



CASH FLOW STATEMENT

In the previous lesson, you have learnt various types of analysis of financial statements and its tools such as comparative statements, common size statement and trend analysis, etc. You have also learnt various kinds of accounting ratios such as liquidity, activity, profitability, solvency, etc. You have learnt that accounts are mainly maintained on accrual basis but cash also plays significant role. Cash is mainly generated for operating activities which is buying assets and discharging liabilities. Cash is also raised from the issue of shares and debentures or loans but adequate cash should be available for use in time and no cash should remain idle. For this another tool of analysis is used which is cash flow statement.. In this lesson, you will learn about cash flow statement and its methods of preparation.



OBJECTIVES

After studying this lesson, you will be able to :

- state the meaning of cash flow statement;
- explain objectives of cash flow statement;
- explain the method of preparing cash flow statement as per format;
- state the limitations of cash flow statement.

30.1 MEANING AND OBJECTIVES

Cash plays a very important role in the economic life of a business. A firm needs cash to make payment to its suppliers, to incur day-to-day expenses and to pay salaries, wages, interest and dividends etc. In fact, what blood is to a human body, cash is to a business enterprise. Thus, it is very essential for a business to maintain an adequate balance of cash. For example, a concern operates profitably but it does not have sufficient cash balance to

pay dividends, what message does it convey to the shareholders and public in general. Thus, management of cash is very essential. There should be focus on movement of cash and its equivalents. Cash means, cash in hand and demand deposits with the bank. Cash equivalent consists of bank overdraft, cash credit, short term deposits and marketable securities.

Cash Flow Statement deals with flow of cash which includes cash equivalents as well as cash. This statement is an additional information to the users of Financial Statements. The statement shows the incoming and outgoing of cash. The statement assesses the capability of the enterprise to generate cash and utilize it. *Thus a Cash-Flow statement may be defined as a summary of receipts and disbursements of cash for a particular period of time. It also explains reasons for the changes in cash position of the firm.* Cash flows are cash inflows and outflows. Transactions which increase the cash position of the entity are called as inflows of cash and those which decrease the cash position as outflows of cash. Cash flow Statement traces the various sources which bring in cash such as cash from operating activities, sale of current and fixed assets, issue of share capital and debentures etc. and applications which cause outflow of cash such as loss from operations, purchase of current and fixed assets, redemption of debentures, preference shares and other long-term debt for cash. In short, a cash flow statement shows the cash receipts and disbursements during a certain period. The statement of cash flow serves a number of objectives which are as follows :

- Cash flow statement aims at highlighting the cash generated from operating activities.
- Cash flow statement **helps in planning the repayment of loan** schedule and replacement of fixed assets, etc.
- Cash is the centre of all financial decisions. It is used as the basis for the projection of future investing and financing plans of the enterprise.
- Cash flow statement helps to ascertain the liquid position of the firm in a better manner. Banks and financial institutions mostly prefer cash flow statement to analyse liquidity of the borrowing firm.
- Cash flow Statement helps in efficient and effective management of cash.
- The management generally looks into cash flow statements to understand the internally generated cash which is best utilised for payment of dividends.





Notes

- Cash Flow Statement based on AS-3 (revised) presents separately cash generated and used in operating, investing and financing activities.
- It is very **useful in the evaluation of cash position** of a firm.

Cash and relevant terms as per AS-3 (revised)

As per AS-3 (revised) issued by the Accounting Standards Board

1. (a) Cash fund :

- Cash Fund includes
- (i) Cash in hand
 - (ii) Demand deposits with banks, and
 - (iii) cash equivalents.

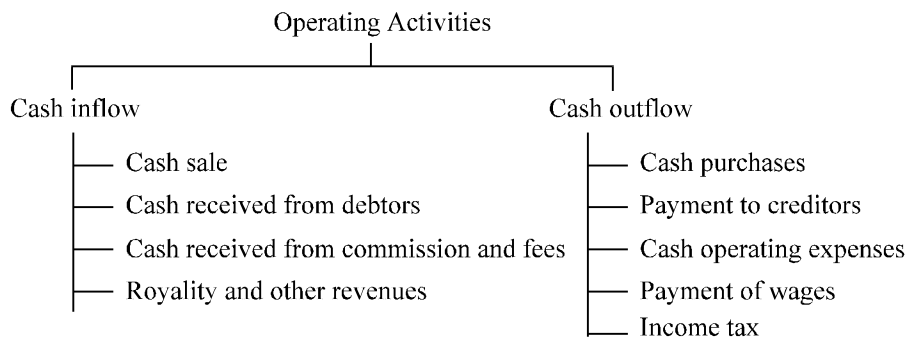
(b) Cash equivalents are short-term, highly liquid investments, readily convertible into cash and which are subject to insignificant risk of changes in values.

2. Cash Flows are inflows and outflows of cash and cash equivalents.

The statement of cash flow shows three main categories of cash inflows and cash outflows, namely : operating, investing and financing activities.

