

Chapter-6 Part-B

Cash Flow Statement

Meaning: It is a statement that shows flow (Inflow or outflow) of cash and cash equivalents during a given period of time.

As per Accounting Standard-3 (Revised) the changes resulting in the flow of cash & cash equivalent arises on account of three types of activities i.e.,

- (1) Cash flow from Operating Activities.
- (2) Cash flow from Investing Activities.
- (3) Cash flow from Financing Activities.

Cash: Cash comprises cash in hand and demand deposits with bank.

Cash equivalents: Cash equivalents are short-term, highly liquid investment that are readily convertible into known amount of cash and which are subject to an insignificant risk of change in the value e.g. short-term investment. Generally these investments have a maturity period of less than three months.

Some examples of cash equivalent: Short-term deposits, marketable securities. Treasury bills, commercial papers, money market funds, money market funds, investment in preference shares if redeemable within three months provided that there is no risk of the failure of the company.

Cash flow exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an enterprise rather than part of its operating, investing and financing activities.

Some types of transaction which are considered movement between cash and cash equivalents are given below:

- 1. Cash deposited into bank.
- 2. Cash withdrawn from bank.

3. Sale of cash equivalent securities (e.g. Sale of short-term investment, sale of commercial papers)

4. Purchases of cash equivalent securities (e.g. Purchase of short-term investment Purchases of Treasury bills).

The above types of transaction are part of cash and equivalents, so these are included in opening and closing cash and cash equivalent only. So these types of transaction no to be included in cash flow from different activities like operating investing, financing activities.

Preparation of cash flow statement

Cash flow from operating activities	-----
Cash flow from investing activities	-----
Cash flow from financing activities	-----
Net increase/decrease in cash & cash equivalent (Total of the above three activities)	-----
Add : Cash & Cash equivalent in the Beginning of the year (Give in opening balance sheet)	-----
Cash & Cash equivalent at the end of the year	-----

Note: The student should ensure that the Cash & Cash equivalent at the end of the year as calculated above will be same as cash & cash equivalent given in closing balance sheet.

Objectives of Cash Flow Statement

1. To ascertain how much cash or cash equivalents have been generated or used in different activities i.e., operating/investing/financing activity.
2. To ascertain the net changes in cash and cash equivalents.
3. To assess the causes of difference between actual cash & cash equivalent and related net earnings/income.
4. To help in formulation of financial policies such as dividend policy, fixed assets policy, capital structure related policy.

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5. To help in short-term financial planning.
 6. To ascertain the liquidity of enterprises.

Limitations of Cash Flow Statement

1. Non cash transaction are not taken into consideration like shares or debentures issued to vendors, depreciating charged during the year.
2. It is a statement related with past data.
3. It is not used for judging the profitability of enterprise.
4. Accrual accounting concept is ignored in this statement e.g. credit sales, credit purchases, outstanding expenses, accrued income are not included.

Computation of Cash flows from different activities.

(1) Cash flow from operating activities: Operating activities are the main revenue generating activities of the enterprises. It also includes all those transactions which are not included in investing and financing activities.

Indirect Method of calculating the cash flow from Operating Activities: Under this method Net Profit before Tax and Extra-ordinary Item is the starting point for further calculations.

Calculation of Net Profit before Tax and Extra-ordinary Item:

Difference between closing balance and opening balance of Balance in statement of Profit & Loss A/c.....

Add:

1. Proposed dividend for current year.....
2. Interim Dividend paid during the year
3. Profit Transferred to Reserve.....

(If reserve of current year increased from previous year)

4. Provision for Taxation made during the year.....

5. Preference Dividend.....

6. Extra Ordinary Item if any Debited to Statement of Profit & Loss.....

Less:

1. Refund of Tax credited to Statement of P & L (.....)

2. Extraordinary-item if any Credited to Statement of P& (.....)

3. Reserves transferred back to statement of Profit and Loss(.....)

Net Profit before Tax and Extra-ordinary item (.....)

Extraordinary items: These items are not related to normal business operation

Format Cash Flow from Operating Activities

Particulars	Rs.

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1. Cash flow from operating activities	
(A) Net Profit Before Tax and Extra – Ordinary Items	-----
Adjustment for Non-cash and Non-Operating items	-
Add :	
i. Depreciation charged during the current year	-----
ii. Preliminary expenses, Discount on issue of debentures, share issue expenses etc. written off	-
iii. Goodwill, Patents and Trademark amortized/written off	-----
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iv. Interest on Long term borrowing and Debentures	(-----
v. Loss on Sales of Fixed Assets/Investments	--)
Less :	(-----
i. Interest income	--)
ii. Dividend Income	(-----
iii. Rental income	--)
iv. Profit on sale of Fixed Assets/Investment	(-----
Operating Profit before Working Capital changes	--)
Adjustment for changes in Working Capital:	
Add : Increase in Current Liabilities and Decrease in Current Assets (other than cash and cash equivalent)	----- -
Less : Increases in Current Assets (other than cash and cash equivalent) and Decrease in Current Liabilities	----- -
Cash Generated from operations before tax and extraordinary items.	-----
Less : Income tax paid (Net of Refund received)	-
Cash flow before Extraordinary item	(-----
Extraordinary items +/-	--) -----
Net cash from (or used in) Operating Activities	-
	(-----
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For the calculation of Proposed Dividend during the current year the proposed dividend account is to be prepared as follows:

Proposed Dividend Account

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Bank (Dividend Paid during the year)	.....		By Balance b/d	.....
	To Balance c/d	.....		By Balance in Statement of P&L A/c	.....
		.....		(Proposed dividend during the current year)	.....

