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## 34

**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 from 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 made 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.

**34.1 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



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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 schedule for 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.
- 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.



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**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.

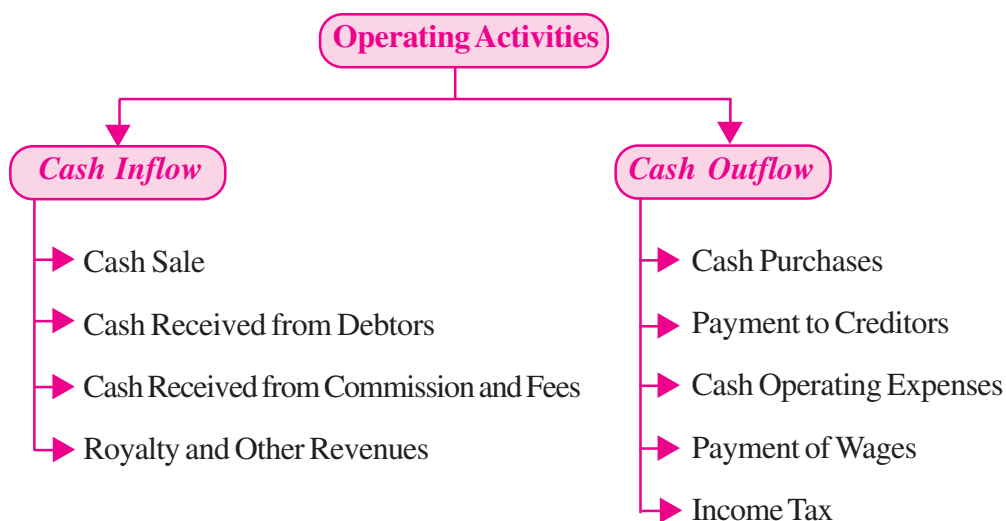
(b) Cash equivalents are short-term, highly liquid investments, readily convertible into cash and which are subject to insignificant risk of changes in values.

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.

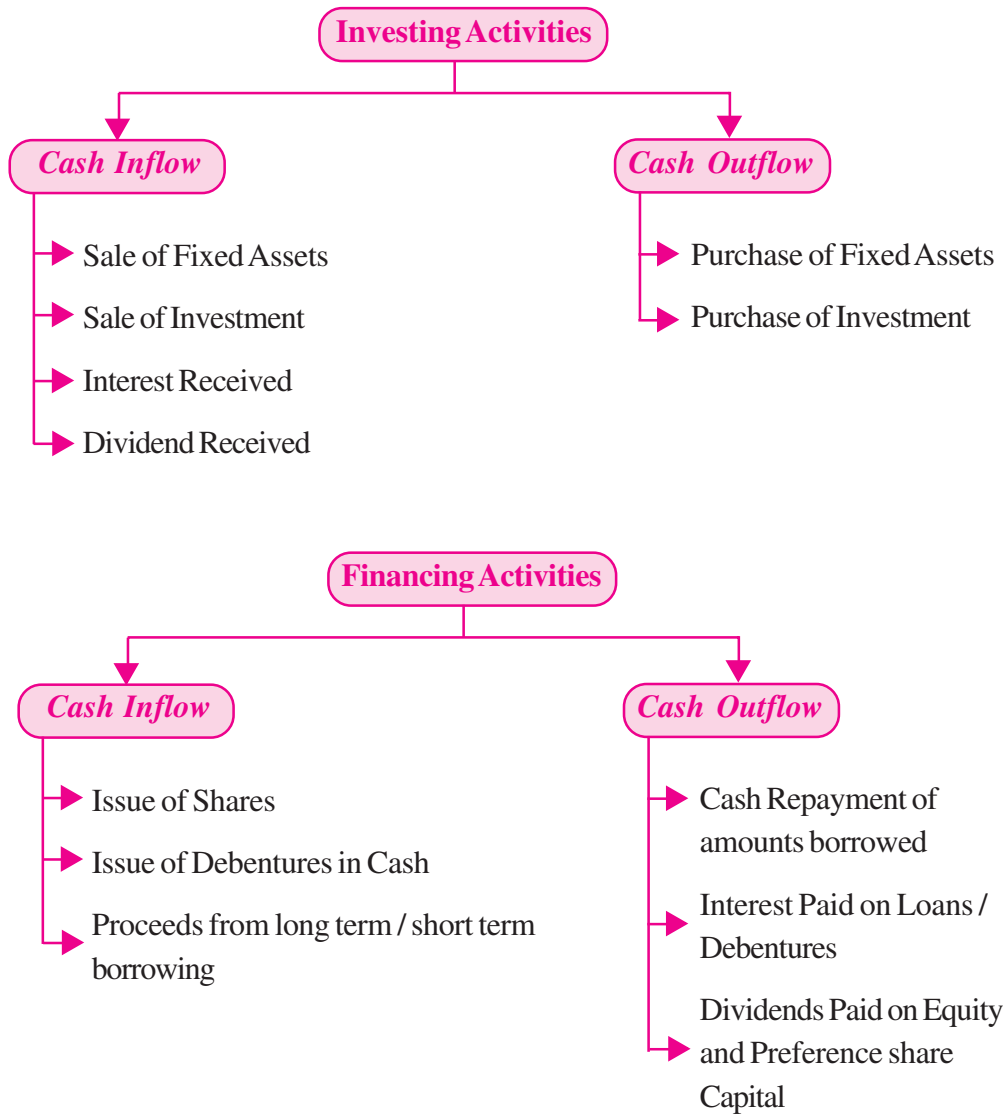
- (a) **Operating activities** are the principal revenue generating activities of the enterprise.
- (b) **Investing activities** include the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
- (c) **Financing activities** are activities that result in 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 :