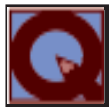
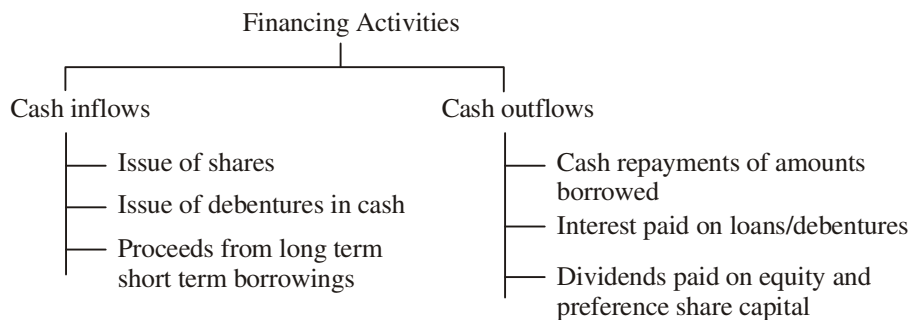
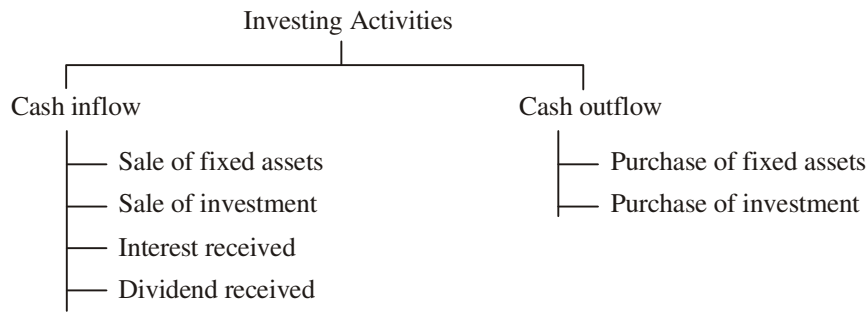
- (a) **Operating activities** are the principal revenue generating activities of the enterprise.
- (b) **Investing activities** include the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
- (c) **Financing activities** are activities that result in change in the size and composition of the owner’s capital (including Preference share capital in the case of a company) and borrowings of the enterprise.

As per AS-3 the inflow and outflow of cash are :





Notes



INTEXT QUESTIONS 30.1

Fill in the blanks with suitable word/words

- (i) Cash flow statement deals with flow of cash which includes cash and
- (ii) Cash flow statement is a statement.
- (iii) Cash flow statement shows cash and during a particular period.
- (iv) As per AS 3 (revised), cash fund includes cash, demand deposit with bank and

30.2 METHOD OF PREPARING CASH FLOW STATEMENT

There are two methods of preparing the Cash Flow Statement. Both methods give the same results in respect of the final total as well as sub-totals of the three sections – operating, investing and the financing. They differ only in the manner the information regarding cash flow from operating activities is presented.



Notes

● **Indirect Method**

**Format of Cash Flow Statement for the year ended
As per Accounting Standard - 3 (Revised)**

Particulars	xxx	Rs
(i) Cash flows from operating Activities	xxx	xxx
Net Profit as per Profit and Loss A/c or difference between closing balance and opening balance of Profit and Loss A/c		
Add : Transfer to reserve	xxx	
Proposed dividend for current year	xxx	
Interim dividend paid during the year	xxx	
Provision for tax made during the current year	xxx	
Extraordinary items, if any, debited to Profit and Loss A/c	xxx	xxx
	xxx	xxx
Less : Extraordinary Items, if any, credited to Profit and Loss A/c	xxx	
Refund of Tax credited to Profit and Loss A/c	xxx	xxx
		xxx
A. Net profit before taxation and Extra ordinary items Adjustment for Non-Cash and Non-Operating Items.		
B. Add :		
– Depreciation	xxx	
– Preliminary expenses	xxx	
– Discount on issue of shares and debentures written off	xxx	
– Interest on borrowings and debentures	xxx	
– Loss on sale of fixed assets	xxx	xxx
		xxx
C. Less :		
– Interest income/received	xxx	
– Dividend income received	xxx	
– Rental income received	xxx	
– Profit on sale of fixed asset	xxx	xxx
		xxx

