RAMA UNIVERSITY

www.ramauniversity.ac.in

FACULTY OF COMMERCE & MANAGEMENT

COURSE: B.COM 3rd SEMESTER

SUBJECT: MANAGEMENT ACCOUNTING

SUBJECT CODE: BCH 302

LECTURE: 6

NAME OF FACULTY: DR. R. S. BISARIYA

Lecture-6

Cash Flow Statement

Cash Flow Statement

CONTENTS

Objectives

After studying this Chapter, you will be able to:

- Explain the meaning of cash flow statement
- Compute cash flow from operating, investing and financing activity
- Prepare cash flow statement as per AS-3

Introduction

Cash is considered one of the vital sources of the firm to meet day to day financial commitments. The cash is considered to be as most important source of life blood of the business. The day to day financial commitments are met out only out of the available resources. The cash resources are availed through two different types of receipts viz. sales, dividends, interests known as regular receipts and sale of assets, investments known as irregular receipts of the business enterprise. To have smooth flow of business enterprise, it should have ample cash resources for its operations. The availability of cash resources is mainly depending on the cash inflows of the enterprises. The smoothness in operations of the enterprise is obtained through an appropriate matching of cash inflows and cash outflows.

To have smoothness in the operations of the enterprise, the firm should have an appropriate volume of cash resources at speedier rate as well as more than the financial commitments of the firm. This smoothness could be attained by way of an appropriate planning analysis on the

Notes

cash resources of the firm. The meaningful analysis is only possible through cash flow statement analysis which facilitates the firm to identify the possible sources of cash as well as the expenses and expenditures of the firm.

6.1 Meaning of Cash Flow Statement

The cash flow statement is being prepared on the basis of extracted information of historical records of the enterprise. Cash flow statements can be prepared for a year, for six months, for quarterly and even for monthly. The cash includes not only means that cash in hand but also cash at bank.

Objectives of Cash Flow Statements

The following are the main motives of preparing the cash flow statement:

- To identify the causes for the cash balance changes in between two different time periods, with the help of corresponding two different balance sheets.
- To enlist the factors of influence on the reduction of cash balance as well as to indicate the reasons though the profit is earned during the year and vice versa.

Utility of Cash Flow Statement

- To identify the reasons for the reduction or increase in the cash balances irrespective level of the profits earned by the firm.
- It facilitates the management to maintain an appropriate level of cash resources.
- It guides the management to take futuristic decisions on the prospective demands and supply of cash resources through projected cash flows.
  - How much cash resources are required?
  - How much cash requirements could be internally settled?
  - How much cash resources are to be raised through external sources?
  - Which types of instruments are going to be floated for raising the required resources?
- It helps the management to understand its capacity at the moment of borrowing for any further capital budgeting decisions.
- It paves way for scientific cash management for the firm through maintenance of appropriate cash levels i.e. optimum level cash of resources.
- It avoids in holding excessive or inadequate cash resources through proper planning of cash resources.
- It moots control through identification of variations occurred in the cash expenses and expenditures.

Notes

Table 6.1: Cash Flow Statement vs Fund Flow Statement

Cash Flow Statement	Fund Flow Statement
Cash inflow and outflow are only considered	Increase or decrease in the working capital is registered
Causes & changes of cash position	Causes & changes of working capital position
Considers only most liquid assets pertaining to cash resource; which fosters only for very short span of planning	Considers in general i.e. current assets; the duration of the liquidity of the current assets are longer in gestation than the liquid assets; which paves way for long span of planning
Opening and closing balances of cash resources are considered for the preparation	Increase or decrease of working capital is considered but not the opening and closing balance for preparation
The flow in the statement means real cash flow	The flow in the statement need not be real cash flow

Self Assessment

Fill in the blanks:

1. The cash flow statement is being prepared on the basis of extracted information of ………………… of the enterprise.
2. The ………………… are availed through two different types of receipts viz. sales, dividends, interests known as regular receipts and sale of assets, investments known as irregular receipts of the business enterprise.
3. The cash includes not only means that cash in hand but also …………………

6.2 Classification of Cash Flow

As per AS-3 (revised) the cash flow statement is prepared in a manner reporting the cash flows into following categories:

6.2.1 Cash Flow from Operating Activities

Cash flows from operating activities are earned from the principal revenue - producing activities of an enterprise. Through these activities the net profit or loss of the business is also determined. Examples of such a flow from operating activities are given in AS-3 (revised) as follows:

Cash receipts from the sale of goods and rendering of services;

Cash receipts from royalties, fees, commissions and other revenue;

Cash payments to suppliers for goods and services;

Cash payments to and on behalf of employees;

Cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits;

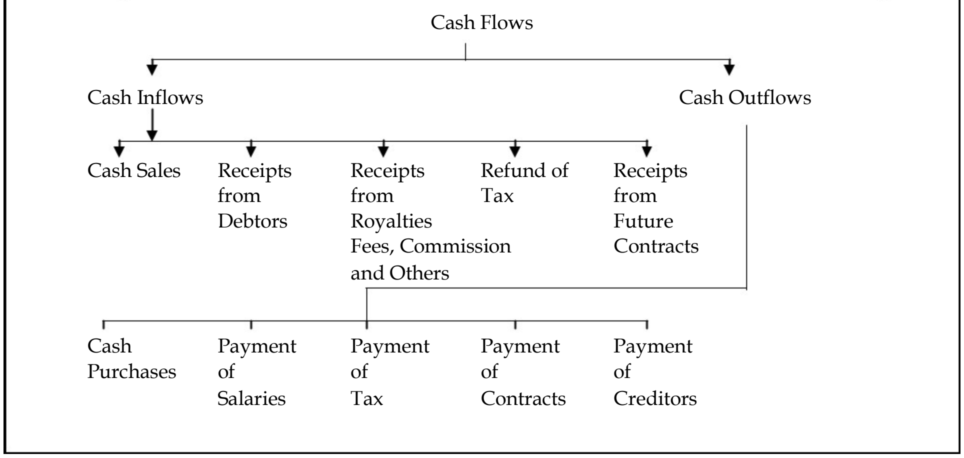
Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities, and

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.

