

CASH FLOW STATEMENT

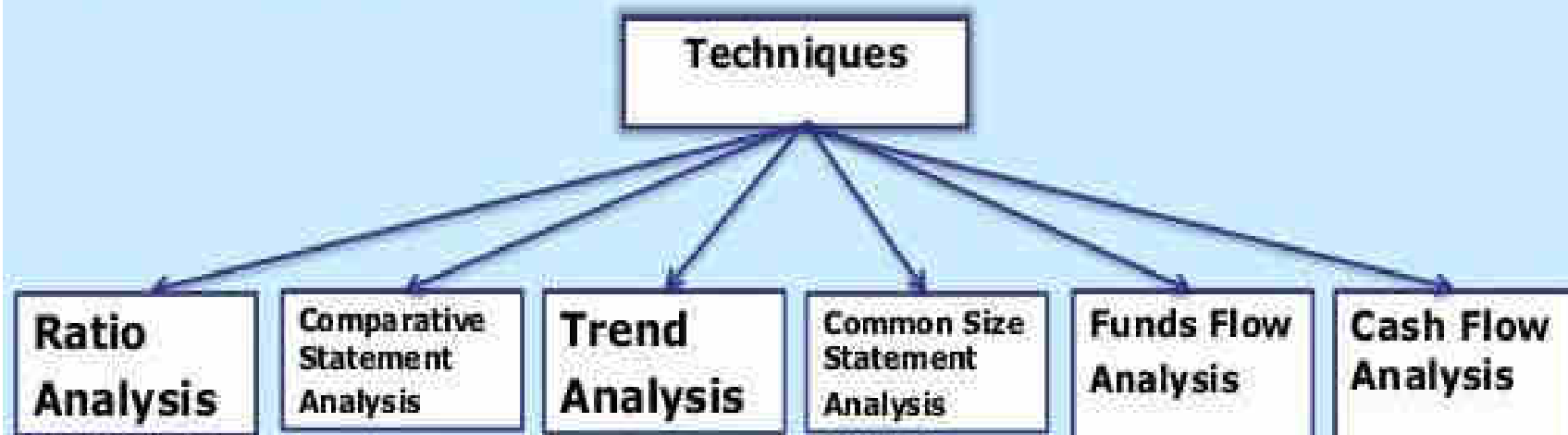
B.COM.SEMESTER- 6, HONS. & GENL.

Prepared By

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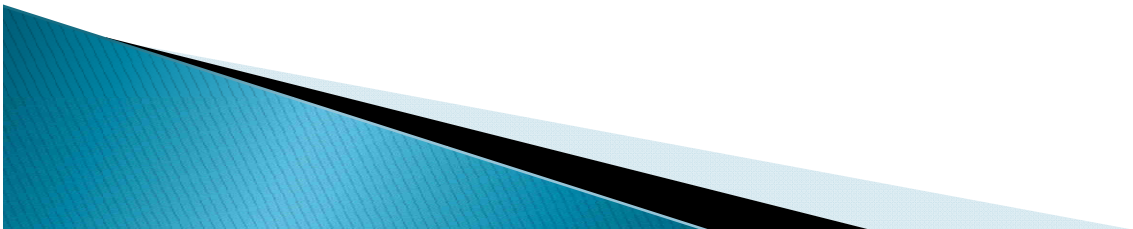
Techniques Of Financial Statement Analysis

- Financial statement analysis is interpreted mainly to determine the financial and operational performance of the business concern. A number of methods or techniques are used to analyse the financial statement of the business concern.



Definition:

- ▶ **A Cash Flow Statement is a statement which gives an analytical information regarding the details of the inflows and out flows of cash of an enterprise during a particular period of time distinctly depicting their sources and uses.**



Differences Between Cash Flow and Funds Flow

Basis for Comparison	Cash Flow	Fund Flow
Inherent meaning	Cash flow is based on a narrow concept called “cash”.	Fund flow is based on a wider concept called “working capital”.
Usefulness	The utility of the cash flow statement is to find out the net cash flow.	The utility of fund flow is to understand the financial position of the company.
Source	The cash flow statement starts with opening balance and after adjustments come out with net cash inflow/outflow.	The fund flow statement calculates the difference between sources of funds and the application of funds.
WC shown	Shown in the operating activities of the cash flow statement.	Shown in the statement of changes in working capital.
Type of accounting	Follows the <u>cash basis of accounting</u> .	Follows the <u>accrual basis of accounting</u> .
Effect	Through cash flow analysis we get to know the net cash flow.	Through fund flow analysis we get to know the change in working capital.