Cash Flow Statement

D. Operating profits before working capital changes (A + B – C)	xxx	xxx
E. Decrease in current assets and increase in current liabilities		xxx
F. Less : Increase in current assets and decrease in current liabilities		xxx
G. Cash generated from operations (D + E – F)		xxx
H. Less : Income tax paid (Net tax refund received)		xxx
I. Cash flow from before extraordinary items		xxx
Adjusted extraordinary items (+/-)		xxx
J. Net cash from operating activities		xxx
(ii) Cash from investing accounting		
Add :		
– Proceeds from sale of fixed assets		xxx
– Proceeds from sale of investments		xxx
– Proceeds from sale of intangible assets		xxx
– Interest and dividend received		xxx
		xxx
Less :		
– Rent income	xxx	
– Purchase of fixed assets	xxx	
– Purchase of investment	xxx	
– Purchase of intangible assets like goodwill	xxx	xxx
		xxx
Advanced extraordinary items (+/-)		xxx
Net cash from (or used in) investing activities		xxx
		xxx
(iii) Cash flows from financing activities		
Add :		
Proceeds from issue of shares and debentures	xxx	
Proceeds from other long term borrowings	xxx	
	xxx	
Less :		
Final dividend fund	xxx	
Interim dividend fund	xxx	
Interest on debentures and loans paid	xxx	

MODULE - 6A

Analysis of Financial Statements



Notes



Notes

Repayment of loans	xxx	
Redemption of debenture preference shares	xxx	xxx
Adjust extraordinary items (+/-)	xxx	xxx
Net cash from (or used in) financing activities		xxx
		xxx
(iv) Net increase/Decrease in cash and cash equivalent (i + ii + iii)		xxx
(v) Add : cash and cash equivalents in the beginning of the year		
– cash in hand	xxx	
– cash at bank overdraft	xxx	
– short term deposit	xxx	
– marketable securities	xxx	
(vi) Less : cash and cash equivalents in the end of the year		
– cash in hand	xxx	
– cash at Bank (by bank overdraft)	xxx	
– short term deposits	xxx	
– Cash flow from operation	xxx	xxx
		xxx

● Direct method

Format for Cash flow Statement for the year ended As per Accounting Standard-3 (Revised)

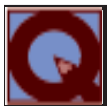
Particulars		Rs
(i) Cash flow from operating activities		
A. Operating cash receipts		
– Cash sales	xxx	
– Cash received from customers	xxx	
– Trading commission received	xxx	
– Royalties received	xxx	xxx
B. Less : Operating cash payment		
– Cash purchase	xxx	
– Cash paid to the supplier	xxx	
– Cash paid for business expenses like office expenses, Manufacturing expenses, selling and distribution expenses	xxx	xxx
C. Cash generated from operation (A – B)		xxx
D. Less Income tax paid (Net of tax refund received)		xxx
E. Cash flow before extraordinary items		xxx

Cash Flow Statement

F. Adjusted extraordinary items (+/-)/Receipt/payment	xxx
G. Net cash flow from (or used in) operating activities	xxx
(ii) Cash flow from investing activities (calculation same as under indirect method)	xxx
(iii) Cash flow from financing activities (Calculation same as under indirect method)	xxx
(iv) Net increase/decrease in cash and cash equivalents (i + ii + iii)	xxx
(v) Add cash and cash equivalent in the beginning of the year (same as under indirect method)	xxx
(vi) Less cash under cash equivalent in the end of the year	xxx
	xxx

Some facts about cash flow statement :

- (i) Only listed companies are required to prepare and present Cash flow statement.
- (ii) The Accounting period for the Cash Flow Statement is the same for which Profit and Loss Account and Balance Sheet are prepared.
- (iii) Cash flow items are as (a) Cash flow from operating activities : (b) Cash flow from investing activities (c) Cash flow from financing activities.
- (iv) Operating activities include revenue producing activities which are not investing and financing activities.
- (v) There are two methods of calculating cash flow from operating activities namely Direct method and Indirect method. SEBI (Securities Exchange Board of India) Guidelines recommend for only direct method.
- (vi) Extra ordinary Items : The Cash flow associated with extra ordinary items should be classified as arising from operating, investing financing activities. For example, the amount received from Insurance Company on account of Loss of Stock or loss from earthquake should be reported as cash flow from operating activities.



INTEXT QUESTIONS 30.2

Fill in the blanks with appropriate word/words.

- (i) Only companies prepare cash flow statement.
- (ii) There are two methods for calculating cash flow from operations i.e.
(i) Direct method (ii) method.

MODULE - 6A

Analysis of Financial Statements



Notes



Notes

- (iii) Cash flows are classified in to three i.e. operating activities, financing activities and activities.
- (iv) SEBI guidelines recommend only method for preparing cash flow statement.

30.3 PREPARATION OF CASH FLOW STATEMENT

(i) Operating Activities

Cash flow from operating activities are primarily derived from the principal revenue generating activities of the enterprise. A few items of cash flows from operating activities are :

- (i) Cash receipt from the sale of goods and rendering services.
- (ii) Cash receipts from royalties, fee, Commissions and other revenue.
- (iii) Cash payments to suppliers for goods and services.
- (iv) Cash payment to employees
- (vi) Cash payment or refund of Income tax.

Determination of cash flow from operating activities

There are two stages for arriving at the cash flow from operating activities

Stage-1

Calculation of operating profit before working capital changes, It can be calculated in the following manner.