Notes

Caution Some transactions, such as the sale of an item of plant, may give rise to a gain or loss which is included in the determination of net profit or loss. However, the cash flows relating to such transactions are cash flows from investing activities.

Figure 6.1: Diagrammatic Presentation of Cash Flows from Operating Activities



6.2.2 Cash Flow from Investing Activities

Investing activities of an enterprise include the purchase of fixed assets (as plant and machinery, land and buildings, furniture and fixtures) with an intention to generate the future incomes. On account of being an important activity, a separate disclosure of the cash flows from these activities is made. Examples of cash flows arising from investing activities are in AS-3 (revised) as follows:

cash payments of acquired fixed assets (including intangibles). These payments include those relating to capitalized research and development costs and self-constructed fixed assets;

cash receipts from disposal of fixed assets (including intangibles);

cash payments to acquired 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);

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);

cash advances and loans made to third parties (other than advances and loans made by a financial enterprise);

cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise);

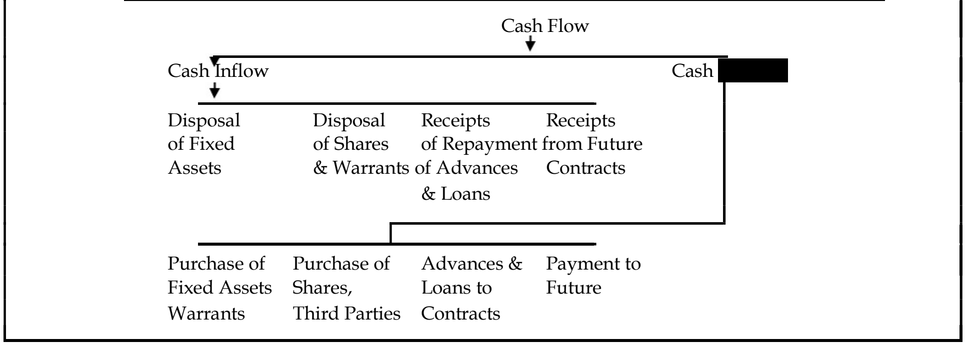
cash payments for future contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

Notes

(h) cash receipts from future contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

Did u know? When a contract is accounted for as a hedge of an identifiable position, the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

Figure 6.2: Diagrammatic Presentation of Cash Flow from Investing Activities



6.2.3 Cash Flow from Financing Activities

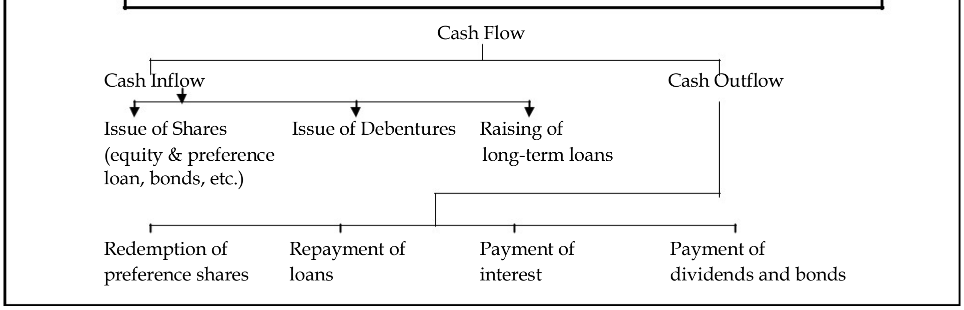
Under financial activities those activities are included which are relating to the size and composition of capital (equity and preferences) and borrowing or loans. As per AS-3 (revised), the separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise. Examples of cash flows arising from financing activities are:

cash proceeds from issuing shares or other similar instruments;

cash proceeds from issuing debentures, loans, notes, bonds and other short or long-term borrowings; and

cash repayments of amounts borrowed.

Figure 6.3: Diagrammatic Presentation of Cash Flow from Financing Activities



Notes

Notes Treatment of Other Items

Besides the above cash flow activities AS-3 (revised) also give the dealing of the some other items. These other items are as follows:

Foreign Currency Cash Flow: Unrealized gain or loss on account of change in the foreign exchange rate is not treated as cash flow. But the effect of change of foreign exchange on the cash and cash equivalents held in a foreign currency is recorded in the cash flow statement to reconcile the cash and cash equivalents at the beginning and at the end of the period. This amount is not adjusted with operating, investing and financing activities but it is shown separately.

Extra-ordinary Items: Cash flow arising from the extra-ordinary item is shown in the cash flow statement after classifying it into operating, investing and financing activities. This is done so that ordinary users may understand them easily. For example, loss by fire in store is compensated by insurance company. It will be treated as cash flow from operating activities.

Interest and Dividends: If a financial enterprise is receiving interest and dividend then such a cash flow arising from interest and dividend will be considered into operating activities. If interest and dividend are received by other enterprise, such a cash flow arising from interest and dividend will be considered into investing activities and if interest and dividend is paid, such a cash flow arising from interest and dividend is considered into financing activities. This cash flow arising from interest and dividend paid or received is disclosed separately.

Taxes on Income: If no adverse information is given relating to taxes paid on incomes, cash flow arising from the taxes paid as income is classified in operating activities. If taxes are paid on such income which is relating to finance, such a cash flow will be classified into financial activities.