Differences Between Cash Flow and Funds Flow (Contd.)

Basis for Comparison	Cash Flow	Fund Flow
Is it a financial statement?	Yes.	No.
Term	Short term analysis of cash flow.	Long term analysis of working capital.
Used for	Cash budgeting.	<u>Capital budgeting.</u>

MEANING OF CASH FLOW AND CASH FLOW STATEMENT

Cash Flows are inflows and outflows, i.e., the movement of cash and cash equivalents.

The **Cash Flow Statement** is prepared according to Revised Accounting Standard-3 on cash flow statement. The standard requires that cash flow be classified and shown in the cash flow statement under three heads, namely:

1. Cash Flow from Operating Activities
2. Cash Flow from Investing Activities ; and
3. Cash Flow from Financing Activities

OBJECTIVES OF CASH FLOW STATEMENT

The objectives of cash flow statement are:

- ❖ To ascertain the sources from activities (i.e., operating/investing/financing activities) from which cash and cash equivalents were generated by an enterprise.
- ❖ To ascertain the uses by activities (i.e., operating/investing/financing activities) for which cash and cash equivalents were used by an enterprise.
- ❖ To ascertain the net change in cash or cash equivalents indicating the difference between sources and uses from or by the three activities between the dates of two Balance Sheets.

Uses and Advantages of Cash Flow Statement

- 1. Liquidity:** It shows the liquidity position of the business
- 2. Optimum Cash:** Helps to management to make a plan about the optimum use of cash during a predetermined period.
- 3. Management Assistance:** Helps the management to avoid both idle or excess cash and shortage of cash.
- 4. Movement of Cash:** Shows the flows in and flows out of cash.
- 5. Analysis:** Analyses the movement of cash during a particular period.
- 6. Optimum Result:** Helps to utilise the excess cash for the maximum benefit of the business.
- 7. Cash Management:** Helps to make the plan for the recovery of any shortage of cash during a particular period.

IMPORTANT DEFINITIONS AS PER ACCOUNTING STANDARD-3 (REVISED)

- I. **Cash** comprises of cash in hand and demand deposits with banks.
- II. **Cash Equivalents** are short-term, highly liquid investments that are readily convertible into known amount of cash and which are subject to an insignificant risk of change in value.
An investment normally qualifies as cash equivalent only when it has a short maturity of, say (a) treasury bills, (b) commercial paper, (c) money market funds and (d) investments in preference shares and redeemable within three months can also be taken as cash equivalents if there is no risk of the failure of the company.
- III. **Cash Flows** are inflows and outflows of cash and cash equivalents. AS-3 requires a cash flow statement to be prepared and presented in a manner that it shows cash flow from various transactions during a period classifying the into:
(i) Operating Activities; (ii) Investing Activities; (iii) Financing Activities.
- IV. **Operating Activities:** operating activities are the principal revenue producing activities of the enterprise and other activities that are not investing or financing activities.

V. **Investing Activities:** Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. These activities include transactions involving purchase and sale of long term productive assets like machinery, land, etc., which are not held for resale.

VI. **Financing Activities:** Financing activities are the activities that result in change in the size and composition of the owner's capital (including preference share capital) in the form of a company's own borrowing or the enterprise.

