

KEY CONCEPTS

■ Cash equivalents ■ Cash inflow ■ Cash outflow ■ Operating activities ■ Investing activities ■ Financing activities

Learning Objectives

To understand:

- Meaning of Cash Flow Statement
- Utility and limitations of cash flow analysis
- Operating activities, investing activities and financing activities
- Transactions effecting inflow and outflow of cash
- Method of preparation of cash flow statement
- Objectives and uses of cash flow statement
- How to Analyze the information in Cash Flow Statement

Lesson Outline

- Introduction
- Utility of Cash Flow Analysis
- Meaning of certain terms used in the context of Cash Flow Statement
- Classification of Cash Flow Statement
- Preparation of Cash Flow Statement
- Cash Flow from Operating Activities
- Cash Flow from Investing Activities
- Cash Flow from Financing Activities
- Format of Cash Flow Statement
- Limitations of Cash Flow Statement
- How to Interpret A Cash Flow Statement
- Lesson Round-Up
- Test Yourself
- List of Further Readings

INTRODUCTION

Cash flow statement, which shows inflows and outflows of the cash and cash equivalents. This statement is usually prepared by companies which come as a tool in the hands of users of financial information to know about the sources and uses of cash and cash equivalents of an enterprise over a period of time from various activities of an enterprise. It has gained substantial importance in the last decade because of its practical utility to the users of financial information.

This statement reports a net cash inflow or net cash outflow for each activity and for the overall business. It also reports from where cash has come and how it has been spent. It explains the causes for the changes in the cash balance. In substance, the cash flow statement summarises a myriad of specific cash transactions into a few categories for a business entity. The statement of cash flows reports the cash receipts, cash payments, and net changes in cash resulting from operating, investing and financing activities of an enterprise during a period in a format that reconciles the beginning and ending cash balances.

Applicability

The applicability of Cash flow statement has been defined under the Companies Act, 2013. As per the definition in the act, a financial statement includes the following:

- i. Balance sheet
- ii. Profit and loss account / Income and expenditure account
- iii. Cash flow statement
- iv. Statement of changes in equity
- v. Explanatory notes

Financial Statements are defined in Companies Act, 2013 (Section 2 (40)) and includes Cash Flow Statement prepared in accordance with Accounting Standard- 3 (AS-3) i.e. Cash Flow Statement.

As per AS 3:

For Companies - As per the Companies Act, 2013, Cash Flow Statement is required to be prepared by every company except a one person, small and dormant company.

For non-companies - AS 3 is not mandatory for entities falling in Level II and Level III.

UTILITY OF CASH FLOW ANALYSIS

A Cash flow statement shows inflow and outflow of cash and cash equivalents from various activities of a company during a specific period. The primary objective of cash flow statement is to provide useful information about cash flows (inflows and outflows) of an enterprise during a particular period under various heads, i.e., operating activities, investing activities and financing activities. This information is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation.

A cash flow statement is useful for short-term planning. A business enterprise needs sufficient cash to meet its various obligations in the near future such as payment for purchase of fixed assets, payment of debts maturing

in the near future, expenses of the business, etc. A historical analysis of the different sources and applications of cash will enable the management to make reliable cash flow projections for the immediate future. It may then plan out for investment of surplus to meet the deficit, if any. Thus, a cash flow analysis is an important financial tool for the management. Its chief advantages are as follows:

<p>1. Helps in efficient cash management: Cash flow analysis helps in evaluating financial policies and cash position. Cash is the basis for all operations; hence a projected cash flow statement will enable the management to plan and coordinate the financial operations properly. The management can know how much cash is needed, from which source it will be derived, how much can be generated internally and how much could be obtained from outside.</p>
<p>2. Helps in internal financial management: Cash flow analysis provides information about funds which will be available from operations. This will help the management in determining policies regarding internal financial management, e.g., possibility of repayment of long-term debts, dividend policies and planning the replacement of plant and machinery.</p>
<p>3. Discloses the movements of cash: Cash flow statement discloses the complete story of cash movement. The increase or decrease in cash, and the reasons therefore can be known. It discloses the reasons for low cash balance in spite of heavy operating profits or for heavy cash balance in spite of low profits. However, comparison of original forecast with the actual results highlights the trends of movements of cash which may otherwise go undetected.</p>
<p>4. Discloses success or failure of cash planning: The extent of success or failure of cash planning can be known by comparing the projected cash flow statement with the actual cash flow statement so that necessary remedial measures can be taken.</p>
<p>5. Evaluate management decisions: The statement of cash flows reports the companies' investing and financing activities and thus gives the investors and creditors about cash flow information for evaluating managers' decisions.</p>
<p>6. Show the relationship of net income to changes in the business cash: Usually cash and net income move together. High levels of income tend to lead to increase in cash and vice-versa. However, a company's cash balance can decrease when its net income is high, and cash can increase when income is low. The users want to know the difference between the net profit and net cash provided by operations. The net profit shows the progress of the business during the year while cash flow relates more to the liquidity of the business. The users can assess the reliability of net profit with the help of cash flow statement.</p>
<p>7. Efficiency in cash management: Cash flow analysis helps in evaluating financial policies and cash position. It facilitates the management to plan and co-ordinate the financial operations properly. The management can estimate how much funds are needed, from which source they will be derived, how much can be generated internally and how much should be arranged from outside.</p>

MEANING OF CERTAIN TERMS USED IN THE CONTEXT OF CASH FLOW STATEMENT

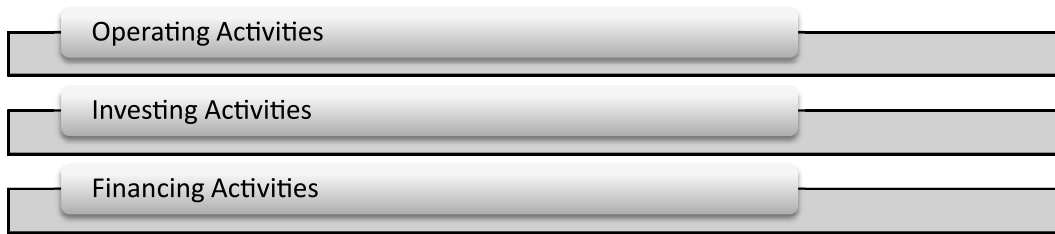
Cash: Cash comprises cash in hand and demand deposits with banks. Demand deposits mean those deposits which are repayable by bank on demand by the depositor.

Cash equivalents: Cash equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value. Cash equivalents are held for the purpose of meeting short term cash commitments rather than for investments or other purposes. Examples of cash equivalents are treasury bills, commercial paper etc. Investments in shares are excluded from cash equivalents unless they are in substance cash equivalents, for example preference shares of a company acquired shortly before their specified redemption date (provided there is only an insignificant risk of failure of the company to repay the amount at maturity).