Non-cash Transactions: The non-cash transactions are not recorded in cash flow statement because they do not have a direct impact on the current cash flow while they affect the capital and assets as purchase of fixed assets by the issue of shares or debentures. In AS-3 (revised) examples of non-cash transactions are mentioned as below:

the acquisition of assets by assuming directly related liabilities,

the acquisition of an enterprise by means of issue of shares, and

the conversion of debt to equity.

Balances of Foreign Branches: In some situations, the balance of cash and cash equivalent held with foreign branches are not available due to foreign exchange control or other legal restrictions. So the management should use that amount which can be measured in cash and cash equivalent.

Self Assessment

Fill in the blanks:

Cash flows from ………………… activities are earned from the principal revenue - producing activities of an enterprise.

………………… activities of an enterprise include the purchase of fixed assets.

Notes

6. Cash proceeds from issuing shares or other similar instruments are the examples of cash flow from ………………… activities.
7. The ………………… are not recorded in cash flow statement because they do not have a direct impact on the current cash flow while they affect the capital and assets as purchase of fixed assets by the issue of shares or debentures.
8. Cash flow arising from the ………………… is shown in the cash flow statement after classifying it into operating, investing and financing activities.

6.3 Preparation of Cash Flow Statement

Cash flow statement provides information about the cash receipts and payments of an enterprises for a given period. It provides important information that supplements the profit and loss account and balance sheet.

The statement of cash flows is required to be reported by Accounting Standard-3 (Revised) issued by the Institute of Chartered Accountants of India in March 1997 Which replaces the 'Changes in Financial Position' as per AS-3.

There are certain changes in the preparation of cash flow statement from the previous methods as a result of the introduction of AS-3 (Revised).

AS-3 (Revised) is mandatory in nature in respect of accounting periods commencing on or after 1-4-2001 for the following:

1. Enterprises whose equity or debt securities are listed on a recognised stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.
2. All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds ` 50 crores.

There are two methods of converting net profit into net cash flows from operating activities:

(i) Direct method, and

(ii) Indirect method.

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 profit & loss account. In this case, each cash transaction is analysed separately and the total cash receipts and payments for the period are 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:

1. Cash sales of goods and services;
2. Cash collected from debtors (customers);
3. Cash receipts of interest or dividends;
4. Cash receipts of royalties, fees, commission and other revenues;

Notes

5. 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.

Indirect Method

In this method, the net profit (loss) is used as the base and converted to net cash provided by (used in) operating activities. The indirect method adjusts net profit for items that affected net profit but did not affect cash. Non-cash and non-operating charges in the profit & loss account are added back to the net profit, while non-cash and non-operating credits are deducted to calculate operating profit before working capital changes. It is a partial conversion of accrual basis profit to cash basis profit. Necessary adjustment are made for increase/decrease in current assets and current liabilities to obtain net cash from operating activities.

Format of Cash Flow Statement

1. Cash Flow Statement (Direct Method)

Cash Flow Statement (Direct Method)

(`)

Cash Flows from Operating Activities		
Cash receipts from customers		(xxx)
Cash paid to suppliers and employees		xxx
Cash generated from operations		(xxx)
Income-tax paid		xxx
Cash flow before extraordinary items		xxx
Proceeds from earthquake disaster settlement, etc.		xxx
Net cash flow from operating activities	(a)	xxx
Cash flows from Investing Activities		
Purchase of fixed assets		(xxx)
Proceeds from sale of equipment		xxx
Interest received		xxx
Dividend received		xxx
Net cash flow from investing activities		xxx
Cash flows from Financing Activities		
Proceeds from issuance of share capital		xxx
Proceeds from long-term borrowings		xxx
Repayments of long-term borrowings		(xxx)
Interest paid		(xxx)
Dividend paid		(xxx)
Net Cash flow from financing activities	(b)	xxx
Net increase (decrease) in cash and cash equivalents during the period	(a-b+c)	xxx
Cash and cash equivalents at beginning of period		xxx
Cash and cash equivalents at end of period		xxx

Notes

2. Cash flow statement (Indirect method)

Cash Flow Statement (Indirect Method) (Accounting Standard-3 (Revised)

		(`)
Cash flow from Operating activities		
Net profit before tax and extraordinary items		xxx
Adjustments for:		
-Depreciation		xxx
-Foreign exchange		xxx
-Investments		xxx
-Gain or loss on sale of fixed assets		(xxx)
-Interest/dividend		xxx
Operating Profit Before Working Capital Changes		xxx
Adjustment for:		
-Trade and other receivables		xxx
-Inventories		(xxx)
-Trade payables		xxx
Cash Generated from Operations		xxx
-Interest paid		(xxx)
-Direct taxes		(xxx)
Cash before Extraordinary Items		xxx
Deferred revenue		xxx
Net cashflow from operating activities	(a)	xxx
Cashflow from Investing activities		
Purchase of fixed assets		(xxx)
Sale of fixed assets		xxx
Sale of investments		xxx
Purchase of investments		(xxx)
Interest received		xxx
Dividend received		xxx
Loans to subsidiaries		xxx
Net cashflow from investing activities	(b)	xxx
Cashflow from Financing Activities		
Proceeds from issue of share capital		xxx
Proceeds from long term borrowings		xxx
Repayment to finance/lease liabilities		(xxx)
Dividend paid		(xxx)
Net cashflow from financing activities	(c)	xxx
Net Increase (decrease) in cash and cash equivalents during the period	(a+b+c)	xxx
Cash and cash equivalents at the beginning of the year		xxx
Cash and cash equivalents at the end of the year		xxx

Notes

> *Notes* As per the amendment of Clause 32 of the Listing Agreement of SEBI, 1995, all the listed companies have to prepare and publish their Cash Flow Statement as per the above formats with their annual financial statements in the reports. SEBI recommends the indirect method to prepare the cash flow statement.

Example: From the information as contained in the income statement and the balance sheet of SLV Ltd., you are required to prepare a cash flow statement using (i) Direct Method and Indirect Method.

