

INTRODUCTION

Cash Flow Statement is an integral Part of Financial Statements. It is a Statement which discloses Changes in Cash and Cash equivalents between two periods outlining the reason for such inflows or outflows.

PRESENTATION OF A STATEMENT OF CASH FLOWS

↓
 Report Cash flows (inflows & Outflows) during the period.

↓
 Classified as:

- (1) **Operating Activities:** These are the principal revenue Producing activities and activities which cannot be classified as investing or financing activities.
- (2) **Investing Activities:** Investing activities are the purchase and Sale of long-term Assets & other investments which are not Cash equivalent.
- (3) **Financing Activities:** These activities result in changes in owner's capital, Preference Capital & Borrowings of the entity.

A separate disclosure of major classes of gross receipts & payments must be made.

CASH & CASH EQUIVALENT

- (a) **Cash** It comprises cash on hand & demand deposit with Bank.
- (b) **Cash Equivalent:** Short term, highly liquid investment that are readily convertible into known amounts of cash & (Equity Shares are liquid but not convertible into known amounts of cash) are subject to insignificant risk of changes in value & has short maturity of say 3 months or less from acquisition date (not Balance Sheet date).

REPORTING OF CASH FLOWS FROM OPERATING ACTIVITIES

(A) DIRECT METHOD:

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 Major classes of gross Cash receipts & payments are disclosed

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 Not allowed to listed Co.

Receipt & Payment approach

P/L Approach

We convert every item of P/L, relating to operating activity from **Accrual to Cash Basis** by making adjustments for changes during the period in inventories and receivables & payables, other non-cash items like depreciation, provisions, etc.

(B) INDIRECT METHOD:

In order to find cash flow from operating Activities we have to do following adjustments to Net Profit after Tax

1. Add back **provision for Tax** and deduct Amount of Tax paid.
2. Adjustment for **non-cash items**.
3. Adjustments for doing **regrouping** for financing and investing activity items like interest, dividend.
4. Adjustment for **working capital changes** (Only relating to Operating items).

EXAMPLES OF CASH FLOWS

(A) Operating Activities:

Cash flows from operating activities are primarily derived from the principal revenue producing activities of the enterprise. Examples of cashflows from operating activities are:

- i. Cash receipts from sales and services.
- ii. Cash receipts from royalties, fees, and commissions.
- iii. Cash payments to suppliers.
- iv. Cash payments to employees.
- v. Cash receipts and payments for insurance (premiums, claims).
- vi. Income tax payments/refunds **(not linked to financing/investing)**.
- vii. Receipts/payments related to trading financial contracts (futures, options).
- viii. Enterprise holding securities and loans for dealing or trading purposes.
- ix. Financial Enterprises: Cash advances and loans are operating activities.
- x. Asset Sales: Cash flows from selling items like plant machinery are investing activities, despite gains/losses impacting net profit.

(B) Investing Activities:

Examples of cash flow from investing activities are:

- a. Payments to acquire fixed assets (including intangibles, capitalized R&D costs, self-constructed fixed assets).
- b. Receipts from disposal of fixed assets (including intangibles).
- c. Payments to acquire shares, warrants, debt instruments, and interests in joint ventures (excluding those considered cash equivalents or for dealing/trading purposes).
- d. Receipts from disposal of shares, warrants, debt instruments, and interests in joint ventures **(excluding those considered cash equivalents or for dealing/trading purposes)**.
- e. Cash advances and loans made to third parties (excluding those by financial enterprises).
- f. Interest Received.
- g. Dividend Received.

(C) Financing Activities:

- (a) Cash proceeds from issue of shares, debentures, loans, Bonds, commercials paper etc.
- (b) Repayments if Borrowings.
- (c) Dividend Payment.
- (d) Interest Payment.
- (e) Buy Back of Shares.