Cash flows: Cash flows are inflows and outflows of cash and cash equivalents. It means the movement of cash into the organisation and movement of cash out of the organisation. The difference between the cash inflows and outflows is known as net cash flow which can be either net cash inflow or net cash outflow. Cash flows 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. Cash management includes the investment of excess cash in cash equivalents.

CLASSIFICATION OF CASH FLOW STATEMENT

The cash flow statement during a period is classified into three main categories of cash inflows and cash outflows i.e. operating, investing and financing activities.



Cash Flows from Operating Activities	Examples of Cash Flows from Operating Activities
Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing and financing activities. Operating activities include cash effects of those transactions and events that enter into the determination of net profit or loss.	<ul style="list-style-type: none"> (a) cash receipts from the sale of goods and the rendering of services; (b) cash receipts from royalties, fees, commissions, and other revenues; (c) cash payments to suppliers for goods and services; (d) cash payments to and on behalf of employees;

<p>A business's normal operations result in both cash receipts and cash payments. Cash receipts result from selling goods and providing services. The cost of goods sold and other operative expenses result in cash disbursements. The revenues and expenses reported in the income statement, however, do not coincide with the cash receipts and payments as we prepare the income statement on an accrual basis. The receipts and payments of cash for these revenues and expenses may occur in either an earlier or later period than the period we report the revenues and expenses.</p>	<ul style="list-style-type: none"> (e) cash receipts and payments of an insurance enterprise for premiums and claims, annuities and other policy benefits; (f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and (g) cash receipts and payments relating to future contracts, forward contracts, option contracts, and swap contracts when the contracts are held for dealing or trading purposes.
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<i>Cash Flows from Investing Activities</i>	<i>Examples of Cash Flows from Investing Activities</i>
<p>Investing activities are the acquisition and disposal of long term assets and other investments not included in cash equivalents. In other words, investing activities include transactions and events that involve the purchase and sale of long-term productive assets (e.g. land, building, plant and machinery etc.) not held for resale and other investments.</p>	<ul style="list-style-type: none"> (a) cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalised research and development costs and self-constructed fixed assets; (b) cash receipts from disposal of fixed assets (including intangibles); (c) cash payments to acquire shares, warrants, or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes); (d) cash receipts from disposal of shares, warrants, or debt instruments of other enterprises and interests in joint ventures (other than receipts from those instruments considered to be cash equivalents and those held for dealing or trading purposes); (e) cash advances and loans made to third parties (other than advances and loans made by a financial enterprise); (f) cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise); (g) cash receipts and payments relating to future contracts, forward contracts, option contracts, and swap contracts except when the contracts are held for dealing or trading purposes, or the transactions are classified as financing activities.

Cash Flows from Financing Activities	Examples of Cash Flows from Financing Activities
Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise	(a) cash proceeds from issuing shares or other similar instruments; (b) cash proceeds from issuing debentures, loans notes, bonds and other short term borrowing; (c) cash repayments of amounts borrowed i.e. redemption of debentures, bonds etc.; (d) cash payments to redeem preference shares; (e) payment of dividend.

Treatment of Some Peculiar Items

Foreign Currency Cash Flows	<p>Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and foreign currency at the date of cash flow. A rate that approximates actual rate may be used if the result is substantially the same as would arise if the rates at the date of cash flows were used. Unrealised gains and losses arising from changes in foreign exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at the end of period exchange rates.</p> <table border="1" style="width: 100%; margin-top: 10px;"> <thead> <tr> <th colspan="2" style="text-align: center;">Reporting of foreign currency cash flows</th> </tr> <tr> <th style="text-align: center;">Cash flows arising from transactions in a foreign currency</th> <th style="text-align: center;">Effects of changes in exchange rates on cash and cash equivalents held in a foreign currency</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">To be recorded in the reporting currency of the enterprise using the exchange rate on the date of cash flow</td> <td style="text-align: center;">To be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the Period</td> </tr> </tbody> </table>	Reporting of foreign currency cash flows		Cash flows arising from transactions in a foreign currency	Effects of changes in exchange rates on cash and cash equivalents held in a foreign currency	To be recorded in the reporting currency of the enterprise using the exchange rate on the date of cash flow	To be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the Period
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Extraordinary Items	<p>Extraordinary items are not the regular phenomenon, e.g., loss due to theft or earthquake or flood. Extraordinary items are non-recurring in nature and hence cash flows associated with extraordinary items should be classified and disclosed separately as arising from operating, investing or financing activities. This is done to enable users to understand their nature and effect on the present and future cash flows of an enterprise.</p>						
Interest and Dividend	<p>According to Accounting Standard-3 (Revised), the treatment of interest and dividends, received and paid, depends upon the nature of the enterprise, that is, financial enterprises and other enterprises.</p> <ul style="list-style-type: none"> ● In the case of financial enterprises: Cash flows arising from interest paid, interest received and dividends received, should be classified as cash flows from operating activities. While dividend paid is a financing activities. 						

	<ul style="list-style-type: none"> In the case of other enterprises: Cash flows arising from interest paid should be classified as cash flows from financing activities. Cash flows arising from interest and dividends received should be classified as cash flows from investing activities; dividends paid should be classified as cash flows from financing activities. <table border="1" data-bbox="398 395 1430 810"> <tr> <th colspan="4" style="text-align: center;"><i>Non-Financial Enterprises</i></th> </tr> <tr> <td style="text-align: center;">Interest paid</td> <td style="text-align: center;">Interest received</td> <td style="text-align: center;">Dividend Paid</td> <td style="text-align: center;">Dividend received</td> </tr> <tr> <td style="text-align: center;">Financing Activities</td> <td style="text-align: center;">Investing Activities</td> <td style="text-align: center;">Financing Activities</td> <td style="text-align: center;">Investing Activities</td> </tr> <tr> <th colspan="4" style="text-align: center;"><i>Financial Enterprises</i></th> </tr> <tr> <td style="text-align: center;">Interest paid</td> <td style="text-align: center;">Interest received</td> <td style="text-align: center;">Dividend Paid</td> <td style="text-align: center;">Dividend received</td> </tr> <tr> <td style="text-align: center;">Operating Activities</td> <td style="text-align: center;">Operating Activities</td> <td style="text-align: center;">Financing Activities</td> <td style="text-align: center;">Operating Activities</td> </tr> </table>	<i>Non-Financial Enterprises</i>				Interest paid	Interest received	Dividend Paid	Dividend received	Financing Activities	Investing Activities	Financing Activities	Investing Activities	<i>Financial Enterprises</i>				Interest paid	Interest received	Dividend Paid	Dividend received	Operating Activities	Operating Activities	Financing Activities	Operating Activities
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<p>Taxes on Income and Gains</p>	<p>Taxes may be income tax (tax on normal profit), capital gains tax (tax on capital profits), dividend tax (tax on the amount distributed as dividend to shareholders). Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities. This clearly implies that:</p> <ul style="list-style-type: none"> tax on operating profit should be classified as operating cash flows. dividend tax, i.e., tax paid on dividend should be classified as financing activity along with dividend paid. Capital gains tax paid on sale of fixed assets should be classified under investing activities. 																								
<p>Acquisition and Disposals of Subsidiaries and other Business Units</p>	<p>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.</p>																								
<p>Non-cash Transactions</p>	<p>Investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement. Examples of such transactions are – acquisition of machinery by issue of equity shares or redemption of debentures by issue of equity shares. Such transactions should be disclosed elsewhere in the financial statements in a way that provide all the relevant information about these investing and financing activities. Hence, assets acquired by issue of shares are not disclosed in cash flow statement due to non-cash nature of the transaction.</p>																								