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**INTEXT QUESTIONS 34.1**

*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 ..... and ..... during a particular period.
- (iv) As per AS 3 (revised), cash fund includes cash, demand deposit with bank and .....

## 34.2 METHOD OF PREPARING CASH FLOW STATEMENT

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

<i>Particulars</i>	₹
(i) Cash flows from operating Activities	xxx
Net Profit as per Statement of Profit and Loss or difference between closing balance and opening balance of Statement of Profit and Loss	xxx
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, shown in statement of Profit and Loss	xxx
	xxx
Less : Extraordinary Items, if any, shown in statement of Profit and Loss	xxx
Refund of Tax credited to be shown in statement Profit and Loss	xxx
<b>A.</b> Net profit before taxation and Extra ordinary items	xxx
Adjustment for Non-Cash and Non-Operating Items.	xxx
<b>B.</b> Add :	
– Depreciation	xxx
– Preliminary expenses written off	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
<b>C.</b> Less :	
– Interest income/received	xxx
– Dividend income received	xxx
– Rental income received	xxx
– Profit on sale of fixed assets	xxx
	xxx
<b>D.</b> Operating profit before working capital changes (A + B – C)	xxx
	xxx
<b>E. Add :</b> Decrease in current assets and increase in current liabilities	xxx



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## Cash Flow Statement

<b>E.</b>	<b>Less :</b> Increase in current assets and decrease in current liabilities	xxx	
<b>G.</b>	Cash generated from operations (D + E – F)		xxx
<b>H.</b>	Less : Income tax paid (Net tax refund received)		xxx
<b>I.</b>	Cash flow from operating activities before extraordinary items		xxx
	Adjusted extraordinary items (+/-)		xxx
<b>J.</b>	Net cash from operating activities		xxx
(ii)	Cash from Investing Activities		
	<b>Add :</b>		
	– 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
	– Rental Income		xxx
			xxx
	<b>Less :</b>		
	– Purchase of fixed assets	xxx	
	– Purchase of investment	xxx	
	– Purchase of intangible assets like goodwill	xxx	xxx
			xxx
	Adjusted extraordinary items (+/-)		xxx
	Net cash from (or used in) investing activities		xxx
			xxx
(iii)	Cash flows from financing activities		
	<b>Add :</b>		
	Proceeds from issue of shares and debentures	xxx	
	Proceeds from other long term borrowings	xxx	
		xxx	
	<b>Less :</b>		
	Final dividend paid	xxx	
	Interim dividend paid	xxx	
	Interest on debentures and loans paid	xxx	
	Repayment of loans	xxx	
	Redemption of debenture and preference shares	xxx	xxx
	Adjusted 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

## Cash Flow Statement

(v) Add : cash and cash equivalents in the beginning of the year		
– cash in hand	xxx	
– cash at bank (Bank overdraft)	xxx	
– short term deposit	xxx	
– marketable securities	xxx	
– cash and cash equivalents in the end of the year		xxx
– cash in hand	xxx	
– cash at Bank (by bank overdraft)	xxx	
– short term deposits	xxx	
– Marketable Securities	xxx	xxx

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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 and 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 34.2

Fill in the blanks with appropriate word/words :

- (i) Only ..... companies prepare cash flow statement.
- (ii) Cash flows are classified in to three parts i.e. operating activities, financing activities and ..... activities.