OPERATING ACTIVITIES

CASH INFLOW

- Cash Sales
- Cash received from Debtors
- Cash received from commission and Fees
- Royalty

In the case of financial companies

- Cash received for Interest and Dividends
- Sale of Securities

CASH OUTFLOW

- Cash purchase
- Payment to creditors
- Cash operating expenses
- Payment of Wages
- Income Tax

In the case of financial companies

- Cash paid for interest
- Purchase of Securities

INVESTING ACTIVITIES

Cash Inflow

- Sale of Fixed Assets
- Sale of Investments
- Interest received
- Dividends received

Cash Outflow

- Purchase of Fixed Assets
- Purchase of Investments

FINANCING ACTIVITIES

Cash Inflow

1. Issue of shares in Cash
2. Issue of Debentures in Cash
3. Proceeds from Long-term Borrowings

Cash Outflow

- Payment of Loans
- Redemption of preference shares
- Buy-back of Equity shares
- Payment of Dividend
- Payment of Interest

Direct Method for the Calculation of Cash Flows from Operating Activities

As the name suggests, under direct method, major heads of cash inflows and outflows (such as cash received from trade receivables, employee benefits expenses paid, etc.) are considered.

It is important to note here that items are recorded on accrual basis in statement of profit and loss. Hence, certain adjustments are made to convert them into cash basis such as the following :

- ▶ 1. Cash receipts from customers = Revenue from operations + Trade receivables in the beginning – Trade receivables in the end.
- ▶ 2. Cash payments to suppliers = Purchases + Trade Payables in the beginning – Trade Payables in the end.
- ▶ 3. Purchases = Cost of Revenue from Operations – Opening Inventory + Closing Inventory.
- ▶ 4. Cash expenses = Expenses on accrual basis + Prepaid expenses in the beginning and Outstanding expenses in the end – Prepaid expenses in the end and Outstanding expenses in the beginning.

▶ **However, the following items are not to be considered:**

1. Non-cash items such as depreciation , discount on shares, etc., be written-off.
2. Items which are classified as investing or financing activities such as interest received, dividend paid, etc.

As per AS-3, under the direct method, information about major classes of gross cash receipts and cash payments may be obtained either

from the accounting records of the enterprise, or by adjusting revenue from operation, cost of revenue from operations and other items in the statement of profit or loss for the following:

- ▶ changes during the period in inventories and trade receivables and payables;
- ▶ other non-cash items; and
- ▶ other items for which cash effects are investing or financing cash flows.

Cash Flows from Operating Activities (Direct Method)

<i>Cash flows from operating activities:</i>	
Cash receipts from customers	XXX
(–) Cash paid to suppliers and employees	<u>(XXX)</u>
= Cash generated from operations	XXX
(–) Income tax paid	<u>(XXX)</u>
= Cash flow before extraordinary items	XXX
+/– Extraordinary items	<u>XXX</u>
= <i>Net cash from operating activities</i>	<u>XXX</u>

**DIRECT METHOD
 FORMAT OF CASH FLOW STATEMENT
 FOR THE YEAR ENDED....
 AS PER ACCOUNTING STANDARD-3 (REVISED)**

Particulars		Rs.
I. Cash Flow from Operative Activities:		
Collection From customers		**
Less: Cash paid to suppliers	**	
Cash paid to employees	**	
Payment for other operating exp.	**	—
Cash generated from operation		**
Less: Income tax paid		**
Cash flow before extraordinary item		**
Add: Extraordinary receipts e.g. earthquake disaster settlement		**
Net cash fro operating activities		**
II. Cash Flow from Investing Activities (same as will discuss under Indirect method)		**
III. Cash Flow from Financing Activities (same as will discuss under Indirect method)		**

INDIRECT METHOD
FORMAT OF CASH FLOW STATEMENT
 For the year ended....
 As per Accounting Standard-3 (Revised)

Particulars	
<p>I. Cash Flow from Operating Activities Net profit as per Profit & Loss A/c or Difference between Closing balance and Opening Balance of Profit & Loss A/c</p> <p>Add: Transfer to reserve Proposed dividend for current year Interim dividend paid during the year Provision for tax payable during the current year Extraordinary items, if any, debited to the profit & loss A/c</p> <p>Less: Extraordinary items, if any, credited to the profit & loss A/c Refund of tax credited to profit & loss A/c</p> <p>(A) Net profit before Taxation and Extraordinary items Adjustment for Non-cash and Non-operating items</p> <p>(B) Add: Items to be added</p> <ul style="list-style-type: none"> • Depreciation • Preliminary expenses/Discount on issue of Shares & Debentures Written off • Goodwill/patents/Trade marks Amortized • Interest on borrowings & debentures • Loss on sale of Fixed Assets <p>(C) Less: Items to be deducted</p> <ul style="list-style-type: none"> • Interest Income • Dividend Income • Rental Income • Profit on sale of Fixed Assets 	<div style="border-top: 1px solid black; margin-top: 20px;"> </div> <div style="border-top: 1px solid black; margin-top: 20px;"> </div> <div style="border-top: 1px solid black; margin-top: 20px;"> </div>
(D) Operating Profit before Working Capital changes (A+B-C)	<div style="border-top: 1px solid black; margin-top: 20px;"> </div>