Net profit before Tax and extra ordinary Items	xxx	
Add Non-cash and non operating Items		
which have already been debited to profit and Loss Account i.e.		
Depreciation	xxx	
Amortisation of intangible assets	xxx	
Loss on the sale of Fixed assets.	xxx	
Loss on the sale of Long term Investments	xxx	
Provision for tax	xxx	
Dividend paid	xxx	xxx
		xxx



Less : Non-cash and Non-operating Items which have already been credited to Profit and Loss Account i.e.

Profit on sale of fixed assets	xxx	
Profit on sale of Long term investment	xxx	xxx
Operating profit before working Capital changes.		xxx

Notes**Stage-II**

After getting operating profit before working capital changes as per stage I, adjust increase or decrease in the current assets and current liabilities.

The following general rules may be applied at the time of adjusting current assets and current liabilities.

A. Current assets

- (i) An increase in an item of current assets causes a decrease in cash inflow because cash is blocked in current assets.
- (ii) A decrease in an item of current assets causes an increase in cash inflow because cash is released from the sale of current assets.

B. Current liabilities

- (i) An increase in an item of current liability causes a decrease in cash outflow because cash is saved.
- (ii) A decrease in an item of current liability causes increase in cash out flow because of payment of liability.

Thus,

Cash from operations = operating profit before working capital changes + Net decrease in current assets + Net Increase in current liabilities – Net increase in current assets – Net decrease in current liabilities.

Illustration 1

The net Income reported in the Income Statement for the year was Rs. 110,000 and depreciation of fixed assets for the year was Rs. 44000. The balances of the current assets and current liabilities at the beginning and end of the year are as follows. Calculate cash from operating activities.



Notes

	End of the year Amount (Rs.)	Beginning of the year Amount (Rs.)
Current Items		
Cash	130,000	140,000
Debtors	200,000	180,000
Inventories	290,000	300,000
Prepaid expenses	15,000	16,000
Account payables	102,000	1,16,000

Solution

Cash from operating Activities

Details	Amount (Rs.)
Net Income	1,10,000
Adjustment for non cash and Non-operating items	
Add Depreciation	44,000
Operating Profit before working capital changes	154,000
Current Assets :	
Add : (a) Decrease in inventories	10,000
(b) Decrease in prepaid expenses	1000
	165,000
Deduct : (a) Increase in Debtors	(20,000)
Current liabilities	
(b) Decrease in Account payables	(14,000)
Net Cash flow from operating Activities	34,000
	131,000



Notes

Step - II**Investing Activities**

Investing Activities refer to transactions that affect the purchase and sale of fixed or long term assets and investments.

Examples of cash flow arising from Investing activities are

1. Cash payments to acquire fixed Assets
2. Cash receipts from disposal of fixed assets
3. Cash payments to acquire shares, or debenture investment.
4. Cash receipts from the repayment of advances and loans made to third parties.

Thus, Cash inflow from investing activities are

- Cash sale of plant and machinery, land and Building, furniture, goodwill etc.
- Cash sale of investments made in the shares and debentures of other companies
- Cash receipts from collecting the Principal amount of loans made to third parties.

Cash outflow from investing activities are :

- Purchase of fixed assets i.e. land, Building, furniture, machinery etc.
- Purchase of Intangible assets i.e. goodwill, trade mark etc.
- Purchase of shares and debentures
- Purchase of Government Bonds
- Loan made to third parties

Illustration 2

From the following information calculate the cash flow from investing activities

Particulars	Opening	Closing
Machinery (at cost)	400,000	420,000
Accumulated Depreciation	100,000	110,000
Patents	280,000	160,000



Notes

Additional Information :

- (i) During the year a machine costing Rs 40,000 with this accumulated depreciation Rs 24000 was sold for Rs 20,000
- (ii) Patents were written off to the extent of Rs 40,000 and some patents were sold at a profit of Rs 20,000

Solution.

Cash Flow from Investing Activities

Particulars	Rs
Inflow from sale of machinery	20,000
Inflow from sale of patent (2)	100000
	120000
Outflow on purchase of machinery (1)	(60000)
Net cash flow from investing activities	60000

Working notes

Machinery A/c

Balance b/d	400000	Bank (Inflow)	20,000
Profit and Loss A/c (Profit on sale of machine)	4000	Accumulated depreciation (Depreciation on machinery sold)	24000
Bank A/c	60000	Balance c/d	420000
	464000		464000

Patent A/c

Balance b/d	280000	Bank A/c (Inflow)	100000
Profit and Loss A/c (Profit)	20000	Balancing figure Profit and Loss A/c	40000 160000
	300000	Balance c/d	300000

Step- III

Financing Activities

The third section of the cash flow statement reports the cash paid and received from activities with non-current or long term liabilities and



shareholders Capital. Examples of cash flow arising from financing activities are

- Cash proceeds from issue of shares or other similar instruments.
- Cash proceeds from issue of debentures, loans, notes, bonds, and other short-term borrowings
- Cash repayment of amount borrowed

Cash Inflow from financing activities are

- Issue of Equity and preference share capital for cash only.
- Issue of Debentures, Bonds and long-term note for cash only

Cash outflow from financing activities are :

- Payment of dividends to shareholders
- Redemption or repayment of loans i.e. debentures and bonds
- Redemption of preference share capital
- Buy back of equity shares.

