CHAPTER 12

CASH FLOW STATEMENT

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

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

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

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

Cash equivalents : Cash equivalents are short-term higly liquid investment that are readily convertible into known amount of cash and which are subject to an insignificant risk of change in the value (of shotterm investment). Generally theses investment have a maturity period of less than three months.

Some example of cash equivalent : Bank overdraft, cash credit, short-term deposits, maketable securities, treasury bills, commercial papers, money market funds (mutual fund), investment in preference shares if redeemable within three months and ensure that there is no risk of the failure of the company.

Some type of transaction which are considered movement between cash and cash equivaletns are given below :

1. Cash deposited into bank.
2. Cash withdrawn from bank.
3. Sale of cash equivalent securities (e.g. sale of short term investment, sale of commercial papers)
4. Purchase of cash equivalent securities (e.g. Purchase of short-term investment, Purchase of Treasury bills).

The above types of transaction are part of cash and cash equivaltens, so these are included in opening and closing cash and cash equivalent only. So these types of transanction not be included in cash from different activities like operating, investing, financing activities.

Preparation of cash flow statement :	
Cash flow from operating activities	________
Cash flow from investing activities	________
Cash flow from financing activities	________
Net increase/decrease in cash & cash equivalent	(Total of the above three activities)
Add : Cash & Cash equivalent in the beginning of the year (Given in opening balance sheet)	________
Cash & Cash equivalent at the end of the year	________

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

OBJECTIVES OF CASH FLOW STATMEMENT :

1. To ascertain how mach cash or cash equivalents have been **generated** or **used** in **different activities** i.e. operating/investing/financing activity.
2. To ascertain the **net changes in cash and cash equivalents.**
3. To assesss the **causes of difference** between actual cash & cash equivalent and related net earning/income.
4. To help in **formulation of financial policies** such as dividend policy, fixed assests policy, capital structure related policy.
5. To help in **short-term financial planing**.
6. To ascertain the **liquidity** of enterprises

LIMITATIONS OF CASH FLOW STATEMENT

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

Computation of Cash flow from different activities.

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

Accounting standard -3 (Revised) has suggested two methods of computing net cash from operating activities (A) Direct Method (B) Indirect Method.

(C) Indirect Method of calculating the cash flow from Operating Activities :

Under this method Net Profit Before Tax and Extra-ordinary Item is the starting point further calculations.

Calculations of Net Profit Before Tax Extra - ordinary Item :

Difference between closing balance and opening balance of profit & loss A/c	____
Add : 1. Proposes divident for current year	____
2. Interim Divident paid during the year.	____
3. Profit Transferred to Reserve	
(If reserve of current year increased from previous year)	____
4. Provision for Taxation made durning the year	____
Less : 1 Refund of Tax credited to P & L A/c	____
2. Extraordinary item if any Credited to P & L A/c	____
Net Profit Before Tax and Extra-ordinary Item	

Extraordinary items : These items are not related to normal business operation and not included in investing and financing activities

Format for Cash Flow from Operation Activities

Particulars	(₹)
1. Cash Flow from Operating Activities	
(A) Net Profit Before Tax and Extra-ordinary Item	______
Adjustment for non-cash and non-operating itmes	
Add : 1. Derpreciation charged during the current year	
2. Preliminay expesnes, Discount on issue of shares and debentures written off	
3. Goodwill, Patents and Trademark Amortised (written off)	
4. Interes on Borrowing and Debentures.	
5. Loss on Sale of Fixed Assets	______
Less : 1. Interest income	
2. Dividend Income	
3. Rental income	______
4. Profit on sale of Fixed Assets	______
(B) Operating Profit before Working Capital changes	
Add : Increase in Current Liabilities and	______
Decrease in current Assets (other than cash and cash equivalent)	
Less : Increase in current Assets (other than cash and cash equivalent) and Decrease in current liabilities	
(C) Cash Generated from operations	
Less : Income tax paid (Net of Refund received)	
(D) Cash flow before Extraordinary item	
Extraordinary items +/-	
(E) Net Cash From (or used in) Operating Activities	

For the calculation of Proposed Dividend during the current year the proposed dividend account is to be prepared as follows :

Dr. Cr.