**34.3 PREPARATION OF CASH FLOW STATEMENT**



Notes

**(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-I**

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	
<b>Add :</b> 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	
<b>Less :</b> 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



**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 ₹ 110,000 and depreciation on fixed assets for the year was ₹ 44000. The balances of the current assets and current liabilities at the beginning and at the end of the year were as follows. Calculate cash from operating activities.

<i>Current Items</i>	<i>End of the year Amount (₹)</i>	<i>Beginning of the year Amount (₹)</i>
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



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**Solution :**

**Step - I**

**Cash from Operating Activities**

<i>Details</i>	<i>Amount (₹)</i>
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 :	
<b>Add :</b> (a) Decrease in inventories 10,000	
(b) Decrease in prepaid expenses 1000	11000
	1,65,000
<b>Deduct :</b> (a) Increase in Debtors Current Liabilities (20,000)	
(b) Decrease in Account payables (14,000)	34,000
Net Cash flow from operating Activities	1,31,000

**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 as 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 outsiders.

**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 outsiders.



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**Illustration 2**

From the following information calculate the cash flow from investing activities

<i>Particulars</i>	<i>Opening</i>	<i>Closing</i>
Machinery (at cost)	4,00,000	4,20,000
Accumulated Depreciation	1,00,000	1,10,000
Patents	2,80,000	1,60,000

**Additional Information :**

- During the year a machine costing ₹ 40,000 with this accumulated depreciation ₹ 24,000 was sold for ₹ 20,000
- Patents were written off to the extent of ₹ 40,000 and some patents were sold at a profit of ₹ 20,000

**Solution :****Cash Flow from Investing Activities**

<i>Particulars</i>	<i>₹</i>
Inflow from sale of machinery	20,000
Inflow from sale of patent (2)	1,00,000
	1,20,000
Outflow on purchase of machinery (1)	(60,000)
Net cash flow from investing activities	60,000

**Working Notes :****Machinery A/c**

Balance b/d	4,00,000	Bank (Inflow)	20,000
Statement of Profit and Loss (Profit on sale of machine)	4,000	Accumulated depreciation (Depreciation on machinery sold)	24,000

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### Cash Flow Statement

Bank A/c	60000	Balance c/d	420000
	464000		464000

### Patent A/c

Balance b/d	2,80,000	Bank A/c (Inflow) Bal. Fig.	1,00,000
Statement of Profit and Loss (Profit)	20,000	Statement of Profit and Loss	40,000
		Balance c/d	1,60,000
	3,00,000		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 notes 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:

Particulars	31.12.2006 ₹	31.12.2007 ₹
Equity share capital	4,00,000	5,00,000
10% debentures	1,50,000	1,00,000
Securities premium	40,000	50,000

## Cash Flow Statement

**Additional Information :** Interest paid on debentures ₹10000.

### Solution :

Calculation of Cash from financing activities

<i>Particulars</i>		₹
Cash proceeds from the issue of shares (Including premium)		1,10,000
Interest paid on debentures	10,000	
Redemption of debentures	50,000	60,000
		50,000

### Illustration 4

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

- Cash sale of goods
- Cash paid to suppliers of raw material
- Cash payments of salaries and wages to employees.
- Cash payment to acquire fixed assets
- Cash proceeds from issues of shares at premium.
- Payment of dividend
- Interest received on investments
- Interest on debentures
- Payment of income tax
- Cash payment of long term loans

### Solution

#### A. Cash Flow from operating Activities

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

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(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 Investments** : It is an Income on Investments (Cash inflow)

### 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 34.3

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

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

### 34.4 TREATMENT OF SPECIAL ITEMS

- (i) **Payment of Interim Dividend** : The following procedure is followed
- (a) The amount of interim dividend paid during the year is shown as outflow of cash in cash flow statement.
- (b) It will be added back to the profits for the purpose of calculating cash provided from operating activities.
- (c) No adjustment is necessary if the cash provided from operating activities is calculated on the basis of revised figure of net profit.

- (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 an increase in share capital. For example, if a company issues 10000 equity shares of ₹ 10 each for cash only, ₹ 100,000 would be shown as inflow of cash from financing activities. Similarly, the redemption of preference shares 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 ₹ 60,000 in the current year and ₹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 ₹10000 during the year. Hence, ₹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 in the opening balance sheet and closing balance 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.