ADJUSTMENTS FOR PROBLEM SOLVING

(1) Treatment of Changes In Working Capital In Cash Flow Statement

Sr. No.	Particulars	Treatment
1.	Increase in Current Asset	Deduct difference between Opening and Closing Balance.
2.	Decrease in Current Asset	Add difference between Opening and Closing Balance
3.	Increase in Current Liability	Add difference between Opening and Closing Balance
4.	Decrease in Current Liability	Deduct difference between Opening and Closing Balance

Tip to remember: **Inverse relationship** for current Asset and **Positive relationship** for Current Liability.

Important: Change in Working Capital is considered **only for items of operating Activities**. E.g. change in Interest accrued but not due is not considered as it is item of FA.

(2) Profit and Loss Appropriation A/c (To find Net Profit)

Particulars	₹	Particulars	₹
To General Reserve (Transfer)*	.....	By Balance b/d	.....
To Interim Dividend	.....	By Profit & Loss A/c	.....
To Final Dividend of last year	.....	(Profit After Tax during year)	
To Balance c/f	.....	
Total	.....	Total	.....

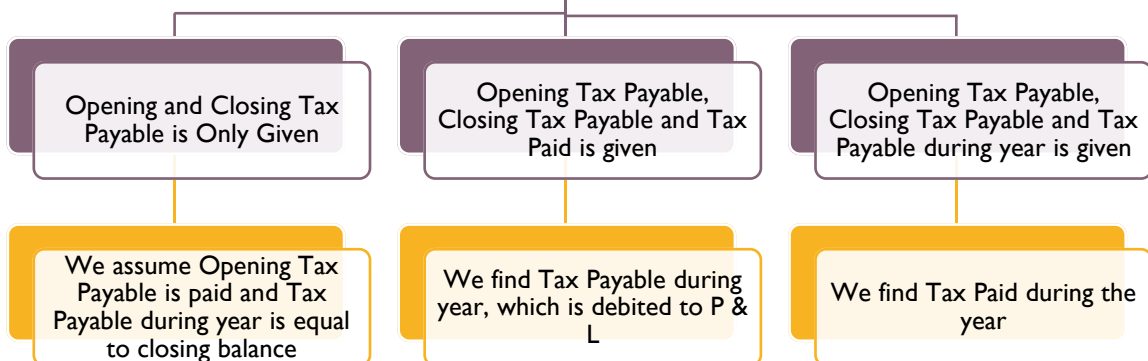
* Sometimes we may have to prepare Reserves Account first to identify amount transferred from Appropriation to Reserves Account. **This is true in case of Bonus issue, creation of CRR etc.**

(3) Income Tax Adjustment

PBT = PAT + Provision for Tax created during year.

Provision for Tax A/c (Simply Tax Payable A/c)

Particulars	Amount (₹)	Particulars	Amount (₹)
To Tax paid		By Balance b/d	.....
- Advance Tax	(Opening Tax payable)	
- TDS	By P&L	.....
- Self Assessment Tax	(Tax payable for year)	
To P&L	By P&L	.....
(Excess Provision for earlier years)		(Short provision for earlier year)	
To Balance c/f		
(Tax payable at year bed)			