Income Statement and Reconciliation of Earnings for the year ended 31.3.2007

		`
Net Sales		25,20,000
Less: Cost of sales	19,80,000	
Depreciation	60,000	
Salaries and wages	2,40,000	
Operating expenses	80,000	
Provision for taxation	88.000	24,48,000
Net operating profit		72,000
Non-recurring income:		
Profit on sale of equipment		12,000
		84,000
Retained earnings (balance in profit & loss account brought forward)		1,51,800
		2,35,800
Dividend declared and paid during the year		72,000
Profit & Loss account balance as on 31.3.2007		1,63,800

Comparative Balance Sheets

	31.3.2006	31.3.2007
	`	`
Fixed assets		
Land	48,000	96,000
Building and equipments	3,60,000	5,76,000
Current assets		
Cash	60,000	72,000
Debtors	1,68,000	1,86,000
Stock	2,64,000	96,000
Advances	7,800	9,000
	9,07,800	10,35,000
Capital	3,60,000	4,44,000
Surplus in profit & loss A/c	1,51,800	1,63,800
Sundry creditors	2,40,000	2.34,000
Outstanding expenses	24,000	48,000
Income tax payable	12,000	13,200

Contd…

Notes

Accumulated depreciation on building and equipments	1,20,000	1,32,000
	9,07,800	10,35,000

Cost of equipment sold was ` 72,000.

Solution:

Direct Method
SLV Limited
Cash Flow Statement for the year ended 31.3.2007

	`	`
Cash Flows from Operating Activities:		
Cash receipts from customers	25,02,000	
Cash paid to suppliers and employees	21,15,200	
Cash generated from operations	3,86,800	
Income tax paid	(86,800)	
Net Cash from Operating Activities		3,00,000
Cash Flows from Investing Activities:		
Purchase of land	(48,000)	
Purchase of building and equipment	(2,88,000)	
Sale of equipment	36,000	
Net Cash used in Investing Activities		(3,00,000)
Cash Flows from Financing Activities:		
Issue of share capital	84,000	
Dividend paid	(72,000)	
Net Cash from Financing Activities		12,000
Net Increase in Cash and Cash Equivalents		12,000
Cash and Cash Equivalents at the beginning		60,000
Cash and Cash Equivalents at the end		72,000

Working Notes

(i) Cash receipts from customers:		
Sales revenue		25,20,000
Add: Debtors at the beginning		1,68,000
		26,88,000
Less: Debtors at the end		1,86,000
		25,02,000
(ii) Cash paid to suppliers and employees:		
Cost of goods sold		19,80,000
Add: Operating expenses		80,000
Salaries and wages		2,40,000
		23,00,000
Add: Creditors at the beginning	2,40,000	
Stock at the end	96,000	
Advances at the end	9,000	
Outstanding expenses at the beginning	24,000	3,69,000
		26,69,000

Contd…

Notes

	Less: Creditors at the end	2,34,000	
	Stock at the beginning	2,64,000	
	Advances at the beginning	7,800	
	Outstanding expenses at the end	48,000	5,53,800
			21,15,200
(iii)	Income tax paid		
	Tax payable at the beginning		12,000
	Add: Provision for taxation		88,000
			1,00,000
	Less: Tax payable at the end		13,200
	Tax paid during the year		86,800
(iv)	Accumulated depreciation written off on equipments (sold)		
	Accumulated depreciation at the beginning		1,20,000
	Add: Depreciation for the year		60,000
			1,80,000
	Less: Accumulated depreciation at the end		1,32,000
			48.000
(v)	Sale price of equipment		
	Cost price		72,000
	Less: Accumulated depreciation		48,000
			24,000
	Add: Profit on sale		12,000
			36,000
(vi)	Purchase of building and equipments		
	Balance at the beginning		3,60,000
	Less: Cost of equipment sold		72,000
	Balance		2,88,000
	Balance at the end		5,76,000
	Purchased during the year		2,88.000

Indirect Method
SLV Limited
Cash flow statement for the year ended 31.3.2007

	Dr.	Cr.
Cash Flows from Operating Activities:	`	`
Net profit before taxation and extra-ordinary item	1,60,000	
Adjustments for:		
Depreciation	60,000	
Operating profit before working capital changes	2,20,000	
Increase in debtors	(18,000)	
Decrease in stock	1,68,000	
increase in advances	(1,200)	
Decrease in creditors	(6,000)	
Increase in outstanding expenses	24,000	
Cash generated from operation	3,86,800	

Contd…

Notes

Income tax paid	(86,800)	
Net Cash from Operating Activities		3,00,000
Cash Flows from Investing Activities:		
Purchase of land	(48,000)	
Purchase of building and equipments	(2,88,000)	
Sale of equipment	36,000	
Net Cash Used in Investing Activities		(3,00,000)
Cash Flows from Financing Activities:		
Issue of share capital	84,000	
Dividend paid	(72,000)	
Net Cash from Financing Activities		12,000
Net Increase in Cash and Cash Equivalents		12,000
Cash and Cash Equivalents at the beginning		60,000
Cash and Cash Equivalents at the end		72,000

Solved Problems for Practice

1. From the following profit and loss account, you are required to compute cash from operations.

Profit and Loss Account for the year ending 31st Dec, 2008

	`		`
To Salaries	10,000	By Gross profit	50,000
To Rent	2,000	By Profit on sale of land	10,000
To Depreciation	4,000	By Income tax refund	6,000
To Loss on sale of plant	2,000		
To Goodwill written off	8,000		
To Proposed dividend	10,000		
To Provision for taxation	10,000		
To Net profit	20,000		
	66,000		66,000

If profit & loss account is given, the net profit should be adjusted to derive the cash from either operations or lost in operations.