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### Cash Flow Statement

<i>Assets</i>	<i>March 31, 2006 Amount (₹)</i>	<i>March 31, 2007 Amount (₹)</i>
Plant and machinery	13,50,000	14,40,000

It is informed that depreciation amounting to ₹ 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 transactions affecting the asset account, the proper procedure is to prepare the plant and machinery account as shown below:

#### Plant and Machinery Account

<i>Particulars</i>	<i>Amount</i>	<i>Particulars</i>	<i>Amount</i>
Balance b/d	13,50,000	Depreciation (given)	60,000
Bank A/c (New machine purchased)	1,50,000	Balance c/d	14,40,000
	15,00,000		15,00,000

#### Note

- In the absence of specific information, it may be presumed that the additional machinery was purchased for ₹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.

#### Illustration 6

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

<i>Liabilities</i>	<i>March 31, 2013 Amount ₹</i>	<i>March 31, 2014 Amount ₹</i>	<i>Assets</i>	<i>March 31, 2013 Amount ₹</i>	<i>March 31, 2014 Amount ₹</i>
Accumulated depreciation (Building)	7,00,000	7,90,000	Building	3,84,0000	3,91,0000

#### Additional Information

A part of the building of ₹ 74,000 was sold for ₹ 60,000. The accumulated depreciation on building sold was ₹ 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	
<i>Particulars</i>	₹	<i>Particulars</i>	₹
Balance b/d	38,40,000	Cash (Inflow)	60,000
Statement of Profit and loss (gain on sale)	6,000	Accumulated Depreciation A/c	20,000
Bank A/c			
Purchase (outflow)	1,44,000	Balance c/d	39,10,000
	39,90,000		39,90,000

**Accumulated Depreciation Account**

Dr		Cr	
<i>Particulars</i>	₹	<i>Particulars</i>	₹
Building A/c	20,000	Balance b/d	7,00,000
Balance c/d	7,90,000	Statement of Profit and Loss	1,10,000
	8,10,000		8,10,000

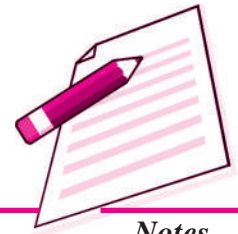
**Note**

- The gain on sale of building (i.e. ₹ 6000) would be deducted from the reported Income (or profit)
- Purchase of building for ₹144,000 is identified from the balancing figure in the Building account as an outflow of cash.
- ₹ 110,000 a charge to Profit and Loss Account is non-cash expense 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 of M/s Gill India (Pvt) Limited.

<i>Liabilities</i>	<i>March 31, 2013</i> ₹	<i>March 31, 2014</i> ₹
Provision for taxation	15000	20000

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## Cash Flow Statement

Net Income for the year 2013-14 is ₹ 50,000

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

### Solution

Provision for the year 2012-13 is an outflow of cash.

Provision for the 2013-14 shall be dealt with as follows

	₹
Net Income for the 2013-14	50,000
Add provision for Taxation for 2013-14	<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.

<i>Liabilities</i>	<i>March 31, 2013</i>	<i>March 31, 2014</i>
	₹	₹
Provision for Taxation	50,000	70,000

The amount of tax paid during 2013-14 amounted to ₹ 40000. How would you deal with this item presuming to be non current? You are also given net profit after taxation was ₹ 80000.

### Solution

To solve this problem, one should find out the amount of provision for tax charged to Statement of Profit & Loss for the year 2013-14.

### Provision for Taxation Account

Dr

Cr

<i>Particulars</i>	<i>Amount</i>	<i>Particulars</i>	<i>Amount</i>
	₹		₹
Bank (payment)	40,000	Balance b/d	50,000
Balance c/d	70,000	Statement of Profit and loss (Balances Figure)	60,000
	<u>1,10,000</u>		<u>1,10,000</u>

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

## Cash Flow Statement

Net Income after taxation	80,000
<b>Add:</b> Provision for taxation treated as non-cash expense	60,000
	<u>1,40,000</u>

### Illustration 9

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

<i>Liabilities</i>	<i>March 31, 2013</i> ₹	<i>March 31, 2014</i> ₹
Provision for Taxation	20,000	30,000

You are informed that Provision for Taxation ₹ 50,000 was charged to Statement of profit and Loss for the year 2013-14. Ascertain the cash used.