PREPARATION OF A CASH FLOW STATEMENT

<i>Cash Flow Statement</i>	
A. Cash flows from operating activities	xxx
B. Cash flows from investing activities	xxx
C. Cash flows from financing activities	xxx
Net increase (decrease) in cash and cash equivalents (A + B + C)	xxx
+ Cash and cash equivalents at the beginning	xxx
= Cash and cash equivalents at the end	xxx

A. Cash Flows from Operating Activities

Operating activities are the main source of revenue and expenditure in an enterprise. Therefore, the ascertainment of cash flows from operating activities need special attention. An enterprise should report cash flows from operating activities either by using following method:

Direct Method: whereby major classes of gross cash receipts and gross cash payments are disclosed

Indirect Method: whereby net profit or loss is duly adjusted for the effects of

- (1) transactions of a non-cash nature,
- (2) any deferrals or accruals of past/future operating cash receipts, and
- (3) items of income or expenses associated with investing or financing cash flows.

It is important to mention here that under indirect method, the starting point is net profit/loss before taxation and extra ordinary items as per Statement of Profit and Loss of the enterprise. Then this amount is for non-cash items, etc., adjusted for ascertaining cash flows from operating activities.

Direct Method

Under direct method, cash receipts from operating revenues and cash payments for operating expenses are arranged and presented in the cash flow statement. The difference between cash receipts and cash payments is the net cash flow from operating activities. It is in effect a cash basis Statement of Profit & Loss. In this case each cash transaction is analysed separately and the total cash receipts and payments for the period is determined. The summarised data for revenue and expenses can be obtained from the financial statements and additional information. We may convert accrual basis of revenue and expenses to equivalent cash receipts and payments. Make sure that a uniform procedure is adopted for converting accrual base items to cash base items.

The following are some examples of usual cash receipts and cash payments resulting from operating activities:

Cash sales of goods and services;
Cash collected from debtors (customers);
Cash receipts of interest or dividends;
Cash receipts of royalties, fees, commission and other revenues;
Cash payments to suppliers (creditors);
Cash payments for various operating expenses i.e. rent, rates, power etc.;
Cash payments for wages and salaries to employees;
Cash payments for income tax etc.

Some of the items to be shown in the cash flow statement are illustrated below:

Collections from Customers: If a business has only cash sales, the amount of sales revenue in the income statement is the amount of cash collected from the customers. However, when the business has credit sales we have to adjust the amount of sales revenue for changes in debtors and bills receivable. The opening balance of debtors or bills receivable represents uncollected amount from a previous period and it is presumed that cash has been collected during the current accounting period. The closing balance of debtors or bills receivable represents uncollected amount in the current accounting period. Therefore in order to calculate the cash received from debtors, the opening balance (debtors/bills receivable) should be added to the amount of credit sales and closing balance should be subtracted therefrom.

Alternatively, Cash Collected from Debtors can also be calculated as given below:

$$\text{Cash Collected from Debtors} = \text{Credit Sales} + \text{Decrease in Accounts Receivable} \text{ or } - \text{Increase in Accounts Receivable.}$$

Payment to Suppliers: The analysis of cash payments to suppliers begins with cost of goods sold from the Statement of Profit & Loss. The amount of purchases is calculated by adding closing stock and subtracting opening stock from the cost of goods sold. The cash payment made to suppliers is calculated by making adjustments for change in sundry creditors/bills payable.

$$\begin{aligned} \text{Purchases} &= \text{Cost of Goods Sold} + \text{Closing Stock} - \text{Opening Stock} \\ &\text{OR} \\ \text{Purchases} &= \text{Cost of Goods Sold} + \text{Increase in Stock} \text{ or } - \text{Decrease in Stock} \end{aligned}$$

Cash Paid to Suppliers = Purchases + Opening Balance of Creditors (Bills Payable) - Closing Balance of Creditors (Bills Payable).

OR

Cash Paid to Suppliers = Purchases + Decrease in Accounts Payable or - Increase in Accounts Payable.

Payment to Employees:

Cash Paid for Wages and Salaries = Wages and Salaries Expenses + Opening Balance of Outstanding Wages and Salaries - Closing Balance of Outstanding Wages and Salaries.

OR

Cash Paid for Wages and Salaries = Wages and Salaries Expenses + Decrease in Wages and Salaries Payable or - Increase in Wages and Salaries Payable.

Rent Received: The analysis of rent received is similar to cash collected from customers.

Rent Received = Rent Revenue + Opening Balance of Rent Receivable - Closing Balance of Rent Receivable.

OR

Rent Received = Rent Revenue + Decrease in Rent Receivable or - Increase in Rent Receivable.

Interest Paid: The analysis of interest paid is similar to the analysis of payments to employees.

Interest Paid = Interest Expenses + Opening Balance of Outstanding Interest - Closing Balance of Outstanding Interest.

OR

Interest Paid = Interest Expenses + Decrease in Interest Payable, or - Increase in Interest Payable.

A similar treatment is applied for various other income and expenses to find out the cash inflows or outflows.

Insurance: Different procedure is adopted for insurance expense because insurance is usually purchased (and recorded as an asset) before it becomes an expense. The treatment is as follows:

Cash Paid for Insurance = Insurance Expenses + Closing Balance of Unexpired Insurance - Opening Balance of Unexpired Insurance.

OR

Cash Paid for Insurance = Insurance Expenses + Increase in Unexpired Insurance or - Decrease in Unexpired Insurance.

A similar treatment is applied for other prepaid expenses also.

In direct method of calculating cash flow from operations, the following points should be noted:

- (i) The necessary adjustments should be made for bad debts, sales returns, purchases returns, discount allowed, discount received etc. while calculating the amount received from the customers or paid to suppliers, as the case may be.
- (ii) Items like depreciation, amortisation of intangible assets (such as goodwill, patent, trade mark etc.) or of debenture discount, preliminary expenses, premium on redemption of debentures and preference shares are ignored from the cash flow statement since the method analyses and includes only cash transactions and therefore, non-cash items are omitted from a statement of cash flows.
- (iii) No adjustment is made for loss or gain on the sale of fixed assets and investments since operating cash receipts and payments are reported directly on the cash flow statement.