Proposed Dividend Account

Date	Particular	₹	Date	Particulars	₹
	To (Dividend payable A/c)	______		By Balance b/d	______
	To balance c/d	______		By Profit & Loss A/c (Proposed dividend during the current year)	______

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

Dr. Provision for Taxation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c (Tax Paid during the current year)	....		By Balance b/d	....
	To balance c/d	....		By Profit & loss A/c (Provision for taxation made during the current year)	....

Illustration 2.X ltd made a profit of ₹ 1,00,000 after considering the following items:

1.Depreciation on fixed assets ₹ 20,000. 2. Writing off preliminary expenses ₹ 10,000

3.Loss on sale of furniture ₹ 1,000. 4.Provision of Taxation ₹ 1,60,000.

5. Transfer to General reserve ₹ 14,000 6. Profit on sale of Machinery ₹ 6,000.

The following additional information is available to you:

Particulars	31-03-2007 (₹)	31-03-2008 (₹)
Debtors	24,000	30,000
Creditors	20,000	30,000
Bills Receivables	20,000	17,000
Bills Payables	16,000	12,000
Prepaid Expenses	400	600

Calculate Cash Flow from Operating Activities.

Solution. Calculation of Net Profit Before Tax And Extra-ordinary Item

Net Profit (Given) ₹1,00,000

Add: Provision for Taxation ₹1,60,000

Transfer to general reserve	₹ 14,000
Net Profit Before Tax And Extra-ordinary Item	₹2,74,000

CASH FLOW FROM OPERATING ACTIVITIES

Particulars	₹	₹
Net Profit Before Tax And Extra-ordinary Item		2,74,000
Adjustment for non-cash and non-operating items		
Add: Depreciation on fixed assets	20,000	
Preliminary expenses written off	10,000	
Loss on sale of furniture	1,000	31,000
		3,05,000
Less: Profit on sale on machinery	6000	(6,000)
Operating Profit before working capital changes		2,99,000
Add: Increase in creditors	10,000	
Decrease in Bills Receivables	3,000	13,000
		3,12,000
Less: Increase in Debtors	6,000	
Increase in Prepaid Expenses	200	
Decrease in Bills Payables	4,000	(10,200)
Cash generated from operation		3,01,800
Less: Income tax Paid		(1,60,000)
Cash Flow from Operating Activities		1,41,800

2. Cash Flow from Investing Activities:

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

Inflows of Cash : (plus items)	Outflows of Cash(minus items)
1. Cash Received from sales of fixed Assets.	1. Cash paid for purchase of fixed assets.
2. Cash Received from sales of Investment.	2. Cash paid for purchase of Investment.
3. Interest Received.	3. Cash paid for purchase of intangible fixed assets like goodwill, patents and copy writes.
4. Dividend Received.	
5. Rent Received	

For the calculation of sale or purchases of fixed assets and investment, the following accounts are prepared:1. Fixed Assets Account 2. Investment Account.

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

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

Dr. Fixed Assets Account (at written down value) Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d			By Bank A/c(Sale of investment)	
	To Bank A/c (additional purchase)			By Depreciation A/c (Dep. on fixed assets sold)	
	To Profit &Loss A/c (profit on sale of fixed assets)	---------		By Profit & loss A/c (Loss on sale of fixed assets)	
				By Depreciation A/c (Current year dep. on remaining fixed assets)	-------
				By balance c/d	----------

Fixed Assets (at cost) : when provision for depreciation account or accumulated depreciation account eparately maintained. In this method two account name fixed assets account and provision for reciation account is maintained.

Dr. Fixed Assets Account (at original cost) Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	______		By Bank A/c(Sale of investment)	______
	To Bank A/c(additional purchase)	______		By Depreciation A/c (Dep. on fixed assets sold)	______
	To Profit &Loss A/c (profit on sale of fixed assets)	---------		By Profit & loss A/c (Loss on sale of fixed assets)	______
				By balance c/d	----------

Dr. Provision for Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Fixed Assets A/c (total Depreciation on fixed assets sold)	..		By Balance b/d	....
	To balance c/d	....		By Profit & loss A/c (Depreciation charged on fixed assets during the current year)	....