**(E) Add: Decrease in Current Assets and
Increase in Current Liabilities**

- Decrease in Stock/Inventories
- Decrease in Debtors/Bills Receivable
- Decrease in Accrued Income
- Decrease in prepaid expenses
- Increase in creditors/Bills payable
- Increase in outstanding expenses
- Increase in Advance incomes
- Increase in Provision for Doubtful Debts

**(F) Less: Increase in Current Assets and
Decrease in Current Liabilities**

- Increase in Stocks/Inventories
- Increase in Debtors/Bills Receivable
- Increase in Accrued Income
- Increase in Prepaid expenses
- Decrease in creditors/Bills payable
- Decrease in outstanding expenses
- Decrease in Advance incomes
- Decrease in Provision for Doubtful Debts

(G) Cash Generated from Operations (D+E-F)

(H) Less: Income Tax paid (Net of Tax Refund received)

**(I) Cash Flow before Extraordinary items
Extraordinary items (+/-)**

(J) Net cash from Operating Activities

II. Cash Flow from Investing Activities

- **Add:** Proceeds from Sale of Fixed Assets
 - **Add:** Proceeds from Sale of Investments
 - **Add:** Proceeds from Sale of Intangible Assets
 - **Add:** Interest and Dividend Received
(For non-financial companies only)
 - **Add:** Rent Income
 - **Less:** Purchase of Fixed Asset
 - **Less:** Purchase of Investment
 - **Less:** Purchase of Intangible Assets like Goodwill
- Extraordinary items (+/-)

Net Cash from Investing Activities

III. Cash Flow from Financing Activities

- **Add:** Proceeds from issue of shares and Debentures
- **Add:** Proceeds from Other Long term Borrowings
- **Less:** Final Dividend Paid
- **Less:** Interim Dividend Paid
- **Less:** Interest on Debentures and Loans paid
- **Less:** Repayment of Loans
- **Less:** Redemption of Debentures/Preference shares

Extraordinary items (+/-)

Net Cash from Financing Activities

IV. Net Increase/Decrease in Cash and Cash Equivalents (I+II+III)

V. Add: Cash and Cash Equivalents in the beginning of the year.

- Cash in Hand
- Cash at Bank (**Less:** Bank Overdraft)
- Short-term Deposits
- Marketable Securities.

VI. Cash and Cash Equivalents at the end of the year

- Cash in Hand
- Cash at Bank (**Less:** Bank Overdraft)
- Short-term Deposits
- Marketable Securities

Notes:

1. Amounts in brackets indicate negative amounts, i.e., amounts that are to be deducted.
2. Increase/Decrease in unpaid Interest on Debentures/Loans affects the Cash Flow from Financing Activities and not Operating Activities.
3. Increase/Decrease in Unclaimed Dividend affects the Cash Flow from Financing Activities and not Operating Activities.
4. Increase/Decrease in Accrued Interest on Investment affects the Cash Flow from Investing Activities and not Operating Activities.