Illustration 3

From the following information. Calculate the Cash from financing activities:

	31.12.2006	31.12.2007
Particulars	Rs	Rs
Equity share capital	400,000	500,000
10% debentures	150,000	100,000
Securities premium	40000	50000

Additional Information : Interest paid on debentures Rs10000.

Solution. Calculation of Cash from financing activities

Particulars	Rs	
Cash proceeds from the issue of shares (Including premium)		110000
Interest paid on debenture	10000	
Redemption of debenture	50000	60,000
		50,000



Notes

Illustration 4

Classify the following into cash flows from operating activities investing activities financing activities

- (a) Cash sale of goods
- (b) Cash paid to suppliers of raw material
- (c) Cash payments of salaries and wages to employees.
- (d) Cash payment to acquire fixed assets
- (e) Cash proceeds from issues of shares at premium.
- (f) Payment of dividend
- (g) Interest received on investment
- (h) Interest on debenture
- (i) Payment of income tax
- (j) Cash payment of a long term loan

Solution**A. Cash Flow from operating Activities**

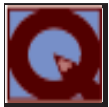
- (a) **Cash sale of goods :** Normal business activity of selling Inventories or goods (Cash inflow)
- (b) **Cash paid to suppliers** of raw materials
Routine payments for purchasing the goods (Cash outflow)
- (c) **Cash payment of salaries and wages :**
Cash payments to employees for their services in the office (Cash outflow)
- (i) **Payment of Income Tax :** Payment of tax on business Income (Cash outflow)

B. Cash Flow from investing Activities

- (a) **Cash payment to acquire fixed assets :** Purchase of long term assets (Cash outflow)
- (b) **Interest received on Investment :** it is an Income on Investment (Cash inflow)

**Notes****C. Cash Flow from financing Activities**

- (a) Cash proceeds from issuing shares at premium : (Cash inflow)
 - (b) **Payment of dividends** : It is related to issue of share capital, a (Cash outflow)
 - (c) **Interest paid on debentures** : Payment associated with loan capital (Cash outflow)
- (i) **Cash payment of a long term loan** : Redemption of loan or borrowed capital (Cash outflow)

**INTEXT QUESTIONS 30.3**

Classify the following items into (i) Operating (ii) Investing and Financing activities.

- (i) Refund of income tax
- (ii) Payment of dividend to shareholder
- (iii) Purchase of land and building
- (iv) Purchase of plant
- (v) Interest paid on debentures.

30.4 TREATMENT OF SPECIAL ITEMS**(i) Payment of Interim Dividends**

The following procedure is followed

- (i) The amount of interim dividend paid during the year is shown as outflow of cash in cash flow statement.
- (ii) It will be added back to the profits for the purpose of calculating cash provided from operating activities.
- (iii) No adjustment is necessary if the cash provided from operating activities is calculated on the basis of revised figure of net profit.

**Notes****(ii) Proposed dividend**

The dividend is always declared in the general meeting after the preparation of Balance Sheet. It is therefore, a non-operating item which should not be permitted to affect the calculation of cash generated by operating activities. Thus, the amount of proposed dividends would be added back to current years profit and payments made during the year in respect of dividends would be shown as an outflow of cash.

(iii) Share Capital

The increase in share capital is regarded as inflow of cash only when there is a increase in share capital. For example, if a company issues 10000 equity shares of Rs.10 each for cash only, Rs. 100,000 would be shown as inflow of cash from financing activities. Similarly, the redemption of preference share is an outflow of cash. But where the share capital is issued to finance the purchase of fixed assets or the debentures are converted into equity shares there is no cash flow. Further, the issue of bonus shares does not cause any cash flows.

(iv) Purchase or sale of fixed Assets

The figures appearing in the comparative balance sheets at two dates in respect of fixed assets might indicate whether a particular fixed asset has been purchased or sold during the year. This would enable to determine the inflows or outflows of cash. For example, If the plant and machinery appears at Rs 60,000 in the current year and Rs.50,000 in the previous year, the only conclusion, in the absence of any other information is that there is a purchase of fixed assets for Rs.10000 during the year. Hence, Rs.10000 would be shown as outflow of cash.

(v) Provision for Taxation

It is a non-operating expenses or an item of appropriation in the Income statement/Profit and Loss Account and therefore should not be allowed to reduce the cash provided from operating activities. Hence, if the profit is given after tax and the amount of the provision for tax made during the year is given, the same would be added back to the current year profit figure.

In the cash flow statement, the tax paid would be recorded separately as an outflow of cash. The item of provision for taxation, would not be treated as current assets.

