the balances (i.e. opening and closing balances) of Fixed Assets and the balances (i.e. opening and closing balances) of Provision for Depreciation (Accumulated Depreciation) are given in the Balance Sheet and ***depreciation charged during the year along with sale of part of machinery*** is given in the adjustment.

Example:

Balance Sheet

Liabilities	**Previous Year Rs**	**Current Year Rs**	**Assets**	**Previous Year Rs**	**Current Year Rs**
			Machinery (On Cost)	2,00,000	2,80,000
			Accumulated Depreciation	(20,000)	(70,000)

Adjustment:

1. Depreciation charged during the year is Rs 55,000
2. During the year, a part of machinery costing Rs 15,000 was sold for Rs 4,000

Solution:

Machinery Account

Dr. **Cr.**

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Balance b/d	2,00,000	Depreciation A/c (on part) Ψ	**5,000**
		Cash- Sale of Machinery°	**4,000**
		Loss on Sale of Machinery * (15,000 – 5,000 – 4,000)	**6,000**
Cash (*Balancing Figure- Purchase of Machinery*) ♠	**95,000**	Balance c/d	2,80,000
	2,95,000		2,95,000

Accumulated Depreciation Account (Provision for Depreciation Account)

Dr. **Cr.**

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Fixed Assets (*Balancing Figure* - Dep. on part of Fixed Assets) Ψ	**5,000**	Balance b/d	20,000
		Depreciation charged during the year♦	**55,000**
Balance c/d	70,000		
	75,000		75,000

Treatment

Investing	**Operating**
♠ (–) Rs **95,000** as Purchase of Machinery ° (+) Rs **4,000** as Sale of Machinery	♦ (+) Rs **55,000** as Depreciation charged during the year * (+) Rs **6,000** as Loss on Sale of Machinery

NOTE: *An easy way to spot-out which of the above methods to use is to analyse the following two conditions.*

1. *Whether (Net) or (On Cost) is mentioned with the balances of the Fixed Assets in the Balance Sheet. If (Net) is mentioned, then it implies that Fixed Assets are shown at their Written-down Values and if (on Cost) is mentioned, then it implies that Fixed Assets are shown at their original costs.*
2. *If nothing is mentioned with the balances of the Fixed Assets, then we need to see whether the opening and closing balances of Provision for Depreciation (Accumulated Depreciation) are mentioned either in the Balance Sheet or in the Adjustments. If the balances of Provision for Depreciation are mentioned, then we need to prepare its accounts separately.*

❖ PROPOSED DIVIDEND

***Case 1:* When Proposed Dividend is given in the Balance Sheet and <u>no related adjustment is given.</u>**

Example:

Balance Sheet

Liabilities	Previous Year Rs	Current Year Rs	Assets	Previous Year Rs	Current Year Rs
Proposed Dividend	*10,000	♦12,000			

Solution:

Treatment

Financing	Operating
* (–) Rs **10,000** as Dividend Paid	♦ (+) Rs **12,000** as Proposed Dividend

***Case 2:* When Proposed Dividend is given in the Balance Sheet and**
Adjustment: Dividend ***made*** during the year.

Example:

Balance Sheet

Liabilities	Previous Year Rs	Current Year Rs	Assets	Previous Year Rs	Current Year Rs
Proposed Dividend	10,000	12,000			

Adjustment: Dividend Rs 15,000 ***made*** during the year

Solution:

Proposed Dividend Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Bank (*Balancing Figure-* ***Dividend Paid***)	*13,000	Balance b/d	10,000
Balance c/d	12,000	Profit and Loss (***Made***)	♦15,000
	25,000		25,000

Treatment

Financing	Operating
* (–) Rs **13,000** as Dividend Paid	♦ (+) Rs **15,000** as Proposed Dividend

Case 3: **When Proposed Dividend is given in the Balance Sheet and Adjustment:** Dividend ***paid*** during the year.