To adjust the net profit, the non-operating expenses and non-cash expenses are to be added and the non-operating income and non-cash incomes are to deducted.

The purpose of adding non-cash expenses and non-operating expenses is to nullify the process of deduction which already took place during the moment of finding out the profits.

Cash from operations	`	`
Net profit made during the year		20,000
Add:		
Non-cash expenses		
Depreciation	4,000	
Loss on sale of plant	2,000	
Goodwill written off	8,000	

Contd...

Non-operating expenses		
Proposed dividend	10,000	
Provision for taxation	10,000	34,000
Less		
Non-Operating/cash income		
Profit on sale of land	10,000	
Income tax refund	6,000	16,000
		38,000

From the following balance sheets of Sudhir Ltd., for the year ended 31st March, 2006 and 2007, prepare a cash flow statement.

		31.3.2006		31.3.2007
		`		`
Assets				
Property		2,00,000		2,50,000
Plant and machinery	4,00,000		4,50,000	
Less: Depreciation	1,40,000	2,60,000	1,50,000	3,00,000
Loans to subsidiary Co.		–		15,000
Share in subsidiary Co.		20,000		20,000
Stock in trade		1,40,000		1,50,000
Debtors		1,00,000		1,50,000
Bank		35,000		1,57,000
		7,55,000		10,42,000
Liabilities				
Equity Share of ` 20 each		3,00,000		4,00,000
Share premium		–		10,000
Profit & Loss appropriation A/c		1,00,000		1,00,000
Profit for the year		–		2,00,000
6% Debentures		1,50,000		1,00,000
Profit on Redemption of Debentures		–		2,000
Sundry creditors		1,40,000		1,10,000
Provision for taxation		50,000		1,00,000
Proposed dividend		15,000		20,000
		7,55,000		10,42,000

Additional Information:

During the year, plant costing ` 50,000 was sold for ` 10,000. Accumulated depreciation on this plant was ` 30,000. Loss on sale of plant was charged to profit & Loss account. Income-tax paid during the year was ` 60,000.

Notes

Solution:

Sudhir Limited
Cash Flow Statement for the year ended 31.3.2007
Cash Flows from Operating Activities

	`
Net profit before tax and extraordinary items	2,00,000
Adjustments for:	
Depreciation	40,000
Provision for taxation	1,10,000
Proposed dividend	20,000
Loss on sale of machinery	10,000
Operating profit before working capital changes	3,80,000
Adjustments for:	
Increase in debtors	(50,000)
Increase in stock-in-trade	(10,000)
Decrease in creditors	(30,000)
Cash generated from operations	2,90,000
Tax paid	(60,000)
Net cash from operating activities	2,30,000
Cash flows from investing activities	
Purchase of property	(50,000)
Sale of plant	10,000
Purchase of machinery	(1,00,000)
Loans to subsidiaries	(15,000)
Net cash used in Investing activities	(1,55,000)
Cash flows from financing activities	
Issue of equity share capital at premium	1,10,000
Redemption of debentures	(48,000)
Dividends paid	115,000)
Net cash from financing activities	47,000
Net increase in cash and cash equivalents	
(` 2,30,000 - ` 1,55,000 + 47,000)	1,22,000
Cash and cash equivalents at the beginning of the year	35,000
Cash and cash equivalents at the end of the year	1,57,000

Working Notes:

Dr. **Property Account** Cr.

Particulars	`	**Particulars**	`
To Balance b/d	2,00,000	By Balance c/d	2,50,000
To Bank (purchases)			
(balancing figure)	50,000		
	2,50,000		**2,50,000**

Notes

Plant & Machinery Account

Particulars	`	Particulars	`
To Balance b/d	4,00,000	By Bank (plant sold)	10,000
To Bank (purchases)	1,00,000	By Accumulated depreciation	30,000
(balancing figure)		(on plant sold)	
		By Loss on plant sold	10,000
		By Balance c/d	4,50,000
	5,00,000		**5,00,000**

Accumulated Depreciation Account

Particulars	`	Particulars	`
To Plant & machinery A/c	30,000	By Balance b/d	1,40,000
(on plant sold)		By Dep. for the year	40,000
To Balance c/d	1,50,000	(balancing figure)	
	1,80,000		**1,80,000**

Loans to Subsidiary Account

Particulars	`	Particulars	`
To Bank (balancing figure)	15,000	By Balance c/d (closing)	15,000
	15,000		**15,000**

Equity Share Capital Account

Particulars	`	Particulars	`
To Balance c/d	4,00,000	By Balance b/d	3,00,000
		By Bank (balancing figure)	1,00,000
	4,00,000		**4,00,000**

Share Premium Account

Particulars	`	Particulars	`
To Balance c/d	10,000	By Bank (balancing figure)	10,000
	10,000		**10,000**

Debentures Account

Particulars	`	Particulars	`
To Bank (balancing figure)	48,000	By Balance b/d	1,50,000
To Profit on redemption A/c	2,000		
To Balance c/d	1,00,000		
	1,50,000		**1,50,000**

Profit on Redemption Account

Particulars	`	Particulars	`
To Balance c/d	2,000	By 6% Debentures A/c	2,000
	2,000		**2,000**

Notes

Provision for Taxation

Particulars	`	Particulars	`
To Bank (tax paid)	60,000	By Balance b/d	50,000
To Balance c/d	1.00,000	By Transfer from P & L A/c	1,10,000
	1,60,000		**1,60,000**

Proposed Dividend

Particulars	`	Particulars	`
To Bank (dividends paid)	15,000	By Balance b/d	15,000
To Balance c/d	20.000	By Transfer from P & L A/c	20,000
	35,000		**35,000**

The comparative balance sheets of M/s Ram Brothers for the two years were as follows:

Liabilities	March 31st		Assets	March 31st	
	2008	2009		2008	2009
Capital	3,00,000	3,50,000	Land &Building	2,20,000	3,00,000
Loan from Bank	3,20,000	2,00,000	Machinery	4,00,000	2,80,000
Creditors	1,80,000	2,00,000	Stock	1,00,000	90.000
Bills payable	1,00,000	80,000	Debtors	1,40,000	1,60,000
Loan from SBI		50,000	Cash	40,000	50,000
	9,00,000	8,80,000		9,00,000	8,80,000

Additional Information:

Net profit for the year 2009 amounted ` 1,20,000.