Preparation of Investment Account:

Dr. Investment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	________		By Bank A/c (Sale of investment)	________
	To Bank A/c (additional purchase)	________		By Profit & loss A/c (Loss on sale of Investment)	________
	To Profit &Loss A/c (profit on sale of Investment)	---------		By balance c/d	________

Illustration 3. From the following information calculate cash flow from investing activities:

Particulars	31-03-2010(₹)	31-03-2011(₹)
Machinery (at Cost)	5,00,000	5,50,000
Accumulated Depreciation	1,00,000,	1,20,000
Patents	2,00,000,	1,20,000
Goodwill	1,50,000	2,00,000
Investment	2,50,000	5,00,000

Additional information:

(i) During the year , a machine costing ₹ 50,000 with its accumulated depreciation of ₹ 25,000 was sold for ₹20,000.

(ii) Patents were written off to the extent of ₹ 60,000 and some patents were sold at a profit of ₹ 10,000.

(iii) 40% of the investment held in the beginning of the year were sold at 10% Profit.

(iv) Interest received on investment ₹ 25,500.

(v) Dividend received on investment ₹ 8,500.

(vi) Rent received ₹ 5,000.

Solution:

Cash Flow from Financing Activities

Particulars	₹
Proceeds from sale of machinery	20,000
Proceeds from sale of investment	1,10,000
Proceeds from sale of Patents	30,000
Cash paid of purchase of machinery	(1,00,000)
Cash paid of purchase of Investment	(3,50,000)
Interest Received	25,500
Dividend Received	8,500
Rent Received	5,000
Net Cash Used in Investing Activities	(2,51,000)

Working Notes:

Dr. Investment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	2,50,000		By Bank A/c	1,10,000
	To Profit &Loss A/c(profit on sale of Investment)	10,000		(Sale of investment)	
	To Bank A/c (additional purchase)	3,50,000		By balance c/d	5,00,000
		6,10,000			6,10,000

Dr. Machinery Account (at original cost) Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	5,00,000		By Bank A/c(Sale of Machinery)	20,000
	To Bank A/c(additional purchase)	1,00,000		By Depreciation A/c (Dep. on Machinery sold)	25,000
				By Profit & loss A/c (Loss on sale of Machinery)	5,000
				By balance c/d	5,50,000
		6,00,000			6,00,000

Dr. Provision for Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Machinery A/c (total Depreciation on machinery sold)	25,000		By Balance b/d	1,00,000
	To balance c/d	1,20,000		By Profit & loss A/c(Depreciation charged on machinery during the current year)	45,000
		1,45,000			1,45,000

Dr. Patents Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	2,00,000		By Bank A/c	30,000
	To Profit &Loss A/c	10,000		(Sale of Patents)	
	(profit on sale of Patents)			By Profit&Loss A/c	60,000
				(Written off)	
				By balance c/d	1,20,000
		2,10,000			2,10,000

4. **Cash Flow from Financing Activities:**

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

Inflows of Cash : (plus items)	Outflows of Cash(minus items)
1.Cash Received from Issue of equity shares capital. 2. Cash Received from Issue of preference shares capital. 3.Cash Received from taking long-term loan.	1Cash paid for repayment of long-term loan. 2.Redemption of Preference share capital in cash 3.Redempton of Debenture in cash 4. Buy back of Equity shares. 5. Interest paid on long-term loan and debentures. 6. Final Dividend paid 7. interim dividend paid

Illustration 4.From the following information, calculate the net cash flow from Financing Activities:

Particulars	31-03-2010(₹)	31-03-2011(₹)
Equity Share Capital	10,00,000	16,00,000
9% Debentures	1,50,000,	1,00,000
Proposed Dividend	3,00,000,	3,50,000
Dividend Payable	--------	50,000
10% Preference Share Capital	2,00,000	3,00,000

Additional information:

1. Interest paid on Debentures ₹ 12,500.
2. During the year 20010-2011, company issued bonus shares to equity shareholders in the ration of 2:1 by capitalizing reserve.
3. The interim dividend of ₹ 75,000 has been paid during the year.
4. 9% Debentures were redeemed as 5% premium.
5. 10% preference shares were issued at 2% discount.