Example:

Balance Sheet

Liabilities	**Previous Year Rs**	**Current Year Rs**	**Assets**	**Previous Year Rs**	**Current Year Rs**
Proposed Dividend	10,000	12,000			

Adjustment: Dividend Rs 15,000 ***paid*** during the year.

Solution:

Proposed Dividend Account

Dr. **Cr.**

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Bank (***Paid***)	*15,000	Balance b/d	10,000
Balance c/d	12,000	Profit and Loss (*Balancing Figure-* ***Made***)	♦17,000
	27,000		27,000

Treatment

Financing	Operating
* (–) Rs **15,000** as Dividend Paid	♦ (+) Rs **17,000** as Proposed Dividend

Case 4: **When Proposed Dividend is given in the Balance Sheet only of the Previous Year but no related adjustment is given.**

Adjustment: NIL

Example:

Balance Sheet

Liabilities	**Previous Year Rs**	**Current Year Rs**	**Assets**	**Previous Year Rs**	**Current Year Rs**
Proposed Dividend	*12,000	–			

Solution:
In this case, the previous year's balance of Proposed Dividend will be treated as **Dividend Paid** and will be deducted from the Financing Activities as Rs 12,000.

Case 5: **When Proposed Dividend is given in the Balance Sheet only of the Current Year but no related adjustment is given.**

Adjustment: NIL

Example:

Balance Sheet

Liabilities	**Previous Year Rs**	**Current Year Rs**	**Assets**	**Previous Year Rs**	**Current Year Rs**
Proposed Dividend	–	*23,000			

Solution:
In this case, the current year's balance of Proposed Dividend will be treated as **Dividend Made** and will be added to the Operating Activities as Rs 23,000.

Case 6: **When Proposed Dividend is given only in the Adjustment as dividend paid, but no proposed dividend is appearing in the Balance Sheet.**

Example:

Balance Sheet

Liabilities	**Previous Year Rs**	**Current Year Rs**	**Assets**	**Previous Year Rs**	**Current Year Rs**
Proposed Dividend	–	–			

Adjustment: Dividend of Rs 15,000 paid during the year 2010.

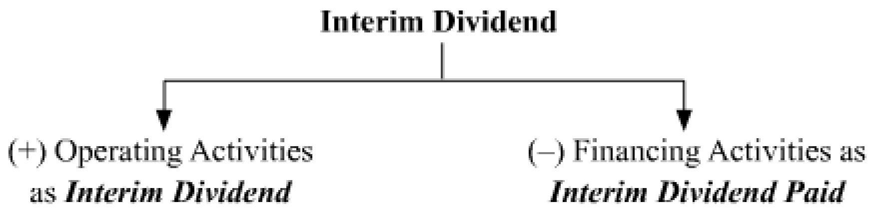
Treatment

Financing	**Operating**
(–) Rs **15,000** as Dividend Paid	(+) Rs **15,000** as Proposed Dividend

❖ INTERIM DIVIDEND

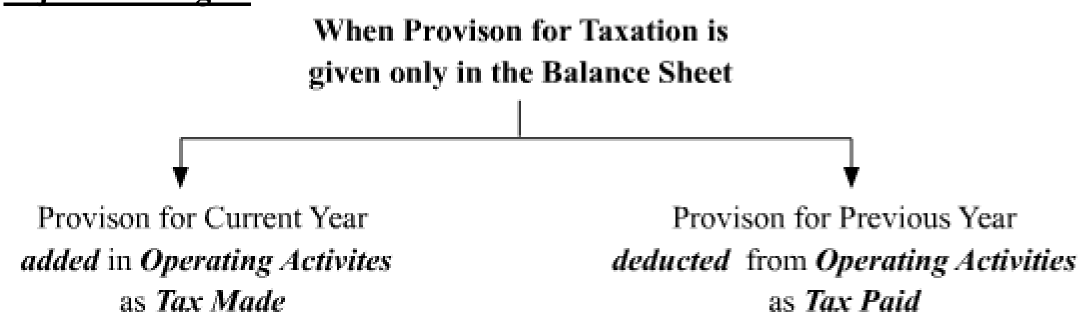
Interim Dividend is always mentioned in the adjustments only. It is not affected by the adjustments on Proposed Dividend and Preference Dividend.