Indirect Method

Indirect method of ascertaining cash flow from operating activities begins with the amount of net profit/loss. This is so because statement of profit and loss incorporates the effects of all operating activities of an enterprise. However, Statement of Profit and Loss is prepared on accrual basis (and not on cash basis). Moreover, it also includes certain non-operating items such as interest paid, profit/loss on sale of fixed assets, etc.) and non-cash items (such as depreciation, goodwill written-off, dividend declared, etc. Therefore, it becomes necessary to adjust the amount of net profit/loss as shown by Statement of Profit and Loss for arriving at cash flows from operating activities.

A summary of adjustments required to convert the net profit to net cash flow from operating activities through indirect method is as follows:

<i>Particulars</i>	<i>Amount (Rs.)</i>
A. Net profit before tax and extraordinary item	
B. Adjustments for non-cash and non-operating items:	
<i>Add:</i> Amount written off in respect of depreciation, goodwill, preliminary expenses, underwriting commission etc.	
<i>Add/Less:</i> Other non-operating items	
C. Adjustment for gains and losses on sale of fixed assets and investments:	
<i>Add:</i> Loss on sale of fixed assets/investments <i>Less:</i> Profit on sale of fixed assets/investments	
D. Adjustments for changes in current assets (except cash and cash equivalents) and current liabilities (except bank overdraft)	
<i>Add:</i> Decrease in accounts of current assets e.g. debtors, bill receivable, stock, prepaid expenses etc. <i>Less:</i> Increase in accounts of current assets.	
<i>Add:</i> Increase in accounts of current liabilities; e.g., creditors, bills payable, outstanding expenses, etc.	
<i>Less:</i> Decrease in accounts of current liabilities.	
E. Cash generated from operations	
<i>Less:</i> Income tax paid.	
F. Adjustments for extra-ordinary items if any	
G. Net cash from (used in) operating activities	

Note: The computation of net cash inflow or cash outflow from operating activities by the indirect method takes a path that is very different from the computation by the direct method. However, the two methods arrive at the same amount of net cash flow from operations.

The logic behind the treatment of various items are explained as follows:

1.	<p>Adjustment for Depreciation and other Non-cash and Non-operating items</p> <p>Depreciation, depletion and amortisation of expenses (amortisation of goodwill, preliminary expenses, premium on redemption of debentures, underwriting commission, etc.) do not affect cash and thus should be added back to the net profit in the cash flow statement. When depreciation is provided it has no effect on cash. However, depreciation is deducted from revenues for the computation of income. Therefore, in going from net profit to cash flow from operations, we add depreciation back to net profit. Likewise, all expenses with no cash effects are added back to net profit in the cash flow statement. In the same manner, revenues that do not provide cash inflow are subtracted from net profit.</p>
2.	<p>Adjustment for Gains and Losses on Sale of Fixed Assets/Investments</p> <p>When fixed assets or investments are sold, there may be either profit or loss on sale. Such profit or loss affects the amount of net profit.</p> <p>For instance, when fixed assets, with a book value of Rs. 75,000 was sold for Rs. 90,000, the actual inflow of cash is Rs. 90,000 which would be reflected in the cash flow statement including a profit of Rs. 15,000. But this profit on sale of fixed asset has already increased the net profit indicating an inflow of cash from operating activities. In order to avoid this duplication, this profit of Rs. 15,000 must be deducted from the net profit. Moreover sale of fixed assets is an investing activity and therefore effect of this profit on sale must be removed from cash flow from operations. Likewise, a loss on sale of fixed assets or investment also require an adjustment to the net profit in the cash flow from operations. This loss is added back to the net profit to compute cash flow from operations.</p>
3.	<p>Changes in Current Assets and Liabilities</p> <p>Most current assets and current liabilities result from operating activities. Sundry debtors and bills receivable result from sales, inventory generates revenues and prepaid expenses are used in operations. On the liabilities side sundry creditors and bills payable are ordinarily incurred to buy inventory and outstanding liabilities relate to salaries, utilities and other expenses. Changes in these current assets and liabilities are reported as adjustments to net profit on the cash flows statement. The following rules apply:</p> <p>(a) An increase in current assets other than cash is deducted from net profit to calculate cash flow from operations:</p> <p>For example, when sundry debtors (net) increase during the year, this means that revenues on accrual basis are higher than revenues on cash basis since goods sold on credit are treated as revenues on accrual basis. In other words, the business operations in the period covered resulted in more revenues but not all these revenues resulted in corresponding increase in cash. Some of the revenues resulted in an increase in debtors only. In order to convert the net profit to net cash provided by operating activities the increase in debtors must be deducted from the reported net profit. However, a decrease in current assets has opposite effect and has to be added back to net profit to determine cash provided for the period.</p> <p>(b) An increase in current liability is added to net profit to arrive at the cash from operation.</p>

For example, when sundry creditors increase during the period covered, it means that expenses on accrual basis are more than they are on cash basis because expenses are incurred for which no payment has been made. So this increase must be added to net profit. However, a decrease in a current liability is subtracted from net profit since more cash has been paid than the expenses recorded on accrual basis.

B & C - CASH FLOWS FROM INVESTING AND FINANCING ACTIVITIES

The details of item leading inflows and outflows from investing and financing activities have already been outlined. While preparing the cash flow statement, all major items of gross cash receipts, gross cash payments, and net cash flows from investing and financing activities must be shown separately under the headings 'Cash Flow from Investing Activities' and 'Cash Flow from Financing Activities' respectively.

FORMAT OF CASH FLOW STATEMENT

There seems to be flexibility in the presentation of cash flow statements. However, a widely accepted format under direct method and indirect method is given below:

Cash Flow Statement (Direct Method)	
A. Cash flows from operating activities	
Cash receipts from customers	
Cash paid to suppliers and employees	
Cash generated from operations	
Income taxes paid	
Cash flow before extraordinary item	
Proceeds from earthquake disaster settlement	
<i>Net Cash from Operating Activities</i>	
B. Cash flows from investing activities	
Purchase of fixed assets	
Proceeds from sale of equipment	
Interest received	
Dividend received	
<i>Net Cash from Investing Activities</i>	
C. Cash flows from financing activities	
Proceeds from issuance of share capital	
Proceeds from long-term borrowings	
Repayments of long-term borrowings	
Interest paid	
Dividend paid	

<p><i>Net Cash from Financing Activities</i></p> <p>Net Increase (Decrease) in Cash and Cash Equivalents (A + B + C)</p> <p>Cash and Cash Equivalents at Beginning of Period</p> <p>Cash and Cash Equivalents at End of Period</p>	
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Cash Flow Statement (Indirect Method)	
<p>A. Cash flows from operating activities</p> <p>Net profit before tax and extraordinary items Adjustments for:</p> <p>Depreciation Foreign exchange Investments</p> <p>Gain or loss on sale of fixed assets</p> <p>Interest/dividend</p> <p>Operating profit before working capital changes.</p> <p>Adjustments for:</p> <p>Trade & other receivables</p> <p>Inventories</p> <p>Trade payables</p> <p>Cash generation from operations</p> <p>Interest paid</p> <p>Direct taxes</p> <p>Cash before extraordinary items</p> <p>Deferred revenue</p> <p><i>Net Cash from Operating Activities.</i></p> <p>B. Cash flows from investing activities</p> <p>Purchase of fixed assets</p> <p>Sale of fixed assets</p> <p>Sale of investments</p> <p>Purchase of investments</p> <p>Interest received</p> <p>Dividend received</p> <p>Loans to subsidiaries</p> <p><i>Net Cash from Investing Activities</i></p> <p>C. Cash flows from financing activities</p> <p>Proceeds from issue of share capital</p>	