During the year a machine costing ` 50,000 (accumulated depreciation ` 20,000) was sold for ` 26,000. The provision for depreciation against machinery as on 31st March, 2008 was ` 1,00,000 and on 31st March, 2009 ` 1,70,000.

You are required to prepare a cash flow statement.

The first step is to prepare non-current accounts.

Non-current account includes both non-current liability and asset.

First, start with non-current liability.

The net profit is normally added with the capital of the owners contribution. As a whole it is known as shareholders' fund or net worth of the firm. Whenever the firm earns profit, the net profit should be added with the initial capital contributed by the owner.

The entry is as follows:		`	`
P& L Appropriation A/c	Dr	1,20,000	
To Mr X Capital Ac			1,20,000

Dr **Capital A/c** Cr

Particulars	`	Particulars	`
To Drawings. Balancing Fig.	70,000	By Balance B/d (Opening)	3,00,000
To Balance c/d (Closing)	3,50,000	By Net profit	1,20,000
	4,20,000		**4,20,000**

Notes

Total capital should be shown at the end of the year 2009 as ` 4,20,000, but it was amounting to ` 3,50,000 shown as a closing balance. It clearly understood that ` 70,000 worth of profit was taken away by the owner for his personal needs; known as drawings.

The next step is to find out the depreciation provided during the year, which affects non-current asset account of the firm i.e. Machinery account.

Before discussing the accounting transactions, the journal entry for provision for depreciation should be known.

		`	`
Provision for depreciation A/c	Dr	20,000	
To sold Machinery Depreciation A/c			20,000

Dr. **Provision for Depreciation Account** Cr.

	`		`
To sold Machinery Depreciation	20,000	By Balance B/d	1,00,000
To Balance C/d	1,70,000	By (Adjusted profit and loss account) Depreciation provided during the year	90,000
	1,90,000		**1,90,000**

Cash sale of the machinery amounted to ` 26,000.

What happens during the cash sale of a machinery?

Debit what comes in - Cash resources are coming in.

Credit what goes out- Machinery is going out of the firm.

		`	`
Cash A/c	Dr	26,000	
To Machinery A/c			26,000

While selling the machinery, it is most important to identify the worth of the sale transaction of the machinery.

	`
Original cost of the asset	50,000
Accumulated Depreciation	20,000
	30,000
Sale price	26,000
Loss on sale of the assets	4,000

Once the loss of the transaction is found out, the amount of the loss should be appropriately recorded.

Debit all losses.

Credit the asset account.

		`	`
Loss of Machinery sale A/c	Dr.	4,000	
To Machinery A/c			4,000

Notes

Dr. **Machinery Account** Cr.

Particulars	`	Particulars	`
To Balance B/d (Opening)	5,00,000	By cash sale	26,000
		By Profit and loss a/c Loss Balancing Fig.	4,000
		By Depreciation Provision	20,000
		By Balance c/d(Closing) 2,80,000+1,70,000	4,50,000
	5,00,000		**5,00,000**

During the purchase of land and building, what happens?

Debit what comes in - land and building are coming in.

Credit what goes out - cash resources are going out.

		`	`
Land & Building A/c	Dr	80,000	
To Cash A/c			80,000

Dr. **Land and Building** Cr.

Particulars	`	Particulars	`
To Balance B/d (Opening)	2,20,000		
To Cash (Purchase)	80,000	By Balance c/d (Closing)	3,00,000
	3,00,000		**3,00,000**

The next step is to prepare adjusted profit and loss account.

Dr. **Adjusted Profit and Loss Account** Cr.

Particulars	`	Particulars	`
To Machinery A/c (Loss on sale)	4,000	By Balance B/d	-----------
To Depreciation provided during the year	90,000	By Cash from operations	2,14,000
To Balance c/d	1,20,000		
	2,14,000		**2,14,000**

The next most important step is to compare the current assets.

Increase in creditors	` 20,000	- cash inflow
Loan from SBI	` 50,000	- cash inflow
Decrease in stock	` 10,000	- cash inflow
Loan repaid	` 1,20,000	- cash outflow
Decrease in bills payable	` 20,000	- cash outflow
Increase in Debtors	` 20,000	- cash outflow

Cash Flow Statement

Inflow	`	Outflow	`
Opening cash balance	40,000	Loan repaid	1,20,000
Creditors	20,000	Bills payable	20,000

Contd...

Notes

Loan from SBI	50,000	Debtors	20,000
Stock	10,000	Land and buildings purchased	80,000
Machinery cash sale	26,000	Drawings	70,000
Cash from operations	2,14,000	Closing cash balance	50,000
	3,60,000		**3,60,000**

4. Data Ltd. supplies you the following balance on 31 st Mar. 2005 and 2006.

Liabilities	2005	2006	Assets	2005	2006
Share capital	1,40,000	1,48,000	Bank balance	18,000	15,600
Bonds	24,000	12,000	Accounts Receivable	29,800	35,400
Accounts payable	20,720	23,680	Inventories	98,400	85,400
Provision for debts	1,400	1,600	Land	40,000	60,000
Reserves and Surpluses	20,080	21,120	Goodwill	20,000	10,000
	2,06,200	**2,06,400**		**2,06,200**	**2,06,400**

Additional Information:

Dividends amounting to ` 7,000 were paid during the year 2006.