- **Treatment of Interim Dividend**



❖ PROVISION FOR TAXATION

***Case 1:* When Provision for Taxation is given only in the Balance Sheet and <u>no adjustment is give</u>**



***Case 2:* When <u>Tax Paid</u> is given in the adjustment**

Example:

Liabilities	Previous Year Rs	Current Year Rs	Assets	Previous Year Rs	Current Year Rs
Provision for Taxation	2,000	3,000			

Adjustment:

Income tax Rs 1,500 paid during the year.

Note: In such case, either Tax Paid or Tax Made is given. If Tax Paid is given, then Tax Made is ascertained by preparing Provision for Taxation Account.

Solution:

Provision for Taxation Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Bank (Tax Paid) ♦	1,500	Balance b/d (Previous Year's Balance)	2,000

Balance c/d (Current Year's Balance)	3,000	Profit and Loss (*Balancing Figure-* Tax Made) *	2,500
	4,500		4,500

Treatment

Financing	Operating
(–) Rs **1,500** as Tax Paid	(+) Rs **2,500** as Tax Made

***Case 3:* When only Previous Year's Balance of Provision for Taxation is given in the Balance Sheet**

Example

Balance Sheet

Liabilities	Previous Year Rs	Current Year Rs	Assets	Previous Year Rs	Current Year Rs
Provision for Taxation	3,000	–			
	3,000				

Solution:
In this case, the previous year's balance of Provision for Taxation is regarded as ***Tax Paid***, thereby is deducted from Cash Flow from Operating Activities.

***Case 4:* When only Current Year's Balance of Provision for Taxation is given in the Balance Sheet**

Example:

Balance Sheet

Liabilities	Previous Year Rs	Current Year Rs	Assets	Previous Year Rs	Current Year Rs
Provision for taxation	–	1,000			
		1,000			

Solution:
In this case, the current year's balance of Provision for Taxation is regarded as ***Tax Made***, thereby is added to the Net Profit as per the Profit and Loss Account.

Case 5: **When Provision for Taxation is given only in the Profit and Loss Account**

Example:

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Provision for taxation	2,000		
	2,000		

Solution:
In this case, Rs 2,000 is added to the Net Profit as per the Profit and Loss Account and the same amount of Rs 2,000 is deducted from Cash from Operations.

❖ **INTEREST ON DEBENTURES (Or LONG-TERM LOANS)**

Case 1: **When rate of interest on Debentures (or on Loans) is *not* mentioned**

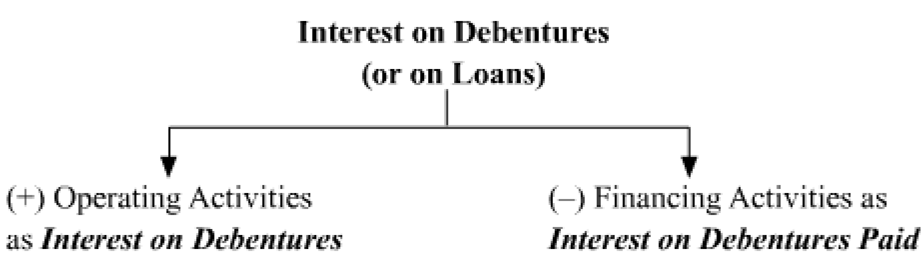
Additional Information: NIL

In this case, as no rate of interest is mentioned, so no interest shall be provided on debentures (or on loans)

Case 2: **When rate of interest is mentioned on Debentures (or on Loans) and there is *no change* in the balance of Debentures from the previous year.**

Additional Information: NIL

In this case, interest on debentures (or on loans) can be calculated either on the opening or closing balances of debentures (as there is no change).



