CASH FLOW STATEMENT

A cashflow statement or statement of cash flows a summary of cash ipts and cash payments out the operating, investing nd financing activities of a business enterprise. Cash flow means the movement of cash into enterprise referred to as sources (cash inflows) and also movement of cash out of the enterprise referred to as ~~sources~~ uses (cash outflows). Thus, cash flows are inflows and outflows of cash and cash equivalents. The difference between ~~the~~ cash inflows and cash outflows is known as net cash flow which can be either a net cash inflow or a net cash outflow depending upon the amounts of two components respectively.

It may be noted that the term cash when used in cash flow statement includes cash and cash equivalents. Cash comprises cash on hand and demand deposits with banks while cash equivalents are short-term highly liquid investments with original maturity of 3 months or less. Examples of cash equivalents are treasury bills, commercial papers, money market funds purchased, etc.

Major classification of cash flows

The statement of cash flows shows 3 main categories of cash inflows (or cash receipts) and cash outflows (or cash payments), namely, operating, investing and financing:-

(i) Cash flows from operating activities :- Operating activities are the principal revenue producing activities of a business enterprise and include cash flows from those transactions and events that enter into the determination of net profit or loss. Examples of cash inflows from main operating activities are:

(i) cash receipts ~~from~~ from the sale of goods and the rendering of services;

(ii) cash receipts from royalties, fees, commission, etc.;

(iii) cash receipts from interest and dividend in the case of finance companies;

(iv) cash payments to suppliers for goods and services;

(v) cash payments to employees for wages, salaries, and other employee benefits;

(vi) cash payment of interest in the case of finance companies;

(vii) cash payments (or refunds) of income taxes unless these can be specifically identified with financing and investing activities;

(viii) cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits.

(ix) cash receipts and payments relating to future contracts, forward contracts, option contracts, and swap contracts when the contracts are held for trading purpose.

(2) Cash flows from investing activities :-

(i) Cash receipts from sale or disposal of fixed assets, including intangible assets;

(ii) Cash receipts from sale of shares, warrants, or debentures of other companies

(iii) Cash receipts from interest, dividend, etc. in respect of investments

(iv) Cash receipts from repayments of advances and loans made to third parties (other than loans and advances of a financial enterprise);

(v) Insurance proceeds from property involved in accident;

(vi) Cash payments to purchase shares, warrants, debentures, etc. of other companies;

(vii) Cash payments to acquire fixed assets including intangible assets;

(viii) Cash payments for capitalised interest, and for capitalised research and development costs;

(ix) Cash advances and loans made to third parties (other than advances and loans made by a financial enterprise)

(3) Cash flows from financing activities :-

(i) Cash receipts from issuing shares, debentures, bonds, loans, notes etc.;

(ii) Repayment or redemption of preference shares, debentures, bonds etc.;

(iii) Payment for buy-back of equity shares;

(iv) Payment of interest on debentures, loans, etc.;

(v) Payment of dividend on equity and preference shares

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Procedure for preparing Cash Flow Statement

On the basis of basic information given in opening and closing balance sheets, profit and loss statement, and additional information available, the following steps are generally taken for preparing the Cash Flow Statement:

(1) Determine how much cash and cash equivalents have changed :- The first step involves the calculation of the difference between the amount of cash and cash equivalents on the first day and on the last day of the accounting year, with the help of opening and closing balance sheets.

(2) Determine cash flows from operating activities :- It is determined by the analysis of revenue and expense items of profit and loss statement.

In addition, an analysis of current assets and current liabilities is also required with the help of opening and closing balance sheets as well as the additional information given.

(3) Determine the cash provided or used by investing activities through the analysis of non-current assets.

(4) Determine the cash provided or used by financing activities :- Here, an analysis of non-current liabilities and Capital A/Cs is made.

(5) Preparation of cash flow statement :- Prepare a formal cash flow statement by classifying all cash inflows and outflows in terms of operating, investing and financing activities. The net cash flow provided by or used in each of the 3 main activities of an entity should be highlighted.

(6) Make sure that the aggregate of net cash flows from operating, financing and investing activities is equal to the net increase or decrease in cash and cash equivalents.

Format of the Cash Flow Statement

Company Name
Cash Flow Statement for the year ending ....

	Rs	Rs
(A) Cash Flows from Operating Activities		
Net profit as per P&L Statement		...
Adjustments for non-cash and non-operating items:		
(+) Depreciation	...	
(+) Amortization of intangible assets	...	
(+/−) Exchange rate effect	...	
(+) Premium on redemption	...	
(+) Preliminary expenses	...	
(+) Discount on issue of shares and debentures	...	
(+) Interest expense	...	
(+/−) Loss or gain on sale of fixed assets/investments	...	
(−) Interest/dividend income	...	
(+) Provision for tax	...	
(−) Refund of tax	...	
Operating profit before working capital changes		...

	Rs	Rs
Adjustments for working capital items		
(−) Increase in C. Assets	...	
(+) Decrease in C. Assets	...	
(+) Increase in C. Liabilities	...	
(−) Decrease in C. Liabilities	...	
(−) Tax paid during the year		...
Net cash from operating activities		...
(B) Cash Flows from Investing Activities		
(−) Purchase of fixed assets	...	
(−) Purchase of investments	...	
(−) Cash loans and advances made to third parties	...	
(+) Sale of fixed assets	...	
(+) Sale of investments	...	
(+) Cash receipts from interest, dividend etc. in respect of investments made	...	
(+) Cash receipts from repayments of advances and loans made to third parties	...	
Net cash from investing activities		...
(C) Cash Flows from Financing Activities		
(+) Proceeds from		

	Rs	Rs
(+) Issue of share capital, debentures, loans, bonds, notes etc.	---	
(−) Repayment of preference shares, debentures, bonds etc.	---	
(−) Payment for buy-back of equity shares	---	
(−) Payment of dividend on shares, interest on loans, debentures etc	---	
Net cash from financing activities		---
Increase/Decrease in cash and cash equivalents (A+B+C)		---
(+) Cash and cash equivalents at the beginning of the year		---
Cash and cash equivalents at the end of the year		---

Important points

(1) The cash flows associated with extraordinary items such as bad debts recovered, claims from insurance companies, winning of a lottery or a law suit etc. are disclosed separately as arising from operating, investing or financing activities in the cash flow statement.

