



4. FINANCIAL STATEMENTS OF COMPANIES

UNIT 2 - CASH FLOW STATEMENT

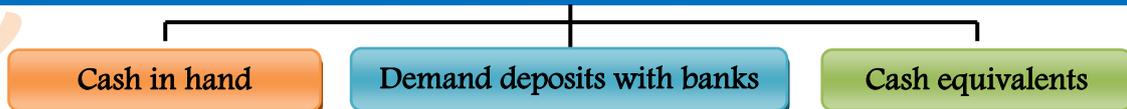
CONCEPT 1 : INTRODUCTION

- Accounting Standard 3 on Cash Flow Statements was issued in March, 2004.
- It is based on cash concept of profit.
- Cash Flow refers both cash and cash equivalents, where, Cash includes Bank A/c also.
- This statement provides information in assessing a company's liquidity, quality of earnings & solvency.

Sr no.	Points	Explanation
[A] Benefits of Cash Flow Statement :		
1]	Provides information	It provides information about the changes in cash & cash equivalents.
2]	Identifies Cash generation	It identifies cash generated from trading operations.
3]	Investment	The operating cash surplus can be applied for investment in fixed assets.
4]	Payment of Dividend & Tax	Portion of cash from operations is used to pay dividend and tax and other portion is ploughed back.
5]	Planning	It is a very useful tool of planning.
[B] Purpose : To explain the cash movements between two points of time.		
[C] Sources of Cash :		
1]	Issue of shares and debentures and raising long-term loan.	
2]	Sale of investments and other fixed assets.	
3]	Cash from operations (Net Operating Profit)	
4]	Decrease in Cash (To balance the Cash Flow Statement)	
[D] Applications of Cash :		
1]	Redemption of preference shares and debentures and repayment of long-term loan.	
2]	Purchase of investments and other fixed assets.	
3]	Payment of tax.	
4]	Payment of dividend.	
5]	Increase in cash (To balance the Cash Flow Statement)	
6]	Loss on Operation (Net Operating Loss)	

✍ **Note :** In cash flow statement, changes in all balance sheet items are to be taken into consideration separately for explaining movement of cash.

CONCEPT 2 : ELEMENTS OF CASH



[i] Components :

- ▶ Short term highly liquid investments readily convertible into known amounts of cash, subject to an insignificant risk of changes in value.
- ▶ Securities with short maturity period (three months or less).

[ii] Objective :

- ▶ Deploy idle cash to meet short-term cash-commitments.



[iii] Examples :

- ▶ Acquisition of preference shares, shortly before their specified redemption date, bank deposits with short maturity period, etc.

✍ Conclusion :

Thus, cash flow statement deals with flow of cash funds but does not consider the movements among cash, bank balance payable on demand and investment of excess cash in cash equivalents.

☺ **Examples :** Cash withdrawn from current account, cash deposited in bank for 60 days, etc.

CONCEPT 3 : CLASSIFICATION OF CASH FLOW ACTIVITIES

Sr no.	Points	Explanation
[A] Operating Activities :		
i]	Definition	Principal revenue generating activities of the enterprise.
ii]	Net impact	Reported as 'Cash flows from operating activities' or 'cash from operation'.
iii]	Key Indicator	It is a key indicator of the extent to which the operations of the enterprises have generated sufficient cash flows to : [a] Maintain the operating capability of the enterprise, [b] Pay dividends, repay loans, and [c] Make new investments without recourse to external sources of financing.
iv]	Information Provided	It provides useful information about internal financing.
v]	Benefits	Information provided is useful in forecasting future operating cash flows.
[B] Investing Activities :		
i]	Definition	Acquisition and disposal of long-term assets and other investments not included in cash equivalents.
ii]	Separate Disclosure	To represent the extent to which the expenditures have been made for resources intended to generate future incomes and cash flows.
[C] Financing Activities :		
i]	Definition	Activities that result in changes in the size and composition of the owner's capital (Equity & Preference) and borrowings of the enterprise.
ii]	Separate Disclosure	To predict claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise.

CONCEPT 4 : CALCULATION OF CASH FLOWS FROM OPERATING ACTIVITIES

[1] Components :

- ☞ Transactions and events that enter into determination of net profit or loss.

[2] Examples :

- [a] Receipts -sale of goods, rendering of services, fees, commission and other revenue;
- [b] Payments-suppliers for goods, employees, etc.

[3] Methods :

- [a] Direct Method : Gross cash receipts and gross cash payments are considered.
- [b] Indirect Method : Net profit or loss is adjusted for transactions of non-cash nature, deferrals or accruals of operating items & income or expense associated with investing or financing activities.