### Solution

#### Provision for Taxation Account

Dr

Cr

<i>Particulars</i>	<i>Amount</i> ₹	<i>Particulars</i>	<i>Amount</i> ₹
Bank (Balancing figure)	40,000	Balance b/d	20,000
Balance c/d	30,000	Statement of Profit and Loss	50,000
	<u>70,000</u>		<u>70,000</u>

### Note :

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

### Illustration 10

From the summarised cash account of ABC Limited prepare cash flow statement for the year ended 31st December 2013 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

<i>Particulars</i>	<i>Amount</i> (₹ 000)	<i>Particulars</i>	<i>Amount</i> (₹ 000)
Balance on 1.1.2013	50	Payment to Suppliers	2,000

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### Cash Flow Statement

Issue of equity shares	300	Purchase of fixed assets	200
Receipts from customers	2,800	Overhead expenses	200
Sale of fixed assets	100	Wages and salaries	100
		Taxation	250
		Dividend	50
		Repayment of Bank Loan	300
		Balance on 31.12.2013	150
	3,250		3,250

**Additional Information :** Net profit before tax for the year 2013 was ₹ 500000.

**Solution :**

#### **Cash Flow Statement of ABC Ltd** *for the year ended 31st December 2013 (Indirect method)*

	₹ 000	₹ 000
A. Cash flow from operating activities		
Net profit before tax	500	
Income tax paid	(250)	
Net cash from operating activities		250
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)		
<b>Add :</b> Opening balance of cash		50
Closing balance of cash		150

## Illustration 11

Following are the Balance Sheets of X Ltd. Prepare Cash Flow Statement.

Particulars	Note No.	31st March, 2014 (₹)	31st March, 2013 (₹)
<b>I. EQUITY AND LIABILITIES</b>			
<b>1. Shareholders' Funds</b>			
(a) Share Capital		25,00,000	20,00,000
(b) Reserves and Surplus	1	2,30,000	1,00,000
<b>2. Current Liabilities</b>			
Trade Payables		4,50,000	7,00,000
<b>Total</b>		<b>31,80,000</b>	<b>28,00,000</b>
<b>II. ASSETS</b>			
<b>1. Non-Current Assets</b>			
Fixed Assets - Tangible Assets (Land)		6,60,000	5,00,000
<b>2. Current Assets</b>			
(a) Inventories		9,00,000	8,00,000
(b) Trade Receivables		11,50,000	12,00,000
(c) Cash and Cash Equivalents		4,70,000	3,00,000
<b>Total</b>		<b>31,80,000</b>	<b>28,00,000</b>



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## Note to Accounts

Particulars	31st March, 2014 (₹)	31st March, 2013 (₹)
<b>1. Reserves and Surplus</b>		
Surplus, i.e., Balance in Statement of Profit & Loss	2,30,000	1,00,000

## Solution :

**X Ltd.**  
**Cash Flow Statement**  
for the year ended 31st March, 2014

Particulars	₹	₹
<b>Cash Flow from Operating Activities</b>		
Profit for the Year (Difference between Closing and Opening Surplus, i.e., Balance in Statement of Profit and Loss) (₹ 2,30,000 - ₹ 1,00,000)	1,30,000	
<b>Add :</b> Decrease in Current Asset and Increase in Current Liabilities :		
Decrease in Trade Receivables	50,000	
	<b>1,80,000</b>	

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## Cash Flow Statement

<i>Less : Increase in Current Asset and Decrease in Current Liabilities :</i>			
Increase in Inventories	(1,00,000)		
Decrease in Trade Payables	(2,50,000)	(3,50,000)	
<i>Cash Used in Operating Activities</i>			(1,70,000)
<b>Cash Flow from Investing Activities</b>			
Cash Payment for Land Purchased		(1,60,000)	
<i>Cash Used in Investing Activities</i>			(1,60,000)
<b>Cash Flow from Financing Activities</b>			
Cash Proceeds from Issue of Shares		5,00,000	
<i>Cash Flow from Financing Activities</i>			5,00,000
<b>Net Increase in Cash and Cash Equivalents</b>			1,70,000
<i>Add: Cash and Cash Equivalents in the Beginning</i>			3,00,000
<b>Cash and Cash Equivalents at the End</b>			4,70,000

### Illustration 12

Prepare Cash Flow Statement on the basis of the information given in the Balance Sheet of P.S. Ltd. as at 31st March, 2014 and 31st March, 2013 :

<i>Particulars</i>	<i>Note No.</i>	<i>31st March, 2014 (₹)</i>	<i>31st March, 2013 (₹)</i>
<b>I. EQUITY AND LIABILITIES</b>			
<b>1. Shareholders' Funds</b>			
(a) Share Capital		2,50,000	2,00,000
(b) Reserves and Surplus	1	70,000	50,000
<b>2. Non-Current Liabilities</b>			
Long-term Borrowings (12% Debentures)		80,000	1,00,000
<b>3. Current Liabilities</b>			
(a) Trade Payables	2	1,60,000	60,000
(b) Other Current Liabilities (Outstanding Liabilities)		20,000	25,000
<b>Total</b>		<b>5,80,000</b>	<b>4,35,000</b>
<b>II. ASSETS</b>			
<b>1. Non-Current Assets</b>			
(a) <i>Fixed Assets :</i>			
(i) Tangible Assets : Land and Building		2,80,000	2,00,000
(ii) Intangible Assets : Patents		2,000	10,000