Case 3: **When rate of interest is mentioned on Debentures (or on Loans) and there is an *increase* in the balance of Debenture from the previous year.**

Additional Information: NIL

Interest on debentures (or on loans) is calculated on the balance of the previous year and the interest calculated is added to Operating Activities and deducted from the Financing Activities.

Case 4: **When rate of interest is mentioned on Debentures (or on Loans) and there is *decrease* in the balance of Debenture from the previous year.**

Additional information: NIL

Interest on debentures (or on loans) is calculated on the balance of the previous year and the interest calculated is added to Operating Activities and deducted from the Financing Activities.

Case 5: **When rate of interest on Debentures (loan) is mentioned and there is an increase in the balance of debentures from the previous year.**

Additional Information: Date of issue of Debentures (raising loan) is given.

Example

Extract of Balance Sheet

Liabilities	2009 Rs	2010 Rs	Assets	2009 Rs	2010 Rs
12% Debenture	1,00,000	1,20,000			

Additional Information: Debentures of Rs 20,000 were issued on July 01, 2010.

Calculation:

Here interest from April 01 to July 01, 2010

$$=1,00,000 \times \frac{12}{100} \times \frac{3}{12} \quad = \quad 3,000$$

Interest from July 01 to March 31, 2010

$$=1,20,000 \times \frac{12}{100} \times \frac{9}{12} \quad = \quad 10,800$$

Total Interest on Debentures 13,800

Treatment: Interest of Rs 13,800 will be added to Operating Activities and will be deducted from the Financing Activities.

Case 6: **When rate of interest on Debentures (loan) is mentioned and there is a decrease in the balance of debentures from the previous year.**

Additional Information: Date of redemption of Debentures (or repayment of loan) is given.

Example

Extract of Balance Sheet

Liabilities	2009 Rs	2010 Rs	Assets	2009 Rs	2010 Rs
12% Debentures	1,00,000	60,000			

Additional Information: Debentures were redeemed on Oct. 01, 2010.

Calculation of Interest on Debentures

Interest from April 01 to Sep 30, 2010		
$=1,00,000\times\frac{12}{100}\times\frac{6}{12}$	=	6,000
Interest from Oct 01 to March 31, 2010		
$=60,000\times\frac{12}{100}\times\frac{6}{12}$	=	3,600
Total Interest on Debentures		9,600

Treatment: Interest on Debentures of Rs 9,600 will be added to the Operating Activities and will be deducted from the Financing Activities.

Case 7: **When rate of interest on Debentures (loan) is mentioned and interest on Debentures is outstanding in the current year.**

Example

Extract of Balance Sheet

Liabilities	2009 Rs	2010 Rs	Assets	2009 Rs	2010 Rs
12% Debentures Interest outstanding on Debentures	1,00,000	1,00,000 2,000			

Calculation of Interest on Debentures

Interest for the year 2010	$=1,00,000\times\frac{12}{100}=$	12,000
Less: Interest Outstanding		(2,000)
Interest paid on Debentures		10,000

Treatment: Rs 12,000 will be added to the Operating Activities and Rs 10,000 will be deducted from the Financing Activities.

Case 8: **When rate of interest on debentures (or on loans) is mentioned and interest on debentures is outstanding for the previous year.**

Example

Extract of Balance Sheet

Liabilities	2009 Rs	2010 Rs	Assets	2009 Rs	2010 Rs
12% Debentures Interest outstanding on Debentures	1,00,000 2,000	1,00,000			

Calculation of Interest on Debentures

Interest for the year 2010	$= 1,00,000 \times \frac{12}{100} =$	12,000
Add: Interest outstanding		2,000
Total Interest paid on Debentures		14,000

Treatment: Rs 12,000 will be added to the Operating Activities and Rs 14,000 will be deducted from the Financing Activities.