Proceeds from long term borrowings	
Repayment to finance/lease liabilities	
Dividend paid	
<i>Net Cash from Financing Activities</i>	
Net Increase (Decrease) in Cash and Cash Equivalents (A + B + C)	
Cash and Cash Equivalents at the Beginning of the Period	
Cash and Cash Equivalents at the End of the Period	

Alternatively the Cash Flows from Operating Activities (Indirect Method) may be summarised as below:

Net profit before tax and extra-ordinary items

Adjustments for non-cash and non-operating items

(+) Depreciation

(+) Amortization of intangible assets, preliminary expenses, debenture discount and the like.

(+) or (-) Other non-cash and non-operating items included in net profit

Adjustments for gains and losses on sale of fixed assets and investments

(-) Gains on sale of fixed assets and investments

(+) Loss on sale of fixed assets and investments

Adjustments for changes in current assets and current liabilities

(-) Increases in current assets

(+) Decreases in current assets

(+) Increases in current liabilities

(-) Decreases in current liabilities

(-) Income-tax paid

(-) Extraordinary items

Net Cash Flows from Operating activities

Illustration 1

From the following balances calculate cash from operations:

<i>Profit made during the year</i>	<i>31st December</i>	
	<i>2021</i>	<i>2022</i>
Bills receivable	5,000	4700
Debtors	1000	1250
Bills payable	2000	2500

Creditors	800	600
Outstanding Expenses	100	120
Prepaid Expenses	80	70
Accrued Income	60	75
Income received in advanced	80	25
Profit made during the year	–	7,000

Solution:

Cash Flow Statement
Calculation of cash from Operating Activities

<i>Particulars</i>		<i>Amount (Rs.)</i>	<i>Amount (Rs.)</i>
	Profit made during the year		7,000
<i>Add :</i>	Decrease in current assets and increases in current liabilities :		
	Decrease in bills receivable (C.A.)	300	
	Increase in bills payable (C.L.)	500	
	Increase in outstanding expenses (C.L.)	20	
	Decrease in prepaid expenses (C.A.)	10	830
	Total		7,830
<i>Less :</i>	Increase in current assets and decrease in current liabilities :		
	Increase in debtors (C.A.)	250	
	Decrease in creditors (C.L.)	200	
	Increase in accrued income (C.A.)	15	
	Decrease in income received in advance (C.L.)	55	520
	Cash from Operating Activities		7,310

[C.A. = Current Asset, C.L. = Current Liability]

Illustration 2

Given below are the balance sheets of Veer & Sons.

I. Equity and Liabilities	01 Jan 2022 Rs.	31 Dec. 2022 Rs.
Creditors	4,000	4,400
Mrs. A's Loan	2,500	-
Loans from Bank	4,000	5000
Capital	12,500	15300
Total	23,000	24,700
II. Assets		
Cash	1,000	700
Debtors	3,000	5,000
Stock	3,500	2,500
Machinery	8,000	5,500
Land	4,000	5,000
Building	3,500	6,000
Total	23,000	24,700

During the year a machine costing Rs. 1000 (accumulated depreciation Rs. 300) is sold for Rs. 500. The provisions for depreciation against machinery as on 01 January 2022 was Rs. 2500 and on 31 December 2022 Rs. 4000. Net profit for the year amounts to Rs. 4500.

You are required to prepare a Cash Flow Statement.

Solution

Cash Flow Statement
For the year ending 31-12-2022

(i) Cash flow from operating activities

Profit made during the year		4500
Add : Depreciation on machinery	1800	
Loss on sales of machinery*	200	

Decrease in stock	1000	
Increase in creditors	400	3400
		7900
Less : Increase in debtors		(-) 2000
Cash inflows from operating activities		5900
Cash flow from investing activities		
Sale of machinery*	500	
Purchase of land (5,000 – 4,000)	(-) 1000	
Purchase of building (6,000 – 3,500)	(-) 2500	(-) 3000
Net cash outflow from investing activities		
Cash flow from financing activities :		
Loan from Bank	1000	
Mrs. A's loan repaid	(-) 2500	
Drawings	(-) 1700	
Net cash outflow from financial activities		(-) 3200
Net decrease in cash and cash equivalents		(-) 300
Cash and cash equivalents on Jan 1, 2022		1000
Cash and cash equivalents on Dec 31, 2022		700

Working Notes:*Machinery Account (At Cost)**

<i>Particulars</i>	<i>Amount</i>	<i>Particulars</i>	<i>Amount</i>
To Balance b/d	10500	By Bank	500
		By Loss on sale of Machinery	200
		By Provision for Depreciation	300
		By Balance c/d	9500
	10500		10500

Depreciation Account

<i>Particulars</i>	<i>Amount</i>	<i>Particulars</i>	<i>Amount</i>
To Machinery	300	By Balance b/d	2500
To Balance c/d	4000	By P & L A/c (balancing figure)	1800
	4300		4300

Illustration 3

Following is the Balance Sheet of ABC Co. Ltd., on at 01st January, 2022 and 31st December 2022.

(Amount In Rs.)

<i>Particulars</i>	<i>01-01-2022</i>	<i>31-12-2022</i>
I. Equity and Liabilities :		
Equity share capital	30,000	35000
Share premium	--	3000
General Reserve	4500	6500
Profit and Loss	3000	8080
6% Debentures	--	7000
Sundry creditors	8500	9070
Provision for taxation	2250	4050
Proposed Divided	3000	3500
Total	51250	76200
II. Assets :		
Land and building	23,000	39000
Plant and machinery	8540	14000
Furniture	550	650
Stock	8240	9570
Sundry debtors	7500	8550
Bank balance	3420	4430
Total	51250	76200

Additional Information :

Depreciation written off during the year

Land and building 6000

Plant and machinery 5000

Furniture 120

You are required to prepare a cash flow statement

Solution :

Note : The following accounts have been prepared to determine the relevant information.