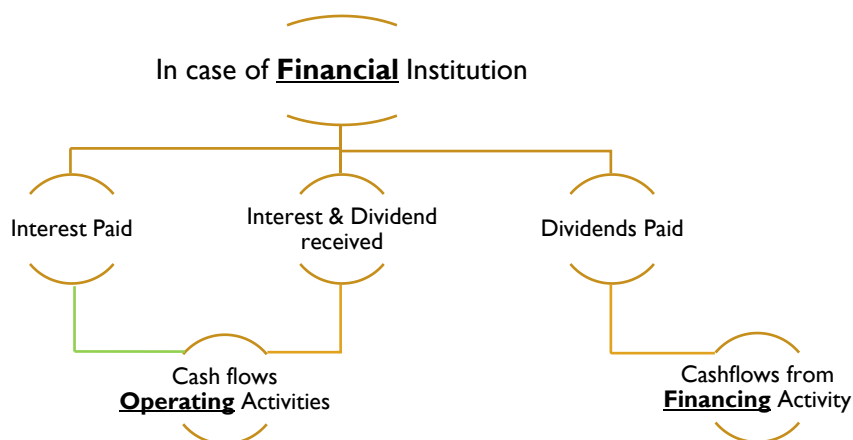
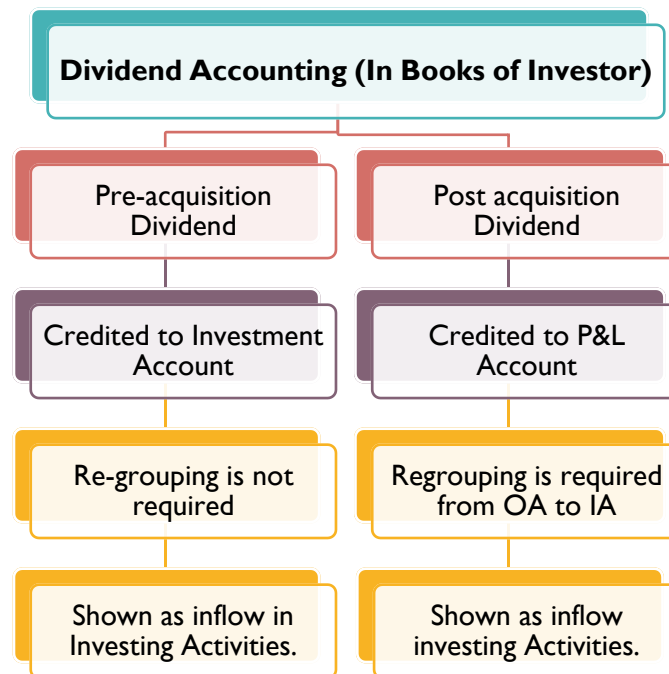
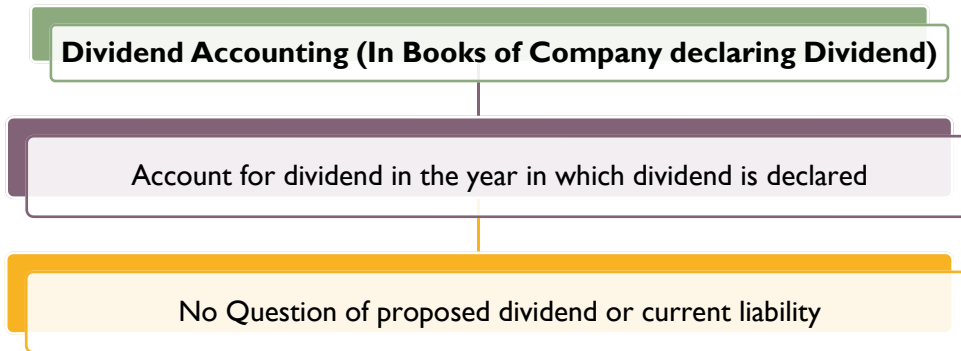
Exam Situations for Tax

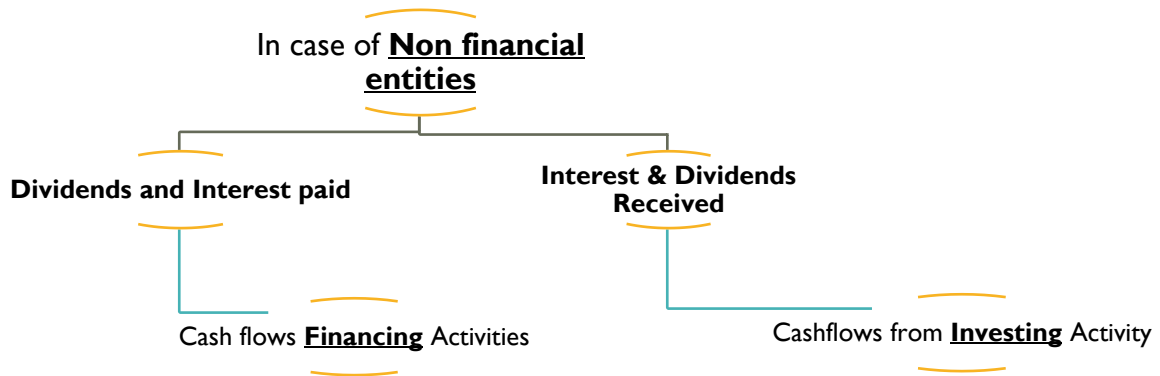
- **Taxes paid are usually classified as Cashflows from Operating Activities. However, if question specifically mentions tax paid from particular activity, like capital gain Tax paid, then take that tax paid under respective activity.**