## Cash Flow Statement

(b) Long-term Loans and Advances		1,30,000	1,00,000
<b>2. Current Assets</b>			
(a) Current Investment		5,000	3,000
(b) Inventories		90,000	70,000
(c) Trade Receivables		60,000	40,000
(d) Cash and Cash Equivalents		13,000	12,000
<b>Total</b>		<b>5,80,000</b>	<b>4,35,000</b>

## Note to Accounts

Particulars	31st March, 2014 (₹)	31st March, 2014 (₹)
<b>1. Reserves and Surplus</b>		
Surplus, <i>i.e.</i> , Balance in Statement of Profit & Loss	70,000	50,000
<b>2. Trade Payables</b>		
Creditors	60,000	40,000
Bills Payable	1,00,000	20,000
	1,60,000	60,000

## Solution :

**P.S. Ltd.**  
**Cash Flow Statement**  
*for the year ended 31st March, 2014*

Particulars	₹
<b>I. Cash Flow from Operating Activities</b>	
Closing Balance of Surplus, <i>i.e.</i> , Balance in Statement of Profit and Loss	70,000
<b>Less:</b> Opening Balance of Surplus, <i>i.e.</i> , Balance in Statement of Profit and Loss	(50,000)
Net Profit before Tax and Extraordinary Items	20,000
<b>Add :</b> Non-cash Expenses : Patents Amortised	8,000
Non-operating Expenses : Interest on Long'term Loans*	12,000
Operating Profit before Working Capital Changes	40,000
<b>Add :</b> Increase in Current Liabilities :	
Increase in Creditors	20,000
Increase in Bills Payable	80,000
	1,40,000

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## Cash Flow Statement

<b>Less :</b>	<i>Increase in Current Asset and Decrease in Current Liabilities :</i>		
	Decrease in Outstanding Expenses	(5,000)	
	Increase in Trade Receivables	(20,000)	
	Increase in Inventories	(20,000)	(45,000)
	<i>Cash Flow from Operating Activities (I)</i>		95,000
<b>II.</b>	<b>Cash-Flow from Investing Activities</b>		
	Purchase of Land and Building		(80,000)
	Loans and Advances		(30,000)
	<i>Cash Used in Investing Activities (II)</i>		(1,10,000)
<b>III.</b>	<b>Cash Flow from Financing Activities</b>		
	Proceeds from Issue of Equity Shares		50,000
	Repayment of Long-term Borrowings		(20,000)
	Interest on Long-term Loans		(12,000)
	<i>Cash Inflow from Financing Activities (III)</i>		18,000
<b>IV.</b>	<b>Net Increase in Cash and Cash Equivalents (I + II + III)</b>		<b>3,000</b>
<b>V.</b>	<b>Cash and Cash Equivalents in the beginning of the year</b>		
	(₹.3,000 + ₹ 12,000)		<b>15,000</b>
<b>VI.</b>	<b>Cash and Cash Equivalents at the end of the year (IV + V)</b>		
	(₹ 5,000 + ₹ 13,000)		<b>18,000</b>

\* Debenture interest @ 12% on ₹ 1,00,000.

### 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 34.4**

*Fill in the blanks with suitable word/words :*

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



*Notes*

**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).
- 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 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.

**TERMINAL EXERCISE**

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.

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### Analysis of Financial Statements



#### Notes

3. Give three examples of operating activities.
4. Give two examples of investing activities.
5. From the following Balance Sheets of X Ltd., prepare Cash Flow Statement:

<i>Particulars</i>	<i>Note No.</i>	<i>31st March, 2014 (₹)</i>	<i>31st March, 2013 (₹)</i>
<b>I. EQUITY AND LIABILITIES</b>			
<b>1. Shareholders' Funds</b>			
(a) Share Capital	1	2,00,000	1,80,000
(b) Reserves and Surplus	2	6,400	6,000
<b>2. Non-Current Liabilities</b>			
<i>Long-term Borrowings :</i>			
10% Debentures		14,000	12,000
<b>3. Current Liabilities</b>			
(a) Short-term Borrowing (Bank Overdraft)		13,600	25,000
(b) Trade Payables (Creditors)		22,000	24,000
(c) Short-term Provisions	3	20,000	16,000
<b>Total</b>		<b>2,76,000</b>	<b>2,63,000</b>
<b>II. ASSETS</b>			
<b>1. Non-Current Assets</b>			
Fixed Assets	4	1,50,000	1,60,000
<b>2. Current Assets</b>			
(a) Trade Receivables		48,000	40,000
(b) Inventories		71,000	60,600
(c) Cash and Cash Equivalents		7,000	2,400
<b>Total</b>		<b>2,76,000</b>	<b>2,63,000</b>