Sometimes, the only information available about provision for taxation is two figures appearing in the opening balance sheet and closing balance



Notes

sheet. In such a case the figure in the opening balance sheet is treated as an outflow of cash while the figure in the closing balance sheet is treated as a non-cash and non-operating expense and thus is added back to net Income figure to find out the cash provided from operating activities.

Illustration 5

The comparative balance sheets of Bansal Private Limited at two different dates provide the following information.

	2006	2007
Assets	Amount (Rs)	Amount (Rs)
Plant and machinery	1350000	1440000

It is informed that depreciation amounting to Rs. 60,000 has been provided during the year. Find the changes that have taken place in the asset and also state their effect on cash flows.

Solution :

In order to identify the transaction affecting the asset account, the proper procedure is to prepare the plant and machinery account as shown below:

Plant and machinery Account

Particulars	Amount	Particulars	Amount
Balance b/d	1350000	Depreciation (given)	60,000
Bank A/c (New machine purchased)	150000	Balance c/d	1440000
	1500000		1500000

Note

- In the absence of specific information, it may be presumed that the additional machinery was purchased for Rs.1,50,000.
- The amount spent on the plant and machinery represents a reduction in the cash and its equivalent. It is, therefore, an example of outflow of cash.



Notes

Illustration 6

In the comparative balance sheet of Wilson Pvt., the position of Building Account is given as under.

	2006 Amount Rs.	2007 Amount Rs.	Assets	2006 Amount Rs.	2007 Amount Rs.
Liabilities					
Accumulated depreciation (Building)	700000	790000	Building	3840000	3910000

Additional Information

A part of the building of Rs.74,000 was sold for Rs.60,000. The accumulated depreciation on building sold was Rs.20,000 Analyse the transaction.

Solution

The different transactions affecting the building account are to be identified by preparing the following accounts :

Building Account

Dr		Cr.	
Particulars	Amount	Particulars	Amount
Balance b/d	3840000	Cash (Inflow)	60000
Profit and loss Account (gain on sale)	6000	Accumulated Depreciation A/c	20000
Bank A/c			
Purchase (outflow)	144000	Balance c/d	3910000
	3990000		3990000

Accumulated Depreciation Account

Dr		Cr.	
Particulars	Amount	Particulars	Amount
Building A/c	20000	Balance b/d	700000
Balance c/d	790000	Profit and Loss A/c	110000
	810000		810000



Notes

Note

- The gain on sale of building (i.e. Rs 6000) would be deducted from the reported Income (or profit)
- Purchase of building for Rs.144,000 is identified from the balancing figure in the Building account as an outflow of cash.
- Rs.110,000 a charge to Profit and Loss Account is non-cash expenses and would be added back to the reported net income (profit)

Illustration 7

The following information is given to you about the provision for taxation for 2006 and 2007 of M/s Gill Private (Pvt) Limited (Ltd.).

Liabilities	2006 Rs	2007 Rs
Provision for taxation	15000	20000

Net Income for the year 2006 is Rs.50,000

How would you deal with this item assuming it as non-current liability?

Solution

Provision for the year 2006 is an outflow of cash.

Provision for the 2007 shall be dealt with as follows

	Rs.
Net Income for the 2007	50,000
Add provision for Taxation for 2007	<u>20000</u>
Cash provided from operating activities	<u>70,000</u>

Illustration 8

The following relevant Information is obtained from the book of Venugopalan Limited (Ltd.).

Liabilities	2006 Rs	2007 Rs
Provision for Taxation	50000	70000

The amount of tax paid during 2007 amounted to Rs.40000. How would you deal with this item presuming to be non current? You are also given net profit after taxation was Rs.80000.



Notes

Solution

To solve this problem, one should find out the amount of provision for tax charged to Profit and Loss Account in the year 2007.

Provision for Taxation Account

Dr		Cr	
Particulars	Amount Rs.	Particulars	Amount Rs.
Bank (payment)	40,000	Balance b/d	50000
Balance c/d	70000	Profit and loss A/c (Balances Figure)	60000
	110000		110,000

- (i) Rs. 40000 is an outflow of cash
- (ii) Cash provided from operating activities will be calculated as

Net Income after taxation	80000
Add: Provision for taxation treated as non-cash expense	60,000
	140,000

Illustration 9

The following comparative balance sheets contain the relevant information about provision for taxation.

Liabilities	2006 Rs.	2007 Rs.
Provision for Taxation	20000	30000

You are informed that Rs. 50,000 was charged to Profit and Loss Account for the year 2007. Ascertain how much cash was used.

Solution

Provision for Taxation Account

Dr		Cr	
Particulars	Amount Rs	Particulars	Amount Rs
Bank (Balancing figure)	40000	Balance b/d	20000
Balance c/d	30000	Profit and Loss Account	50000
	70000		70000

**Note :**

- Rs. 40,000 would be shown as an outflow of cash
- Rs. 50,000 would be treated as non cash expense and added back to net Income figure to compute cash provided from operations.