(4) Investment Account**Investment A/c to find investment purchased & sold**

Particulars	Amount	Particulars	Amount
To Bal. b/d	By Bank (Investment Sold)	.....
To Bank (Investment Purchased)	By Bank (Pre-acquisition dividend)	.....
To P&L (Profit on Sale)	By P&L (Loss on Sale)	.....
To Capital Reserve (Profit)	By Balance c/d	.....
Total	Total	.....

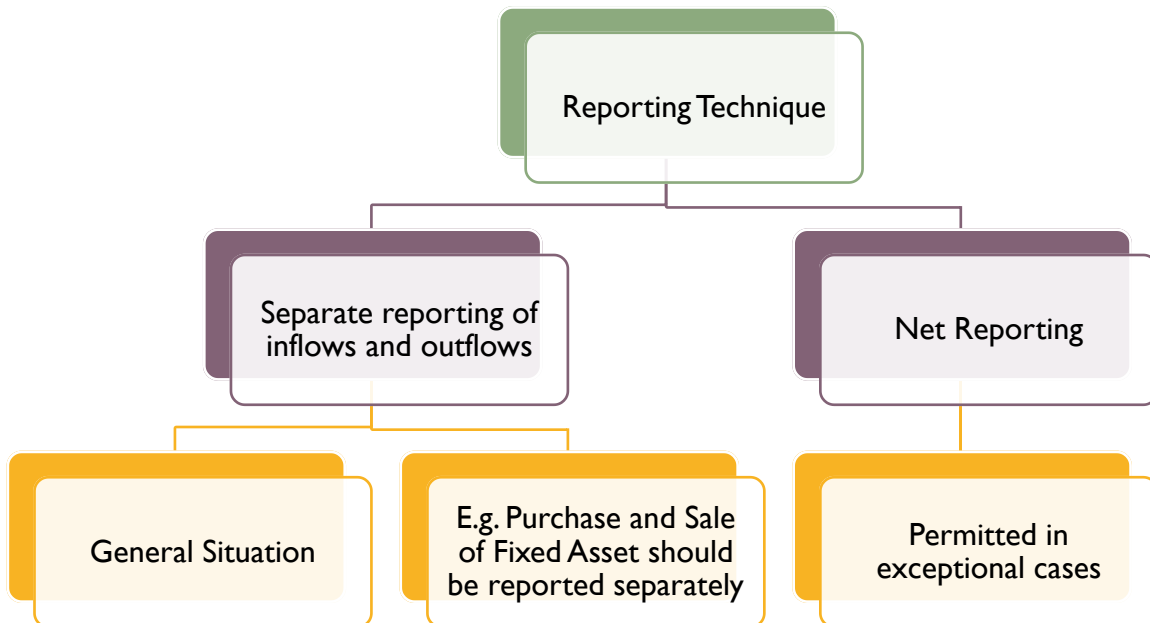
(5) Treatment of Interest and Dividend

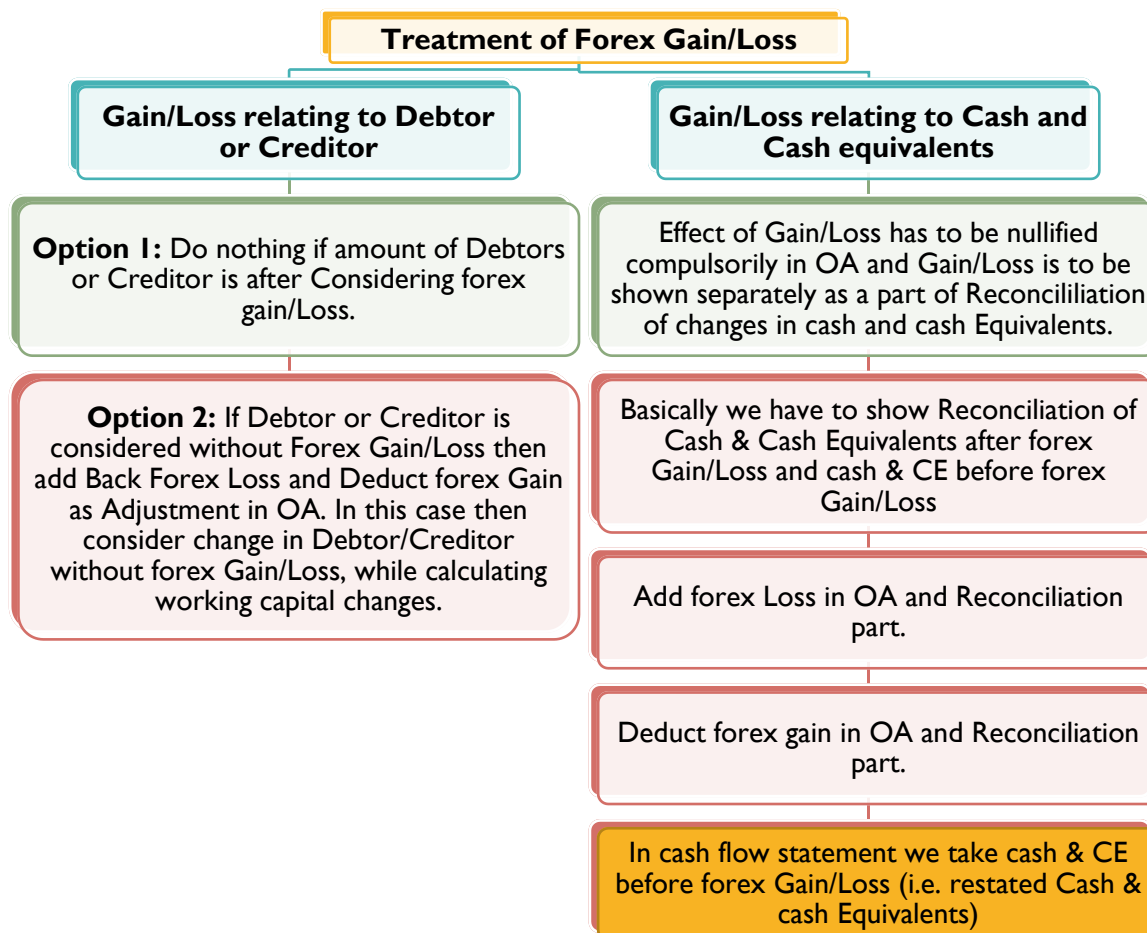




Final Dividend	Interim Dividend
It is proposed by Directors and approved by Shareholders in AGM.	It is paid between two AGM's
It remains unpaid as on Balance-Sheet date. But it is not shown as liability in Balance Sheet.	It is paid as on Balance-Sheet date.
Final Dividend is accounted for in the year in which dividend is declared.	Interim Dividend is accounted for in the year in which dividend is declared.

(6) Reporting Cash Flow on Net Basis



(7) Forex Gain/Loss Treatment**(8) Group Investments and Extra ordinary Items**

- ☞ The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as Investing Activities.
- ☞ Extra ordinary items should be classified as OA, IA, FA as appropriate and be disclosed separately.