Problem:

- ▶ Prepare a Cash Flow Statement for 2019 from the following information.
 - ▶ Income Statement for 2019

Particulars	Rs.	Rs.
Sales		1000000
Less: Cost of Sales(Including depreciation Rs. 10,000)		(750000)
Less : Selling and Administrative Expenses		250000
other expenses	50,000	
Interest on loan	25000	
Profit	<u>5000</u>	
		<u>(80,000)</u>
		<u>1,70,000</u>

Balance Sheet

Liabilities	As at 31.03.18 Rs.	As at 31.03.19 Rs.	Assets	As at 31.03.18 Rs.	As at 31.03.19 Rs.
Share Capital	860000	1000000	Pant & Equipment	12,50,000	14,90,000
Reserve	600000	770000	Stock	3,25,000	4,00,000
Loans	75000	125000	Debtors	2,00,000	1,50,000
Provision for Depreciation	40000	50000	Investments	25,000	75,000
Creditors	275000	225000	Cash & Bank	75,000	65,000
Outstanding expenses	25000	10000			
	1875000	2180000		1875000	2180000

Solution:

Cash Flow Statement under Direct Method

Cash Flow Statement

For the year ended 31.03.2019

Particulars	Rs.	Rs.	Rs.
<u>1. Cash Flows from Operating Activities:</u>			
Collection from Customers (see note 1)		10,50,000	
less: Payment to Suppliers (" " 2)	86,500		
Payment for expenses (" " 3)	90,000	9,55,000	
Cash Generated from Operation		→ 95,000	
Less: Income tax paid		NIL	95,000
Net Cash from Operating Activities			→
<u>2. Cash Flows from Investing Activities:</u>			
Purchase of Investment		(50,000)	
Purchase of Plant & Equipment		(2,40,000)	
Net Cash used in Investing Activities		→	(2,90,000)
<u>3. Cash Flows from Financing Activities:</u>			
Issue of Shares		1,40,000	
Loan raised		50,000	
Less: Payment of Interest		1,90,000	
Net Cash from Financing Activities		→	5,000
Net Decrease in Cash and Cash Equivalents			→ (10,000)
Add: Cash and Cash Equivalents at the beginning of the year			75,000
Cash and Cash Equivalents at the end of the year			65,000

Cash Flow Statement under Indirect Method

Cash Flow Statement For the year ended 31.03.2019

Particulars	Rs.	Rs.	Rs.
1. Cash Flows from Operating Activities:			
Net Profit as per Profit & Loss A/c		1,70,000	
Add: Depreciation	10,000		
Interest on loan	5,000	15,000	
Trading Profit before adjustment of w.e.		1,85,000	
Add: Decrease in Debtors		50,000	
		2,35,000	
Less: Increase in Stocks	75,000		
Decrease in Creditors	50,000		
Decrease in Outstanding Expenses	15,000	1,40,000	
Cash generated from Operation		95,000	
Less: Income tax paid		Nil	
Net Cash from Operating Activities			95,000
2. Cash Flows from Investing Activities			(2,90,000)
(Computation is same as direct method)			
3. Cash Flows from Financing Activities			1,85,000
(Computation is same as direct method)			
Net decrease in cash & cash equivalents			(10,000)
Add: Cash & cash equivalents at the beginning of the year			75,000
Cash and cash equivalents at the end of the year			65,000

Working Notes:

1. Cash from Operation

(i) Collection from customers

1. Cash from Operating

Particulars	Rs.
Collection from Customers (i)	10,50,000
less: Payment to Creditors (ii)	(8,65,000)
" Payment to expenses (iii)	(90,000)
	<u>95,000</u>

(ii) Payment for expenses

	Rs.
Selling & Administrative expenses	50,000
Other expenses	25,000
	<u>75,000</u>
Add: Decrease in out-standing expenses	15,000
	<u>90,000</u>

(iv) Plant and Equipment A/c

	Rs.
To, Balance b/d	12,50,000
To, Bank (Purchase) (Bal fig)	2,40,000
	<u>14,90,000</u>

(i) Collection from Customers

	Rs.
Total Assets	10,00,000
Add: decrease in Debtors	50,000
	<u>10,50,000</u>

(ii) Payment to Creditors

	Rs.
Cost of Sales	7,50,000
Less: Depreciation	10,000
	<u>7,40,000</u>
Add: Closing Stock	4,00,000
	<u>11,40,000</u>
Less: Opening stock	3,25,000
Purchase	8,15,000
Add: Decrease in Creditors	50,000
	<u>8,65,000</u>

By, Balance c/d

	Rs.
By, Balance c/d	14,90,000
	<u>14,90,000</u>