#### Notes to Accounts

<i>Particulars</i>	<i>31 March, 2014 (₹)</i>	<i>31 March, 2013 (₹)</i>
<b>1. Share Capital</b>		
Share Capital	1,80,000	1,55,000
10% Preference Share Capital	20,000	25,000
	<b>2,00,000</b>	<b>1,80,000</b>

## Cash Flow Statement

<b>2. Reserves and Surplus</b>		
General Reserve	4,000	4,000
Surplus <i>i.e.</i> , Balance in Statement of Profit & Loss	2,400	2,000
	6,400	6,000
<b>3. Short-term Provisions</b>		
Provision for tax	8,000	5,000
Proposed Dividend	12,000	11,000
	20,000	16,000
<b>4. Fixed Assets</b>		
Cost	1,80,000	1,82,000
<i>Less</i> : Accumulated Depreciation	30,000	22,000
	1,50,000	1,60,000

6. From the following Balance Sheets of Human Kind Pharamacticuals Ltd.

<i>Particulars</i>	<i>Note No.</i>	<i>31st March, 2014 (₹)</i>	<i>31st March, 2013 (₹)</i>
<b>I. EQUITY AND LIABILITIES</b>			
<b>1. Shareholders' Funds</b>			
(a) Share Capital	1	2,90,000	2,50,000
(b) Reserves and Surplus	2	72,000	50,000
<b>2. Current Liabilities</b>			
Trade Payables		5,000	23,000
<b>Total</b>		<b>3,67,000</b>	<b>3,23,000</b>
<b>II. ASSETS</b>			
<b>1. Non-Current Assets</b>			
<i>Fixed Assets :</i>			
(a) Tangible	3	1,50,000	1,40,000
(b) Intangible (Goodwill)		20,000	30,000
<b>2. Current Assets</b>			
(a) Trade Receivables		1,60,000	1,20,000
(b) Inventories		20,000	18,000
(c) Cash		17,000	15,000
<b>Total</b>		<b>3,67,000</b>	<b>3,23,000</b>

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### Analysis of Financial Statements



#### Notes

## Cash Flow Statement

### Notes to Accounts

Particulars	31st March, 2014 (₹)	31st March, 2013 (₹)
<b>1. Share Capital</b>		
Equity Share Capital	2,40,000	2,00,000
12% Preference Share Capital	50,000	50,000
	<b>2,90,000</b>	<b>2,50,000</b>
<b>2. Reserves and Surplus</b>		
General Reserve	50,000	35,000
Surplus, <i>i.e.</i> , Balance in Statement of Profit & Loss	22,000	15,000
<b>3. Fixed Assets (Tangible)</b>		
Building	80,000	1,00,000
Plant	70,000	40,000
	<b>1,50,000</b>	<b>1,40,000</b>

7. From the following Balance Sheets Kamni Medical College & research Centre Ltd. as at 31st March, 2014 and 31st March, 2013, prepare Cash Flow Statement :

Particulars	Note No.	31st March, 2014 (₹)	31st March, 2013 (₹)
<b>I. EQUITY AND LIABILITIES</b>			
<b>1. Shareholders' Funds</b>			
(a) Share Capital	1	16,00,000	10,40,000
(b) Reserves and Surplus	2	5,50,000	2,60,000
<b>2. Non-Current Liabilities</b>			
<i>Long-term Borrowings:</i>			
9% Debentures		4,00,000	6,00,000
<b>3. Current Liabilities</b>			
Trade Payables		4,50,000	1,00,000
<b>Total</b>		<b>30,00,000</b>	<b>20,00,000</b>
<b>II. ASSETS</b>			
<b>1. Non-Current Assets</b>			
Fixed Assets		20,00,000	15,00,000
<b>2. Current Assets</b>			
(a) Inventories		3,00,000	2,00,000
(b) Trade Receivables		2,00,000	1,00,000
(c) Cash and Cash Equivalents		5,00,000	2,00,000

## Cash Flow Statement

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#### Notes to Accounts

Particulars	31st March, 2014 (₹)	31st March, 2013 (₹)
<b>1. Share Capital</b>		
Equity Share Capital	15,00,000	10,00,000
7% Preference Share Capital	1,00,000	40,000
	16,00,000	10,40,000
<b>2. Reserves and Surplus</b>		
Surplus, i.e., Balance in Statement of P & L	1,50,000	2,00,000
General Reserve	4,00,000	60,000
	5,50,000	2,60,000