Notes**Illustration 10**

From the summarised cash account of ABC Limited (Ltd.) prepare cash flow statement for the year ended 31st December 2006 in accordance with AS-3 (Revised) using the direct method and indirect method. The company does not have any cash equivalents :

Summarised Cash A/c

Particulars	Amount (Rs. 000)	Particulars	Amount (Rs. 000)
Balance on 1.1.2006	50	Payment to Suppliers	2000
Issue of equity shares	300	Purchase of fixed assets	200
Receipts from customers	2800	Overhead expenses	200
Sale of fixed assets	100	Wages and salaries	100
		Taxation	250
		Dividend	50
		Repayment of Bank Loan	300
		Balance on 31.12.2006	150
	3250		3250

Additional information : Net profit before tax for the year 2006 was Rs 500000.

Solution :

**Cash flow statement of ABC Ltd
for the year ended 31st December 2006 (Indirect method)**

	Rs 000	Rs 000
A. Cash flow from operating activities		
Net profit before tax	500	
Income tax paid	(250)	
Net cash from operating activities		250



Notes

B. Cash flow from investing activities		
Purchase of fixed assets	(200)	
Sale of fixed assets	100	
Net cash used in investing activities		(100)
C. Cash flow from financing activities :		
Issue of equity shares	300	
Repayment of bank loan	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash (A+B+C)		100
(Net cash inflow from activities)		

**Cash Flow Statement (Direct Method) of ABC Ltd.
for the year ended 31st December 2006**

	Rs 000	Rs 000
A. Cash flows from operating activities		
Cash receipts from customers	2800	
Cash payments to suppliers	(2000)	
Cash paid for wages and salaries	(100)	
Cash paid for overhead expenses	(200)	
Income tax paid	(250)	
Net cash from operating activities		250
B. Cash flows from investing activities		
Purchase of fixed assets for cash	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
C. Cash flows from financing activities		
Proceeds from issue of equity shares	300	
Payment of bank loan	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash (A+B+C)		100
i.e. Net cash from activities		
Cash at the beginning		50
Cash at the end		150

**Illustration 11**

From the following Information, you are required to prepare the cash flow statement of Classic Ltd. for the year ended 31st March (both methods) :

**Balance Sheets
as at 31st March**

Liabilities	2005 Rs.	2006 Rs.	Assets	2005 Rs.	2006 Rs.
Share Capital	70,000	70,000	Fixed Assets	50,000	91,000
Secured Loans	-	40,000	Inventory	15,000	40,000
Creditors	14,000	39,000	Debtors	5,000	20,000
Tax payable	1,000	3,000	Cash	20,000	7,000
Profit & Loss A/c	7,000	10,000	Prepaid expenses	2,000	4,000
	92,000	162,000		92,000	1,62,000

**Profit and loss Account
for the year ended 31st March 06**

Dr.

Cr.

Particulars	Amount Rs.	Particulars	Amount Rs.
Opening Stock	15,000	Sales	100,000
Purchases	98,000	Closing Inventory	40,000
Gross profit c/d	27,000		
	1,40,000		1,40,000
General Expenses	11,000	Gross profit c/d	27,000
Depreciation	8,000		
Provision for tax	4,000		
Net Profit c/d	4,000		
	27,000		27,000
Dividend (interim)	1,000	balance b/d	7,000
balance c/d	10,000	Net profit b/d	4,000
	11,000		11,000



Creditors A/c

Dr.		Cr.	
Particulars	Amount Rs.	Particulars	Amount Rs.
Cash A/c (Bal. Fig.)	73,000	Balance b/d	14,000
Balance c/d	39,000	Purchases A/c	98,000
	1,12,000		1,12,000

Notes

Fixed Assets A/c

Particulars	Amount Rs		Amount Rs
Balance b/d	50,000	Depreciation	8,000
Purchase of fixed asset	49,000	Balance c/d	91,000
	99,000		99,000

**Cash flow Statement (Indirect Method)
For the year ended march, 31, 2006**

Particulars	Rs.
(A) Cash flow from Operating Activities :	
Net profit as per Profit and Loss A/c	4,000
Add : Provision for Tax (See provision for Tax Account)	4,000
Net profit be fore Tax	8,000
Add : Depreciation	8,000
Operating profit before working	
Capital Changes	16,000
Add : Decrease in Current Assets or	
Increase in Current liabilities	
Increase in Creditors	25000
Less : Increase in current assets or	
Decrease in Current liabilities	
Increase in Debtors	(15000)
Increase in Inventory	(25000)
Increase in prepaid expenses	(2,000)
Cash from Operating Activities	(1,000)
Taxes paid	(2,000)
Net cash from Operating Activities	(3,000)