Solution:

Cash Flow from Financing Activities

Particulars	₹
Proceeds from Issue of Equity Share Capital	1,00,000
Proceeds from Issue of 10%Preference Share Capital (1,00,000x98%)	98,000
Cash paid for Redemption of 9% Debentures (50,000x 105%)	(52,500)
Interest paid on Debentures	(12,500)
Interim Dividend paid	(75,000)
Final Dividend paid (3,00,000-50,000)	(2,50,000)
Net Cash Used in Financing Activities	1,92,000

Note: 1.Bonus shares issued to equity shareholder are not to be shown in the cash flow statement because there is no flow of cash by this activity.

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

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

Comprehensive :

Illustration No. 5 : Prepare a cash flow statement from the following Balance Sheet of Dev' Ltd. :-

Particulars	**31.03.2011 (₹)**	**31.03.2012 (₹)**
I. Equity and Liabilities		
1. Shareholder's funds :		
(a) Share Capital	65	65
(b) Reserve and Surplus 1	42.5	25
2. Share Application money pending allotment	–	–
3. Non-current Liabilities	–	–
4. Current Liabilities	–	–
Trade Payables	10.5	7.7
Total	118	77.7
II. Assets		
1. Non-current Assets		
(a) Fixed Assets	83	46.7
2. Current Assets		
(a) Inventories	13	11
(b) Trade Receivables	19.5	18
(c) Cash and Cash equivalents	2.5	2
Total	118	77.7

Notes to Account No. 1

Particulars	**31.03.2012 (₹)**	**31.03.2011 (₹)**
Reserve and Surplus		
1. Shareholder's funds :		
General Reserve	27,500	15,000
Profit and Loss A/c	15,000	10,000
Total	42,500	25,000

Additional Information :

(1) Depreciation on fixed assets for the year 2011-12 was Rs.14,700

(2) An interim divided of Rs.7000 has been paid to the shareholders during the year.

Solution : Calculation of Net Profit before tax and Extra ordinary item :

Net Profit as Per Profit & Loss A/c (15000-10000)	5,000
Add : Transfer to General Reserve (27,500-15,000)	12,500
Interim Dividend Paid during the year	7,000
Net Profit Before Tax and Extraordinary item	24,500

Cash Flow Statement
for the year ended 31st March 2012

Particulars

	(Rs.) 31.03.2012	**(Rs.) 31.03.2011**
(A) Cash Flow from Operating Activities :		
Net Profit before tax and Extra-ordinary item	24,500	
Adjustment for Non Cash and Non-operating item :		
Add : Depreciation on fixed Assets	14,700	
Operating Profit before Working Capital Changes		39,200
Adjustment for Working Capital Changes :		
Add : Increase in Trade Creditors	2,800	
Less : Increase in Stock	(2,000)	
Increase in Debtors	(1,500)	(700)
Cash flow from Operating Activities		38,500
(B) Cash Flow from Investing Activities		
Purchase of Fixed Assets	(51000)	
Net Cash used in Investing Activities		(51000)
(C) Cash flow from financing Activities		
Proceeds from issue of equity share capital	20,000	
Interim Dividend Paid	(7,000)	
Net Cash from Financing Activities	13,000	13,000
Net Increase in Cash and Cash Equivalents		500
Cash and Cash equivalents in the beginning of the year		2000
Cash and Cash equivalents at the and of the year		2500

Dr. **Fixed Assets A/c (on original cost)** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Balance b/d	46,700		By Depreciation A/c	14,700
	To Bank A/c	51,000		(Current year dep. on remaining fixed assets)	
	(Additional purchase)			By balance c/d	83,000