Notes

#### Additional Information :

- i. During the year a machinery costing ₹20,000
  - ii. Dividend paid ₹ 50,000.
8. From the following Balance Sheets of X Ltd., prepare Cash Flow Statement:

Particulars	Note No.	31st March, 2014 (₹)	31st March, 2013 (₹)
<b>I. EQUITY AND LIABILITIES</b>			
<b>1. Shareholders' Funds</b>			
(a) Share Capital		4,00,000	3,00,000
(b) Reserves and Surplus : Surplus, i.e., Balance in Statement of Profit & Loss		1,10,000	85,000
<b>2. Non-Current Liabilities</b>			
Long-term Borrowing : Bank Loan		75,000	1,00,000
<b>3. Current Liabilities</b>			
(a) Trade Payables (Creditors)		2,95,000	3,10,000
(b) Short-term Provisions	1	60,000	45,000
<b>Total</b>		<b>9,40,000</b>	<b>8,40,000</b>
<b>II. ASSETS</b>			
<b>1. Non-Current Assets</b>			
Fixed Assets (Net)	2	4,15,000	3,20,000
<b>2. Current Assets</b>			
(a) Inventories (Stock)		2,25,000	2,00,000
(b) Trade Receivables	3	3,00,000	2,90,000
(c) Cash and Cash Equivalents			30,000
<b>Total</b>		<b>9,40,000</b>	<b>8,40,000</b>

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#### Notes

## Cash Flow Statement

### Notes to Accounts

Particulars	31st March,	31st March
	2014 (₹)	2013 (₹)
<b>1. Short-term Provisions</b>		
Proposed Dividend	60,000	45,000
<b>2. Fixed Assets</b>		
Less : Accumulated Depreciation	5,50,000	4,00,000
<b>3. Trade Receivables</b>		
Debtors	1,90,000	2,10,000
Bills Receivable	1,10,000	80,000
	<b>3,00,000</b>	<b>2,90,000</b>

### Additional Information :

A piece of machinery costing ₹ 60,000 on which accumulated depreciation was ₹ 15,000 was sold for ₹ 30,000.

9. The Balance Sheets of Virendra Paper Ltd. as at 31st March, 2014 and 2013 are given below :

Particulars	Note No.	31st March, 2014 (₹)	31st March 2013 (₹)
<b>I. EQUITY AND LIABILITIES</b>			
<b>1. Shareholders' Funds</b>			
(a) Share Capital		7,20,000	6,00,000
(b) Reserves and Surplus : Surplus, i.e., Balance in Statement of Profit & Loss		4,80,000	3,75,000
<b>2. Non-Current Liabilities</b>			
Long-term Borrowing :			
10% Debentures		2,70,000	4,50,000
<b>3. Current Liabilities</b>			
Trade Payables		1,20,000	90,000
<b>Total</b>		<b>15,90,000</b>	<b>15,15,000</b>
<b>II. ASSETS</b>			
<b>1. Non-Current Assets</b>			
Fixed Assets	1	7,50,000	7,20,000
<b>2. Current Assets</b>			
(a) Trade Receivables		3,00,000	2,25,000
(b) Inventories		3,60,000	4,20,000
(c) Cash and Cash Equivalents		1,80,000	1,50,000
<b>Total</b>		<b>15,90,000</b>	<b>15,15,000</b>

Notes to Accounts

Particulars		31st March, 2014 (₹)	31st March 2013 (₹)
<b>1. Fixed Assets</b>			
Land		2,40,000	3,00,000
	<i>2014 (₹) 2013 (₹)</i>		
Plant and Machinery	7,50,000 6,00,000		
Less: Accumulated Depreciation	2,40,000 1,80,000		
	5,10,000 4,20,000	5,10,000	4,20,000
		7,50,000	7,20,000



Notes

Additional Information :

- i. Interim Dividend of ₹ 75,000 has been paid during the year.
- ii. Debenture Interest paid during the year ₹ 27,000.

You are required to prepare Cash Flow Statement.



ANSWERS TO INTEXT QUESTIONS

- 34.1** (i) Cash equivalents (ii) financial  
(iii) Cash inflow, cash outflow (iv) Cash equivalent
- 34.2** (i) listed (ii) investing
- 34.3** (i) Operating activities (ii) Financing activities  
(iii) Investing activities (iv) Investing activities  
(v) Financing activities
- 34.4** (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

- (a) Operating activities
- (b) Investing activities
- (c) Financing activities