Notes

(B) Cash flow from Investing Activities :		
Purchase of Fixed Assets (See fixed assets)	(49000)	
Net cash used in Investing Activities		(49000)
(C) Cash Flow from financing Activities		
Proceeds from Raising Secured loan	4000	
Dividend paid	(1000)	
Net Cash flow from Financing Activities	39000	
Net Decrease in Cash a Cash equivalent		(13000)

Working Notes :

1. Fixed Assets A/c

Particulars	Amount Rs.	Particulars	Amount Rs.
Balance b/d	50,000	Depreciation A/c (Given)	8,000
Cash A/c (Purchases) (Bal. fig.)	49,000	Balance C/d	91,000
	99,000		99,000

2. Provision for Tax Account (Tax Payable A/c)

Dr.		Cr.	
Particulars	Amount Rs.	Particulars	Amount Rs.
Cash A/c (Tax paid) (Bal Fig)	2,000	Balance C/d (Given)	1,000
Balance c/d (Given)	3,000	Profit & loss A/c (Provision made during the year)	4,000
	5,000		5,000

Limitations of cash flow statement

Though it is true that cash flow statement is very useful now-a-days and serves many purposes. But it is necessary to take certain precautions while making use of this important tool. The reason is that misleading conclusions might be found by not properly relating net income figure to the cash flow. Some of the significant limitations of Cash Flow Statement are given below:

- It is very difficult to precisely define the term ‘cash’
- There are controversies over a number of items like cheques, stamps, postal orders etc. to be included in cash or not.

- As the present business moves from the cash basis to accrual basis, the prepaid and credit transactions might be represented an increase in working capital and it would be misleading to equate net income to cash flow because a number of non cash items would affect the net income.



INTEXT QUESTIONS 30.4

Fill in the blanks with suitable word/words

- (i) Provision for taxation is expenses.
- (ii) Increases in share capital is
- (iii) purchase of fixed assets is
- (iv) Decrease in share capital is
- (v) Sale a fixed assets is
- (vi) Issue of debentures is



WHAT YOU HAVE LEARNT

- Cash flow statement deals with flow of cash which includes cash equivalent as well as cash.
- Cash flow statement is a summary of cash receipts and disbursements during a certain period.
- Cash flow statement is prepared as per AS-3 (Revised).
- There are two methods for preparing cash flow statement : (i) Direct method (ii) Indirect method.
- Cash flow statement shows three categories of cash inflows and outflows i.e. (i) Operating activities (ii) Investing activities (iii) Financing activities
- Operating activities are the revenue generating activities of the enterprise.
- Investing activities constitute the acquisition and disposal of long term assets and other investments not included in cash and its equivalents.
- Financing activities are activities that result in change in the size and composition of the share capital and borrowings of the enterprise.
- The cash flows from extraordinary items are to be stated separately as arising from operating, investing and financing activities.



Notes



Notes



TERMINAL QUESTIONS

1. What do you mean by Cash Flow Statement? State main objectives of cash flow statement.
2. Define cash as per AS-3 (revised). How the various activities are classified as per AS-3 revised while preparing cash flow statement.
3. Give three examples of operating activities.
4. Give two examples of investing activities.
5. Presented below is the comparative balance sheets of Anjali Ltd. as on 31st March 2007

Details	2007 Amount (Rs)	2006 Amount (Rs)
Cash	40000	57000
Account Receivables	77000	64000
Inventory	132000	140000
Prepaid expenses	12140	16540
Land	125000	150000
Equipment	200000	175000
Accumulated Depreciation (Equipment)	(60000)	(42000)
Building	250000	250000
Accumulated Depreciation (Building)	(75000)	(50000)
	701140	760540
Account payables	33000	45000
Bond payables	235000	265000
Equity share capital (Rs 10 per share)	280000	250000
Retained earnings	153140	200540
	701140	760540



ANSWERS TO INTEXT QUESTIONS

Intext Questions 30.1

- | | |
|---------------------------------|----------------------|
| (i) Cash equivalents | (ii) financial |
| (iii) Cash inflow, cash outflow | (iv) Cash equivalent |

Intext Questions 30.2

- | | |
|-----------------|---------------|
| (i) listed | (ii) indirect |
| (iii) investing | (iv) Direct |

Intext Questions 30.3

- | | |
|----------------------------|---------------------------|
| (i) Operating activities | (ii) Financing activities |
| (iii) Investing activities | (iv) Investing activities |
| (v) Investing activities | |

Intext Questions 30.4

- | | |
|--------------------|-------------------|
| (i) Non operating | (ii) Cash inflow |
| (iii) Cash outflow | (iv) Cash outflow |
| (v) Cash inflow | (vi) Cash inflow |



Activity

Visit the office of a joint stock company and study the cash flow statement prepared by the company. Prepare a list of already possible items (two each) that may increase and decrease the fund from

- Operating activities
- Investing activities
- Financing activities

Activity		
Operating	1.	1.
	2.	2.
Investing	1.	1.
	2.	2.
Financing	1.	1.
	2.	2.

Notes