Land and Building Account

<i>Particulars</i>	<i>Amt</i>	<i>Particulars</i>	<i>Amt</i>
To Balance b/d	23000	By Depreciation	6000
To Bank (purchase)	22000	By Balance c/d	39000
	45000		45000

Plant and Machinery Account

<i>Particulars</i>	<i>Amt</i>	<i>Particulars</i>	<i>Amt</i>
To Balance b/d	8540	By Depreciation	5000
To Bank (purchase)	10460	By Balance c/d	14000
	19000		19000

Furniture Account

<i>Particulars</i>	<i>Amt</i>	<i>Particulars</i>	<i>Amt</i>
To Balance b/d	550	By Depreciation	120
To Bank (purchase)	220	By Balance c/d	650
	770		770

Provision for Taxation Account

<i>Particulars</i>	<i>Amt</i>	<i>Particulars</i>	<i>Amt</i>
To Bank (tax paid)	2250	By Balance b/d	2250
To Balance c/d	4050	By P & L A/c	4050
	6300		6300

Cash Flow Statement for the year ended 31-12-2022

(i) Cash Flow from Operating Activities			
Particulars		Rs.	Rs.
	Profit during the year (8080-3000)	5080	
Add :	Depreciation on :		
	Land and building	6000	
	Plant and machinery	5000	
	Furniture	120	
	General reserve (6,500 - 4,500)	2000	
	Taxation provision	4050	
	Proposed dividend	3500	
	Increase in creditors (9070 – 8500)	570	
Less :	Increase in stock (9570 – 8240)	(-) 1330	
	Increase in debtors (8550 – 7500)	(-) 1050	
Less :	Income tax paid	(-) 2250	
	Cash inflow from operating activities		21690
(ii) Cash Flow from Investing Activities			
Less :	Purchase of land and building	(-)22000	
	Purchase of plant and machinery	(-)10460	
	Purchase of furniture	(-) 220	
	Cash outflow from investing activities		(-)32680
(iii) Cash Flow from Financing Activities			
Add :	Issue of equity shares	5000	
	Share premium	3000	
	Issue of debentures	7000	
		15000	
Less :	Payment of dividend	(-) 3000	
	Cash inflow from financing activities		12000
	Net increase in cash		1010
Add :	Cash balance in the beginning		3420
	Cash balance at the end		4430

Illustration 4

The following Balance Sheets are given :

I. Equity and Liabilities	2021 (Rs.)	2022 (Rs.)
Equity Share Capital	30000	40,000
Redeemable Pref. Capital	15000	10,000
General Reserve	4000	7000
Profit and Loss Account	3000	4800
Proposed Dividend	4200	5000
Creditors	5500	8300
Bills Payable	2000	1600
Provision for Taxation	4000	5000
Total	67700	81700
II. Assets		
Goodwill	11500	9000
Land and Building	20000	17000
Plant	8000	20000
Debtors	16000	20000
Stock	7700	10900
Bills Receivable	2000	3000
Cash in Hand	1500	1000
Cash at Bank	1000	800
Total	67700	81700

It is also given that :

- Depreciation of Rs. 2000 on land and building and Rs.1000 on plant has been charged in 2022.
- Interim dividend of Rs. 2000 has been paid in 2022.
- Income tax Rs.3500 has been paid during 2022.

Prepare Cash Flow Statement for the year 2022.

Solution :**Cash Flow Statement for the year 2022**

(i)	Cash from Operating Activities	Amt (Rs.)	Amt (Rs.)
Add :	Profit during the year (4800 – 3000)	1800	
	Depreciation on plant	1000	
	Depreciation on building	2000	
	Goodwill written off (11500 – 9000)	2500	
	Proposed dividend	5000	
	Interim dividend	2000	
	General reserve (7000 – 4000)	3000	
	Provision for taxation (3500 + 5000 – 4000)	4500	
	Increase in creditors (C.L.) (8300 – 5500)	2800	
		24600	
Less:	Decrease in bills payable (C.L.) (1600 – 2000)	(-) 400	
	Increase in debtors (C.A.) (16000 – 20000)	(-) 4000	
	Increase in stock (C.A.) (7700 – 10900)	(-) 3200	
	Increase in bills receivable (C.A.) (2000 – 3000)	(-) 1000	
	Income tax paid	(3500)	
	Cash inflow from operating activities		12500
(ii)	Cash from Investing Activities		
	Purchase of plant (8000 – 20000 – 1000)	(-) 13000	
	Sale of building (20,000 – 17000 – 2000)	1000	
	Cash outflow from investing activities		(-) 12000
(iii)	Cash from Financing Activities		
	Issue of share capital (40000 – 30000)	10000	
	Redemption of pref. shares (10000 – 15000)	(-) 5000	
	Dividend paid	(-) 4200	
	Interim dividend paid	(-) 2000	

	Cash outflow from financing activities		(-) 1200
	Net decrease in cash		(-) 700
	Cash balance in the beginning (1500 + 1000)		2500
	Cash balance at the end (1000 + 800)		1800

Illustration 5

From the following condensed comparative Balance Sheets of Hotel Hills Ltd., and additional information, prepare a Cash Flow Statement for the year 2022.

I. Equity and Liabilities	2021 (Rs.)	2022 (Rs.)
Share Capital	7000	8000
Share Premium	900	1100
Retained earnings	2382	3082
7% Mortgage loan	--	2000
Creditors	690	600
Outstanding salaries	200	140
Provision for taxation	100	140
Total	11272	15062
II. Assets		
Plant & Machinery	6200	6600
Accumulation Dep. on plant and mach	(3700)	(2620)
Building	9500	11600
Accumulation depreciation on Building	(4300)	(4500)
Land	1000	1200
Stock	1022	962
Debtors	860	760
Prepaid expenses	72	80
Cash	618	980
Total	11272	15062

Additional information:

1. Plant costing Rs. 1600 (accumulated depreciation Rs. 1480) was sold during the year for Rs. 120.
2. Building was acquired during the year at a cost of Rs. 2100. In addition to cash payment of Rs. 100 a 7% mortgage loan was raised for the balance.
3. Dividend of Rs. 800 was paid during the year.
4. A sum of Rs. 1390 was transferred to provision for taxation account in 2022.

Solution :**Cash Flow Statement for the year 2022**

(i) Cash flow from operating activities :		Amount (Rs.)
Net profit during the year (before dividend payment and provision for tax)		2890
Add : Depreciation – Building (4500 – 4300)	200	
Plant (6600 – 6200)	400	
Decrease in stock (C.A.) (1022 – 962)	60	
Decrease in debtors (C.A.) (860 – 760)	100	
Less : Decrease in creditors (600 – 690)	(-) 90	
Decrease in outstanding salaries (140 – 200)	(-) 60	
Increase in prepaid expenses (72 – 80)	(-) 8	
Income tax paid (– 1390 – 100 + 140)	(-) 1350	(-) 748
Net cash inflow from operating activities		2142
(ii) Cash flow from investing activities :		
Purchase of Building	(-) 100	
Purchase of plant and machinery	(-) 2000	
Purchase of land	(-) 200	
Sale of plant	120	
Net cash outflow from investing activities		(-) 2180
(iii) Cash flow from financing activities :		
Issue of shares	1000	
Share premium	200	