(9) Redemption of Debentures/Preference Shares

Sr. No.	Transaction	Entry
1.	Face Value payable	11% Debenture/Pref. Shares Dr. To Debenture/Pref. Shares holders A/c
2.	Premium Payable	Premium on Redemption of Debenture/Pref. shares Dr. To Debenture holders/A/c Pref. shareholders
3.	Cash Paid	Debenture holders or Pref. shareholders Dr. To Cash / Bank

Sr. No.	Transaction	Entry
4.	Write off of Premium	Securities Premium A/c. Dr. Profit & Loss A/c. Dr. To Premium on Redemption of Debenture A/c.
5.	Transfer to CRR (For Pref. shares)	Respective Divisible Profits Dr. To Capital Redemption Reserve A/c.

Notes:

- If entry No. 4 is not passed then premium on redemption of debenture will appear on Asset side under the heading Misc. expenditure. If it is not appearing on Asset side it means premium has been written-off. **We add back Premium as adjustment in OA only if it is debited to P&L Account.**
- If Preference shares are redeemed out of Divisible profits then amount to that extent is required to be transferred to CRR as per Sec. 55. **In this case remember to prepare reserves Account first to find profit transferred to Reserves from P&L Appropriation Account.**

(10) Entries under provision for Dep. Method.

Sr. No.	Transaction	Entry
1.	Providing Depreciation	Dep. A/c. Dr. To Prov. for Dep. A/c.
2.	Transfer of cost on sale of Asset	Asset Disposal A/c. Dr. To Asset A/c.
3.	Transfer of Accumulated Depreciation	Prov. for Dep. A/c. Dr. To Asset Disposal A/c.
4.	Profit on Sale of Asset	Asset Disposal A/c. Dr. To P & L A/c
5.	Loss on sale of Asset	P & L A/c. Dr. To Asset Disposal A/c.

Notes:

- Asset A/c has Debit Balance whereas Provision for Dep. has credit Balance.
- Asset Disposal A/c gets closed.
- Dep. A/c Balance is transferred to P & L and not provision for Depreciation Account Balance.

HEADLINES

- Income Tax paid is shown as outflow separately in cash flow statement hence **we don't consider income tax provision as item of current liability.**
- Profit/ loss on sale of Asset = Sale price - WDV of Asset
- Profit on sale of Asset is cash flow from investing activity, however it is credited to the P & L and considered as Income in P & L hence it is deducted in Operating Activities and taken to investing activities.
- Dividend paid is financing Activity while dividend received is investing activity.
- Entries at the time of sale under provision for depreciation method.
 - Transfer of Cost
 - Transfer Accumulated Depreciation
 - Record received cash
 - Record profit / loss.
- Whenever depreciation is not given in Profit & Loss find out by comparing Balance Sheet, and by Preparing Asset Account.
- Loss on sale of Asset is non-cash item but **profit on sale of Asset is regrouping item** since it is received in cash.
- Whenever provision for tax made during year is not given assume opening provision is paid completely and closing Balance relates to current years provision.
- **If premium on redemption of Debentures is appearing in Balance Sheet asset side** it means it is not written off against divisible profits or securities premium. Don't add back such premium in Operating Activities.
- If Debentures are assumed to have been redeemed at Beginning, then interest would be calculated on closing Balance.
- If profit on sale of asset / investment is directly **transferred to Capital reserve / general reserve** then it will not be deducted from Profit After Tax in calculating Cash flow from operating Activities.
- Trade investments are necessary for business. Hence if there is sale it is treated as inflow from operating activity. Regrouping adjustment is not necessary. Change in Trade investment is treated as change in current Asset.
- Treatment of Govt. Grant Received: Govt. Grant may be Revenue Grant or Capital Grant. **A Revenue Grant is operating Activity, whereas capital Grant is financing Activity.** Grant recognised in P&L is Revenue Grant.