Sr. No.	Points	Explanation
[A] Direct Method :		
i]	Information Required	Information can be acquired by two ways : ▶ From the accounting records : ☺ Example : [a] Cash received from trade receivables. [b] Payment to trade payables, cash expenses, from cash book. ▶ By adjusting sales, cost of sales and other items in P&L A/c for: ▶ Changes in inventories and operating receivables and payables; ▶ Other non-cash items like depreciation, goodwill, preliminary expenses, loss or gain on sale of fixed assets etc.;; ▶ Items associated with investing or financing activities are shown separately in cash flow statement. ☺ Examples : Interest and Dividend - received and paid, etc.
ii]	Also known as	Income statement method.
ii]	More Appropriate	The direct method provides useful information for estimating future cash flows, which is not available under indirect method, thus it is more appropriate than the indirect method.
iii]	Popular Method	Indirect method is more popular in actual practice.
[B] Indirect Method :		
i]	Meaning	Net cash from operating activities is determined by adjusting net profit or loss for the effect of: [a] Changes in inventories and operating receivables and payables; [b] Non-cash items such as depreciation; and [c] Items associated with investing or financing activities are shown separately in cash flow statement.
ii]	Also known as	Reconciliation method
[C] Conclusion :		
i]	Both methods adjust current assets & current liabilities related to operating activities to determine cash from operating activities.	
ii]	Direct method adjusts individual items of P&L A/c & Indirect method adjusts overall net profit or loss.	

CONCEPT 5 : CALCULATION OF CASH FLOWS FROM INVESTING ACTIVITIES

- [1] These activities are related to the acquisition and disposal of long-term assets, non-operating current assets and investments which results in outflow of cash.
- [2] Disposal of the aforesaid assets results in inflow of cash.

CONCEPT 6 : CALCULATION OF CASH FLOWS FROM FINANCING ACTIVITIES

- [a] These activities are related to changes in capital & borrowing of enterprise which affect flow of cash.
- [b] Redemption of shares and repayment of borrowings results in outflow of cash.



Format for Direct Method of Cash Flow Statement

Sr. no.	Particulars	Rs.	Rs.
A]	Cash flow from Operating Activities :		
	– Receipts from Debtors	xxx	
	– Payments made to Suppliers of Goods	(xxx)	
	– Payments made to Expenses Creditors	(xxx)	
	– Payments made to Employees	(xxx)	
	– Cash from Operations	xxx	
	– Less: Income Tax paid (after adjusting Refund)	(xxx)	
	– Add: Extra - ordinary activities	xxx	xxx
B]	Cash flow from Investing Activities :		
	– Purchase/Sale of Fixed Assets	(xxx)/xxx	
	– Purchase/Sale of Investments	(xxx)/xxx	
	– Investments in Joint Venture	(xxx)	
	– Interest received on Investments	xxx	
	– Dividend received	xxx	xxx
C]	Cash flow from Financing Activities :		
	– Issue of Share Capital (Face Value + Premium)	xxx	
	– Receipt of Calls	xxx	
	– Redemption of Capital (FV + POR)	(xxx)	
	– Buy Back of Shares (including Premium paid)	(xxx)	
	– Debentures redeemed/Loan repaid	(xxx)	
	– Interest paid on Debentures/Loan	(xxx)	
	– Dividend paid	(xxx)	xxx
D]	Net ↑ or ↓ in Cash & Cash Equivalents (A+B+C)		xxx
E]	Opening balance of Cash & Cash Equivalents		xxx
F]	Closing balance of Cash & Cash Equivalents		xxx

Format for Indirect Method of Cash Flow Statement

Sr. no.	Particulars	Rs.	Rs.
A]	Cash flow from Operating Activities :		
	Operating Profit before Working Capital Changes (WN 1)	xxx	
	Adjustments :		
	Less :Increase in Current Assets	(xxx)	
	Add : Decrease in Current Assets	xxx	
	Add : Increase in Current Liabilities	xxx	
	Less : Decrease in Current Liabilities	(xxx)	
	Cash from Operations	xxx	
	Less: Income Tax paid (after adjusting Refund)	(xxx)	
	Add : Extra - ordinary activities	xxx	xxx
B]	Cash flow from Investing Activities		xxx
C]	Cash flow from Financing Activities		xxx
D]	Net ↑ or ↓ in Cash & Cash Equivalents (A+B+C)		xxx
E]	Opening balance of Cash & Cash Equivalents		xxx
F]	Closing balance of Cash & Cash Equivalents		xxx



W.N.1 : Adjusted P&L A/c

Particulars	Rs.	Particulars	Rs.
		By Balance b/d	
To Depreciation		By Interest Income	
To Goodwill written off		By Profit on Sale of Asset/Investment	
To Foreign Currency Loss		By Dividend Income	
To Loss on Sale of Asset/Investment		By Foreign Currency Gain	
To Preliminary expenses written off		By Extraordinary Item	
To Interest Expense			
To Income Tax		By Operating Profit Before Working Capital Changes*	
To Extraordinary Item			
To Balance c/d			
	Total Rs.		Total Rs.