Dividend paid	(-) 800	
Net cash inflow from financing activities		400
Net Increase in cash		362
Cash in the beginning		618
Cash at the end of 2015		980

Working Notes :**Retained Earnings Account**

<i>Particulars</i>	<i>Amt</i>	<i>Particulars</i>	<i>Amt</i>
To Dividend paid	800	By Balance b/d	2382
To Balance c/d	3082	By Profit during the year (B.F.)	1500
	3882		3882

Plant and Machinery Account

<i>Particulars</i>	<i>Amt</i>	<i>Particulars</i>	<i>Amt</i>
To Balance b/d	6200	By Sale of plant	120
To Bank-Purchase (B.F.)	2000	By Dep. on plant sold	1480
		By Balanced c/d	6600
	8200		8200

Accumulated Depreciation on Plant & Mach. Account

<i>Particulars</i>	<i>Amt</i>	<i>Particulars</i>	<i>Amt</i>
To Plant (Dep.)	1480	By Balance b/d	3700
To Balance c/d	2620	By P & L A/c (Dep.)	400
	4100		4100

Building Account

<i>Particulars</i>	<i>Amt</i>	<i>Particulars</i>	<i>Amt</i>
To Balance b/d	9500	By Balance b/d	11600
To Bank (purchase) To Mortgage	100		
Loan (Purchase)	2000		
	11600		11600

Accumulated Depreciation on Building Account

<i>Particulars</i>	<i>Amt</i>	<i>Particulars</i>	<i>Amt</i>
To Balance c/d	4500	By Balance b/d	4300
		By P & L A/c (Dep.)	200
	4500		4500

Provision for Taxation Account

<i>Particulars</i>	<i>Amt</i>	<i>Particulars</i>	<i>Amt</i>
To Income tax paid (B.F.)	1350	By Balance b/d	100
To Balance c/d	140	By P & L A/c (provision during the year)	1390
	1490		1490

LIMITATIONS OF CASH FLOW ANALYSIS

Cash flow analysis is a useful tool of financial analysis. However, it has its own limitations. These limitations are as under:

1. Cash flow statement cannot be equated with the income statement. An income statement takes into account both cash as well as non-cash items; therefore, net cash does not necessarily mean net income of the business.
2. The cash balance as disclosed by the cash flow statement may not represent the real liquid position of the business since it can be easily influenced by postponing purchases and other payments.
3. Cash flow statement cannot replace the income statement or the funds flow statement. Each of them has a separate function to perform.

In spite of these limitations it can be said that cash flow statement is a useful supplementary instrument. It discloses the volume as well as the speed at which the cash flows in the different segments of the business. This helps the management in knowing the amount of capital tied up in a particular segment of the business. The technique of cash flow analysis, when used in conjunction with ratio analysis, serves as a barometer in measuring the profitability and financial position of the business.

HOW TO INTERPRET A CASH FLOW STATEMENT

Whenever review any financial statement, we should consider it from a business perspective. Financial documents are designed to provide insight into the financial health and status of an organization.

For example, cash flow statements can reveal what phase a business is in: whether it's a rapidly growing startup or a mature and profitable company. It can also reveal whether a company is going through transition or in a state of decline.

Using this information, an investor might decide that a company with uneven cash flow is too risky to invest in; or they might decide that a company with positive cash flow is primed for growth. Similarly, a department head might look at a cash flow statement to understand how their particular department is contributing to the health and wellbeing of the company and use that insight to adjust their department's activities. Cash flow might also impact internal decisions, such as budgeting, or the decision to hire (or fire) employees.

Cash flow is typically depicted as being positive (the business is taking in more cash than it's expending) or negative (the business is spending more cash than it's receiving).

POSITIVE CASH FLOW

It indicates that a company has more money flowing into the business than out of it over a specified period. This is an ideal situation to be in because having an excess of cash allows the company to reinvest in itself and its shareholders, settle debt payments, and find new ways to grow the business. Positive cash flow does not necessarily translate to profit, however, business can be profitable without being cash flow-positive, and can have positive cash flow without actually making a profit.

NEGATIVE CASH FLOW

It means cash outflow is higher than cash inflow during a period, but it doesn't necessarily mean profit is lost. Instead, negative cash flow may be caused by expenditure and income mismatch, which should be addressed as soon as possible. Negative cash flow may also be caused by a company's decision to expand the business and invest in future growth, so it's important to analyze changes in cash flow from one period to another, which can indicate how a company is performing overall.

Cash Flow Analysis Example – IronMount vs. BronzeMetal

IronMount Corp and BronzeMetal Corp had identical cash positions at the beginning and end of 2022. Each company also reported a net income of Rs. 225,000 for 2022.

<i>Particulars</i>	<i>Iron Mount</i>	<i>Bronze Metal</i>
Operating Activities		
Net Income	225000	225000
Adjustment to reconcile net income		
Depreciation and Amortization	30000	240000
Gain on sale of equipment	(277800)	0
Increase in accounts receivable	(67500)	65550
Decrease in Inventory	56250	(131250)
Increase in accounts payable	17100	(12150)
Decrease in income tax payable	(4500)	(12900)
Net cash provided by operating activities	(21450)	374250
Investing Activities		
Sale of equipment	307350	(30600)
Net cash used for investing activities	307350	(30600)
Financing Activities		

Proceeds from Long term borrowing	30000	(27750)
Net cash provided by (used for) financing activities	30000	(27750)
Increase or Decrease in cash and cash equivalent	315900	315900
Beginning of the year	50000	50000
End of the year	365900	365900

IronMount and Bronze Medal, both companies, have the same end-of-the-year cash of 365,900. Additionally, changes in cash during the year are the same at 315,900. Which company is displaying elements of cash flow stress?

Solution: We note that Cash Flow from Operations is negative for IronMount at -21,450. Gain on equipment sales is deducted as this is not an operating cash flow. IronMount sale of equipment adds 307,350, contributing to the cash increase.

On the other hand, when we look at BronzeMetal, we note that its cash flow from operations is strong at 374,250 and seems to be doing great in its business. They are not relying on the one-time sale of equipment to generate cash flows.

With this, we conclude that IronMount is showing signs of stress due to low core operating income and its reliance on other one-time items to generate cash.

LESSON ROUND-UP

- Cash Flow Statement is in statement of changes in cash position from the beginning and till end of the accounting period.
- As per the Companies Act, 2013, Cash Flow Statement is required to be prepared by every company except a one person, small and dormant company.
- Cash comprises cash on hand and demand deposits with banks.
- Cash equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.
- Accounting Standard (AS) -3 on Cash Flow Statement issued by ICAI is mandatory, AS-3 requires that cash flow statement should report cash flow during the period classified by operating activities, investing activities and financing activities.
- Cash flow means cash inflow and cash outflow.
- Cash inflow means source of cash, and it increases the total cash available at the disposal of the firm.
- Cash outflow means use of cash which decreases the total cash available at the disposal of the firm.
- Net cash flow is the difference between cash inflow and cash outflow.
- Operating activities are the principal revenue activities of the enterprise. These pertain to cash generated by sales and all the operating expenses and are most often the biggest source of cash fl
- Investing activities pertain to the acquisitions and disposal of long-term assets, such as plant, machinery, land and building and other investments.
- Financing activities are those that result in changes in the size and composition of the owner's capital and borrowings of the enterprise.