For the calculation of Provision for Taxation made during the current year the provision of Taxation account is to be prepared as follows:

Provision for Taxation Account

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Bank (Tax paid during the current year)	.....		By Balance b/d	.....
	To Balance c/d	.....		By Statement of P&L A/c	.....
		.....		(Proposed for taxation made during the current year)	.....

Illustration 1:

Cash Flow From Operating Activities

Particulars	Rs.	Rs.
1. Cash flow from Operating Activities		
Net Profit Before Tax And Extra-ordinary Item		2,74,000
Adjustment for non-cash and non-operating items		
Add : Depreciation on fixed assets	20,000	
Preliminary expenses written off	10,000	
Loss on sale of furniture	1,000	31,000
Less : Profit on sale on machinery	6000	3,05,000
		(6,000)
Operating Profit before working capital changes		2,99,000

Adjustment for Working Capital Charges		
Add : Increase in Creditors	10,000	
Decrease in Bills Receivables	3,000	13,000
		3,12,000
Less : Increase in Debtors	6,000	
Increase in Prepaid Expenses	200	
Decrease in Bills Payable	4,000	(10,200)
Cash generated from operation before Tax		3,01,800
Less : Income tax Paid		(1,60,000)
Net Cash Inflow from Operating Activities		1,41,8000

2. Cash Flow from Investing Activities

Investing activities are those activities which related to the acquisition (buying) and disposal (selling) of fixed assets and investment (other than cash equivalents). It also includes income from fixed assets and investment like rent received, interest received on investment, dividend received on investment in shares and mutual funds.

Inflows of Cash: (Plus items)	Outflows of Cash (imines items)
Cash Received from sales of Fixed Assets. Cash Received from sales of Investment. Cash Received from sales of intangible Assets like Patents. Interest Received, Dividend Received, Rent Received	Cash paid from sales of Fixed Assets. Cash paid from sales of Investment. Cash paid from sales of intangible Fixed assets like goodwill, patents and copy rights.

For the calculation of sale or purchase of fixed assets and investment, the following accounts are prepared:

1. Fixed Assets Account 2. Investment Account

Fixed Assets Account: Fixed assets accounts may be prepared by two methods:

(a) At written down value method (when provision for depreciation account/accumulated depreciation account is not maintained):

Fixed Assets Account (at written down value)

Date	Particulars	Rs.	Date	Particulars	Rs.
				By Bank A/c (sale of investment)	.....
	To Balance b/d	.....		By Depreciation A/c (Dep. On fixed assets sold)	.....
	To Bank A/c (Additional Purchase)	.....		By Loss on Sale of fixed assets A/c	
	To Profit on sale of fixed assets A/c	.....		By depreciation A/c (Current year dep. On remaining fixed assets)	.....
		.....		By Balance c/d	.....

(b) Fixed Assets (at cost); When provision for depreciation account or accumulated depreciation account has been separated maintained. In this method two separate account named Fixed Assets Account and Provision for Depreciation account are maintained.

Fixed Assets Account (at original cost)

Date	Particulars	Rs.	Date	Particulars	Rs.
				By Bank A/c (sale of investment)	.....
	To Balance b/d	.....		By Depreciation A/c (Dep. On fixed assets sold)	.....
	To Bank A/c (Additional Purchase)	.....		By Loss on Sale of fixed assets A/c	
	To Profit on sale of fixed assets A/c		By depreciation A/c (Current year dep. On remaining fixed assets)
				By Balance c/d	

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Provision for Depreciation Account

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Fixed Assets A/c (Total Depreciation on Fixed assets sold)	.....		By Balance b/d	.....
	To Balance c/d	.....		By Statement of Profit & Loss A/c (Depreciation charged on fixed assets during the current year)	.....
	

Preparation of Investment Account:

Investment Account

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Balance b/d	.....		By Bank A/c	
	To Bank A/c	.....		(Sale of investment)	.....
	(Additional Purchase)	.....		By Loss on sale of Investment A/c	.....
	To Profit on sale of investment A/c			By Balance c/d	
	

3. Cash Flow from financing Activities

Financing activities are those activities that result in the changes in size and composition of the share capital (equality and preference) and borrowed fund of the business enterprises. Generally cost related to these funds also included in financing activities like interest paid on loans and debentures and dividend paid on equity and preference capital.

Inflows of Cash: (Plus items)	Outflows of Cash (minus items)
	1. Amount paid for repayment of long-term loan.
	2. Redemption of Preference share

1. Proceeds from Issue of equity Share capital.	capital in cash.
2. Proceeds from Issue of preference shares capital.	3. Redemption of Debenture in cash
3. Proceeds from taking long-term loan and issue of debentures.	4. Buy bank of Equity shares (Extra Ordinary Item)
4. Proceeds from Bank Overdraft and Cash Credit.	5. Payment of Bank Overdraft and Cash Credits
	6. Interest paid on long-term loan and debentures
	7. Final Dividend paid.
	8. Interim dividend paid.
	9. Dividend paid on Preference Shares

Note:

1. Bonus shares worth Rs. 5,00,000 issued to equity shareholder are not to be shown in the cash flow statement because there is no flow of cash by this activity.

2. If any other information is not given in the question about final dividend paid amount then the previous year proposed dividend is assumed as dividend payable in current year. Current year proposed dividend amount is assumed as proposed dividend in current year and to be added in operating activities to calculated net profit before tax and extraordinary item.

3. Previous year proposed dividend- unpaid dividend = Final dividend paid during the current year is cash used in financing activities.

Financing Business Enterprise Transaction Treatment in Cash Flow statement

Financing business enterprises are the business enterprises which deal in finance like investment companies, mutual fund house, banks. These enterprises purchase and sale of securities as their stock, so it is treated as operating activities and interest received, dividend received and interest paid are considered as routine business activities and included in their operating activities.

Comprehensive