Land was purchased for ` 20,000.

` 10,000 were written off on goodwill during the year.

Bonds of ` 12,000 were paid during the course of the year.

You are required to prepare a cash flow statement.

The first step is to prepare non-current accounts.

The first step is to prepare non-current assets and liabilities account.

As far as non-current asset account is concerned, Land account has to be prepared.

The opening balance is lesser than the closing balance of the Land account of the firm.

It is only due to purchase of land only inflated the value of the land at the end of the time horizon.

Debit what comes in - Land has come in.

Credit what goes out- cash resources have gone out of the firm at the moment of purchase.

		`	`
Land A/c	Dr	20,000	
To cash A/c			20,000

Dr. **Land A/C** Cr.

Particulars	`	Particulars	`
To Balance B/d (Opening)	40,000		
To Cash (Purchase)	20,000	By Balance c/d (Closing)	60,000
	60,000		**60,000**

The non-current liability account is to be prepared.

The first non-current liability account that is affected is the share capital account.

Notes

The opening balance of share capital is less than the closing balance of the share capital account. It means that the firm has undergone for further issue of share capital. The further issue of share capital brings forth cash inflows to the firm.

		`	`
Cash A/c	Dr	8,000	
To share capital A/c			8,000

Dr. **Share Capital Account** Cr.

Particulars	`	**Particulars**	`
		By Balance B/d (Opening)	1,40,000
To Balance c/d (Closing)	1,48,000	By Cash Balancing figure	8,000
	1,48,000		**1,48,000**

The next non-current liability account is the Bonds account.

During the repayment of bonds or redemption of bonds, the cash resources are going out of the firm.

		`	`
Bond A/c	Dr	12,000	
To Cash (redemption)			12,000

Dr. **Bond Account** Cr.

Particulars	`	**Particulars**	`
To cash (redemption)	12,000	By Balance B/d (Opening)	24,000
To Balance c/d (Closing)	12,000		
	24,000		**24,000**

The next step is to prepare the Adjusted Profit & Loss account

Dr. **Adjusted Profit & Loss Account** Cr.

To Provision for doubtful debts	200	By Balance B/d	20,080
To Goodwill written off	10,000	By Cash from operations	18,240
To Dividends paid	7000		
To Balance c/d	21,120		
	38,320		**38,320**

The next most important step is to compare the current assets during the two years.

Increase in Accounts payable `2,960 - Cash inflow

Decrease in Inventories `13,000 - Cash inflow

Increase in accounts receivable `5,600 - Cash outflow

The next step is to draft the Cash flow statement.

Cash Flow Statement

Inflow	`	**Outflow**	`
Opening cash balance	18,000	Increase in bills receivable	5,600
Issue of shares	8,000	Purchases of land	20,000
Increase in Bills payable	2,960	Dividends paid	7,000

Contd...

Decrease in stock	13,000	Bonds repaid	12,000
Cash from operations	18,240	Closing cash balance	15,600
	60,200		**60,200**

Task Illustrate the impact of the changes taken place on the current assets and current liabilities to the tune of cash flows determination of the firm.

Self Assessment

Choose the appropriate answer

Cash position at the opening and closing comprises of

Cash in hand

Cash at bank

Both cash in hand and at bank

None of the above.

Cash flow analysis superior than the fund flow analysis due to

Shorter span of cash resources are considered

Real cash flows only taken into consideration

Opening and closing cash balances are only considered

(a), (b) & (c).

Sale of the plant and machinery falls under the category of

Non-current asset sale – cash in flow

Current asset sale – cash out flow

Non-current asset sale – cash out flow

None of the above.

Which of the following cannot be included in financing cash flows?

Payments of dividends

Repayment of debt principal

Sale or repurchase of the company's stock

Proceeds from issuing shares.

Which of the following cannot be included in cash outflows?

Operating and capital outlays

Family living expenses

Loan payments

None of these.

Notes

14. Which of the following is not a part to the Statement of Cash Flows (or Cash Flow Statement)?

Operating Activities

Investors' Activities

Financing Activities

Supplemental Activities.

Which of the following is not included under operating activities?

Receipts from income

Payment for a new investment

Payment for expenses and employees

Funding of debtors.

Which of the following is included under cash outflows?

Buying new assets

Money the business borrows

Proceeds from selling an investment

None of these.

Which of the following is not judged about by the cash flow statements?

Profitability

Financial condition

Financial management

Movement of fund

6.4 Summary

Cash flow statement indicates sources of cash inflows and transactions of cash outflows prepared for a period.

It is an important tool of financial analysis and is mandatory for all the listed companies.

The cash flow statement indicates inflow and outflow in terms of three components: (1) Operating, (2) Financing, and (3) Investment activities.

Cash inflows include sale of assets or investments, and raising of financial resources.

Cash outflows include purchase lo assets or investments and redemption of financial resources.

There are two methods of converting net profit into net cash flows from operating activities:

Direct method, and

Indirect method.

6.5 Keywords

Notes

Cash: It includes cash in hand and demand deposits with bank.

Cash Equivalents: refer short-term risk free highly liquid investment.

Cash Flow Statement: The statement which indicates the flow (movement) of cash during a period.

Flow of Cash: It means the change in cash. It also includes the inflow and outflow of cash.

6.6 Review Questions

The comparative balance sheets of RKV Ltd., for the last two years were as follows:

Liabilities	2006	2007	Assets	2006	2007
	`	`		`	`
Loan from wife		20,000	Cash	11,000	15,000
Bills payable	12,000	8,000	Debtors	40,000	35,000
Creditors	25,000	52,000	Stock	25,000	30,000
Loan from Bank	43,000	60,000	Machinery	20,000	14,000
Capital	66,000	34,000	Land & Buildings	50,000	80,000
	1,46,000	**1,74,000**		**1,46,000**	**1,74,000**

Additional Information:

Net loss for the year 2007 amounted to ` 13,000.