TEST YOURSELF

1. What is a cash flow statement? State its uses and limitations.
2. Which are the various sources and uses of cash flows from operating activities?
3. What do you mean by cash from operating activities? How is this calculated?
4. Discuss briefly the major classification of cash flows as per AS-3 (Revised).
5. From the following Balance Sheets of Roop Ltd., prepare a cash flow statement.

I. Equity and Liabilities	2021 (Rs.)	2022 (Rs.)
Equity Share Capital	15000	2,0000
12% Preference share capital	7500	5000
General Reserve	2000	3500
P & L A/c	1500	2400
Creditors	3750	4950
Total	29750	35850
II. Assets		
Goodwill	3600	2000
Building	8000	6000
Plant	4000	10000
Debtors	11900	15450
Stock	1000	1500
Cash	1250	900
Total	27950	35850

Depreciation charged on plant was Rs. 1000 and on building Rs. 6000.

[Ans. Cash from operations Rs. 8150; Net decrease in cash Rs. 350.

Purchase of plant Rs. 7000; purchase of building Rs. 4000].

6. Calculate Cash Flow from Operating Activity

Balance Sheet

As on 1st January, 2023

I. Equity and Liabilities	Rs.
Equity	50,000
Capital	10,000
General Reserve	5,000
Profit & Loss Balance Debentures	20,000
Sundry Creditors	20,000
Proposed Dividend	5,000
Total	1,10,000

II. Assets	
Fixed Assets	40,000
Investments	10,000
Sundry Debtors	20,000
Stock	20,000
Cash	15000
Goodwill	5000
Total	1,10,000

7. The Balance Sheets of a Prem Limited Company at 31.3.2021 and 31.3.2022 were as follows :

I. Equity and Liabilities	31.3.2021 (Rs.)	31.3.2022 (Rs.)
Equity Share Capital	4500	6500
General Reserve	500	750
Profit and Loss Account	1000	1500
Debentures	1000	2000
Sundry	870	1100
Creditors	7870	11850
Assets	Rs.	Rs.
Fixed Assets	4600	8300
Stock	1100	1300
Debtors	1870	1950
Cash	200	2500
Preliminary Expenses	100	50
Total	7870	11850

Additional information :

Depreciation on fixed assets for the year 2021-22 was Rs. 1170. Prepare a Cash Flow Statement [Ans. Cash from operations Rs. 1850; Net increase in cash Rs. 50]

8. Balance sheet of XYZ is as follows:

I. Equity and Liabilities	2021 (Rs.)	2022 (Rs.)
Share	7000	7400
Capital Debentures	1200	600
Sundry	1036	1184
Creditors	70	80
Provision for doubtful debts P & L A/c	1004	1056
Total	10310	10320
II. Assets		
Cash	900	780
Sundry Debtors	1490	1770
Stock	4920	4270
Land	2000	3000
Goodwill	1000	500
Total	10310	10320

Additional Information :

- (i) Dividend totaling Rs. 350 was paid.
- (ii) Land was purchased for Rs. 1000 and amount provided for the amortization of goodwill totaled Rs. 500.
- (iii) Debentures of Rs. 600 were redeemed. Prepare a Cash flow statement.

[Ans. Cash from operations Rs. 1430; Net Decrease in cash Rs. 120]

[Hint : Provision for doubtful debts has been added back to profit to calculate cash from operations]

9. The Balance Sheet of Smartkart Ltd, as at March 31st 2021 and 2022 are given follows :

I. Equity and Liabilities	2021 (Rs.)	2022 (Rs.)
Accumulated Depreciation	2000	2150
Creditors	720	900
Taxes Payable	600	600
Bills payable	1400	2600
Debentures	3500	3500
Equity capital	5000	6000

Profit and Loss Account	2640	2090
Total	15860	17840
II. Assets		
Cash	600	800
Debtors	700	1200
Prepaid	360	240
Rent Stock	3200	2800
Investments	4000	4000
Fixed Assets	7000	8800
Total	15860	17840

Additional information

1. Purchased a new fixed asset costing Rs. 2500; paid Rs. 1300 cash and given short-term bills payable for the remainder.
2. Net loss for the year ending 31-3-2022 was Rs. 150.
3. One fully depreciated asset of an original cost of Rs. 700 and no salvage value was abandoned.

[Ans. Cash inflow from operating activities Rs. 900 ; Net increase in cash Rs. 200]

[Hint: Tax paid Rs. 600, Dividend paid Rs. 400 [i.e. 2640 – 150-2090]

10. Anand Ltd., arrived at a net income of Rs. 5,00,000 for the year ended March 31, 2022. Depreciation for the year was Rs. 2,00,000. There was a profit of Rs. 50,000 on assets sold which was transferred to Statement of Profit and Loss account. Trade Receivables increased during the year Rs. 40,000 and Trade Payables also increased by Rs. 60,000. Compute the cash flow from operating activities by the indirect approach.
11. From the information given below you are required to calculate the cash paid for the inventory:

<i>Particulars</i>	<i>(Rs.)</i>
Inventory in the beginning	40,000
Credit Purchases	1,60,000
Inventory in the end	38,000
Trade payables in the beginning	14,000
Trade payables in the end	14500

[Ans.: Rs. 1,59,500]

12. For each of the following transactions, calculate the resulting cash flow and state the nature of cash flow, viz., operating, investing and financing.

- (a) Acquired machinery for Rs. 2,50,000 paying 20% by cheque and executing a bond for the balance payable.
- (b) Paid Rs. 2,50,000 to acquire shares in Informa Tech. and received a dividend of Rs. 50,000 after acquisition.
- (c) Sold machinery of original cost Rs. 2,00,000 with an accumulated depreciation of Rs. 1,60,000 for Rs. 60,000.

Ans.:

- (a) Rs. 50,000 investing activity (outflow);
- (b) Rs. 2,00,000 investing activity (outflow);
- (c) Rs. 60,000 investing activity (inflow)].

13. State the meaning of the terms: (i) Cash Equivalents, (ii) Cash flows.

LIST OF FURTHER READINGS

- **Advanced Accounts**
Author: M.C. Shukla, T.S. Grewal & S.C. Gupta
Publisher: S. Chand & Company Ltd.
- **Corporate Accounting**
Author: Dr. S. N. Maheshwari & Dr. Suneel K Maheshwari
Publisher: Vikas Publishing House
- **Fundamentals of Corporate Accounting**
Author: Bhushan Kumar Goyal
Publisher: Taxmann
- **Treatise of Ind AS**
Author: CA. (Dr.) Alok K. Garg
Publisher: Bloomsbury