(2) Taxes paid are usually classified as cash outflows from operating activities However, when it is possible to identify the tax outflow with investing or financing activity the tax flow may be appropriately classified as an investing or financing activity, and the total amount of tax paid is disclosed.

(3) Some operating, financing or investing activities do not require the use of cash or cash equivalents. These non-cash items should be excluded from the cash flow statement.

(4) Transfers to general reserve, dividend equalisation reserve, sinking funds and other reserves are simply appropriations of profits and, hence must be added back.

(5) Loss on the sale of fixed assets and investments is a non-cash item and must be added back to the net income if the same has been shown as a deduction in the Profit and Loss Statement.

(6) Refund of tax increases the cash but it is not an operating income. Hence, it is to be reduced from the net income figure.

(7) Profit or gain on the sale of fixed assets and long-term investments is a non-operating item. Therefore, it is to be deducted from the reported ~~net~~ income.

(8) Marketable ~~investments~~ securities representing temporary investments are treated as current assets. Any loss or gain on the sale of such investments does not require any adjustment in the reported income or profit. However, any loss or gain on the sale of long-term investments must be added to or deducted from the net income since it is a non-operating item.

The amount of interim dividend paid will be added back to reported profits for the purpose of calculating cash from operations if such profits have been shown after appropriation of interim dividend.

(10) Provision for tax made during the year is to be added back to the current years profit figure. In the Cash Flow Statement, the tax paid would be shown separately as an outflow of cash in calculating cash from operations.

It is to be further noted that in case the provision for taxation is appearing in the opening as well as closing balance sheets, the figure in the opening B/S is treated as an outflow of cash from operations while the figure in the closing B/S is treated as a non-cash and non-operating expense and is thus added back to the net income figure to find out the cash provided from operations.

(11) Proposed dividend would be added back to current years profits if already appropriated, and actual dividend paid during the year would be shown as an outflow of cash from financing activities.

(12) When the debtors given in the comparative balance sheets are good debtors, any increase in the item 'provision for doubtful debts' between the two balance sheets would be added back to the reported surplus of the current year whereas net decrease, if any, would be deducted from the net income of the current year.

(13) Unrealised losses and gains arising from changes in foreign exchange rates are not cash flows. However, the effect of exchange rate ~~effects~~ changes on cash and cash equivalents held in foreign currency must be reported in the Cash Flow Statement in order to reconcile cash and cash equivalents at the beginning and at the end of the period.

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Illustration 8 (Cash Flow from Operating Activities)

The following is the financial position of Aruna Limited :

	2010	2011
Liabilities :	₹	₹
Equity Share Capital	4,50,000	5,00,000
General Reserve	40,000	70,000
Profit and Loss Account	30,000	48,000
Proposed Dividend	42,000	50,000
Creditors	55,000	83,000
Bills Payable	20,000	16,000
Provision for Taxation	40,000	50,000
	6,77,000	8,17,000
Assets :		
Goodwill	1,15,000	90,000
Land and Building	2,00,000	1,70,000
Plant	80,000	2,00,000

Debtors	1,60,000	2,00,000
Stock	77,000	1,09,000
Bills Receivable	20,000	30,000
Cash	25,000	18,000
	6,77,000	8,17,000

Additional Information:

(i) Depreciation of ₹ 15,000 and ₹ 25,000 have been charged on Plant, and Land and Building respectively.

(ii) An interim dividend of ₹ 20,000 has been paid in 2011.

(iii) An income-tax of ₹ 35,000 was paid during 2011.

Calculate cash from operating activities as per AS-3 (Revised).

Illustration 13

The following are the Balance Sheets of M Ltd. as at 31st March, 2009 and 31st March, 2010:

Liabilities	2009 ₹	2010 ₹	Assets	2009 ₹	2010 ₹
Equity share capital	20,00,000	25,00,000	Goodwill	–	50,000
General reserve	5,00,000	6,00,000	Land and Building	9,10,000	8,00,000
Profit and Loss A/c	3,00,000	4,50,000	Plant and Machinery	23,50,000	26,70,000
Long-term loan	8,00,000	3,00,000	Stock	1,80,000	2,15,000
Sundry creditors	1,00,000	1,30,000	Sundry debtors	90,000	1,40,000
Provision for tax	80,000	90,000	Cash at bank	1,65,000	1,70,000
			Preliminary expenses	85,000	25,000
	37,80,000	**40,70,000**		**37,80,000**	**40,70,000**

Additional Information:

1. The company paid dividend @ 10% to equity shareholders. Share-holders were entitled to receive dividend on new shares issued during the year.
2. The company issued 10,000 equity shares of ₹ 10 each to supplier of machinery. Further, machines costing ₹ 4,00,000 were purchased against payment in cash. There was no sale of machines during the year.
3. Interest paid on long-term loan ₹ 80,000.

Prepare Cash Flow Statement.

Note: Ignore corporate dividend tax. **[B.Com. Delhi 2011]**