During the year a machine costing ` 5,000 (accumulated depreciation ` 2,000) was sold for ` 2,500. The provision for depreciation against machinery as on 31-12-2006 was ` 6,000 and on 31-12-2007 ` 7,000.

From the above information, prepare a cash flow statement.

Draw the proforma of the Adjusted profit and loss account.

The financial position of RKV Ltd. on 1st January, 2006 and December 31, 2006 was as follows:

Liabilities	1-1-2006	31-12-06	Assets	1-1-06	31-12-06
	`	`		`	`
Current liabilities	36,000	41,000	Cash	4,000	3,600
Mrs. Tall's loan	-	20,000	Debtors	35,000	38,400
Loan from bank	30,000	25,000	Stock	25,000	22,000
Capital	1,48,000	1,49,000	Land	20,000	30,000
			Building	50,000	55,000
			Machinery	80,000	86,000
	2,14,000	**2,35,000**		**2,14,000**	**2,35,000**

During the year the RKV withdrew ` 26,000 for domestic expenses. The provision for depreciation against machinery as on 1.1.2006 was ` 27,000 and 31.12.2006 ` 36,000.

Prepare the cash flow statement for the year ended 31st December, 2006.

Notes

4. Since everything has some utility, analyse the cash flow statement analysis and explain its various utilities.
5. Discuss the procedure of determining cash provided by operating activities. Give suitable example to illustrate your answer.
6. The following is the abstract of balance sheet of Software securities ltd for the year 2005 and 2006.

	2005	2006		2005	2006
Liabilities	(`)	(`)	**Assets**	(`)	(`)
Provision for depreciation	1,08,000	3,96,000	Land	26,000	81,000
Retained earning	2,44,800	3,70,800	Building	60,000	3,60,000
9% Debenture	2,70,000	1,98,000	Accumulated depreciation on building	19,800	37,800
Account payable	72,000	41,400	Equipment	1,22,400	3,47,400
Expense payable	0	18,000	Accumulated depreciation on Equipment	18,000	50,400
			Stock in hand	10,800	97,200
			Account receivable	36,000	1,22,400
			Cash in hand	66,600	97,200
			Preliminary expenses	10,800	7,200

The income statement of Software Securities Ltd. is as under

Sales	16,02,000
less cost of sale	8,37,000
less operating exp.	3,97,800
less interest exp.	21,600
loss on sale of equipments	3,600
	1,26,000
Net income before tax	3,42,000
Provision of tax	1,17,000
Net Income after tax	2,25,000

Additional Information:

Operating expenses include depreciation of ` 59400 and charges from preliminary expenses of ` 3600.

Land was sold at its book value.

Cash dividend paid for the year 2006 amounted to ` 27000 and fully paid bonus shares were given in the ratio of 2 shares for every 3 shares held.

Interest expenses were paid in cash.

Equipment with a cost of ` 298800 was purchased for cash .Equipment with a cost of ` 73800 (book value ` 64800) was sold for ` 61200.

Debenture for ` 18000 were redeemed for cash and for ` 54000 were redeemed by converting into equity shares at par value.

Notes

(g) Equity shares of ` 162000 were issued for cash at par.

Income tax paid during the year amounted to ` 117000.

Prepare the cash flow statement with both the methods.

Determine which of the following are added back to [or subtracted from, as appropriate] the net income figure (which is found on the Income Statement) to arrive at cash flows from operations.

Depreciation

Deferred tax

Amortization

Any gains or losses associated with the sale of a non-current asset.

Support your answers with elaborative reasoning.

1. Assume that you are thinking of purchasing a new machine that will allow you to offer a new product to your customers. The machine will cost ` 100,000 to purchase and install, and after five years (when you plan to sell it) the machine will be worth about ` 10,000. Your facility has plenty of room, so you won't have any additional rental costs for space, and you can piggyback advertising for the new product on to your existing advertising budget. You will, however, have to pay for insurance, personal property taxes, and a part-time employee to operate the machinery (these items are included in your fixed costs which will total ` 12,000 in the first year). Also, there will be costs for materials, supplies, and electricity that will vary depending on the volume of production. These variable costs will amount to about 60 percent of the sales revenues. Develop a projected cash flow statement for the project.
2. Think of the possible errors that might be committed while developing the cash flow statements and suggest ways to prevent such mistakes beforehand.
3. Show by example how to prepare a cash flow statement using a balance sheet.
4. Unlike the balance sheet and the income statement, the cash flow statement is not based on accruals accounting, why?
5. For each of the following items, indicate which part (out of Operating, Investing, Financing and Supplemental) will be affected and why.

   Depreciation Expense

   Proceeds from the sale of equipment used in the business.

   The Loss on the Sale of Equipment

   Declaration and payment of dividends on company's stock

   Gain on the Sale of Automobile formerly used in the business

Answers: Self Assessment

1. historical records	2. cash resources
3. cash at bank	4. operating
5. Investing	6. financing
7. non-cash transactions	8. extra-ordinary item
9. (c)	10. (b)

Notes

11. (a)
12. (c)
13. (d)
14. (b)
15. (b)
16. (a)
17. (d)

6.7 Further Readings

Books

B.M. Lall Nigam and I.C. Jain, *Cost Accounting*, Prentice-Hall of India (P) Ltd.

Hilton, Maher and Selto, *Cost Management*, 2nd Edition, Tata McGraw-Hill Publishing Company Ltd.

M. N. Arora, *Cost and Management Accounting*, 8th Edition, Vikas Publishing House (P) Ltd.

M. P. Pandikumar, *Management Accounting*, Excel Books.

Online links

www.authorstream.com

www.allinterview.com