

**T. Y. B.COM.  
SEMESTER - 5**

SUBJECT:

MANAGEMENT ACCOUNTING - 1

TOPIC:

CASH FLOW STATEMENT

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# CASH FLOW STATEMENT

- **Accounting Standard-3 (AS-3)**, issued by The Institute of Chartered Accountants of India (ICAI) in June 1981, which dealt with a statement showing 'Changes in Financial Position', (Fund Flow Statement), has been revised and now deals with the preparation and presentation of Cash flow statement.
- The revised AS-3 has made it mandatory for all listed companies to prepare and present a cash flow statement along with other financial statements on annual basis.
- Hence, it may be noted, that Fund Flow statement is no more considered relevant in accounting and so not discussed here.

# OBJECTIVES OF CASH FLOW STATEMENT

- Cash flow statement aims at highlighting the cash generated from operating activities.
- Cash flow statement helps in planning the repayment of loan schedule and replacement of fixed assets, etc.
- Cash is the centre of all financial decisions. It is used as the basis for the projection of future investing and financing plans of the enterprise.
- Cash flow statement helps to ascertain the liquid position of the firm in a better manner. Banks and financial institutions mostly prefer cash flow statement to analyse liquidity of the borrowing firm.
- Cash flow Statement helps in efficient and effective management of cash.
- The management generally looks into cash flow statements to understand the internally generated cash which is best utilised for payment of dividends.
- Cash Flow Statement based on AS-3 (revised) presents separately cash generated and used in operating, investing and financing activities.
- It is very useful in the evaluation of cash position of a firm.

# BENEFITS OF CASH FLOW STATEMENT

- A cash flow statement when used along with other financial statements provides information that enables users to evaluate changes in net assets of an enterprise, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timings of cash flows in order to adapt to changing circumstances and opportunities.
- Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different enterprises.
- It also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.
- It also helps in balancing its cash inflow and cash outflow, keeping in response to changing condition. It is also helpful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and impact of changing prices.

# CASH AND CASH EQUIVALENTS

- As stated earlier, cash flow statement shows inflows and outflows of cash and cash equivalents from various activities of an enterprise during a particular period. As per AS-3, 'Cash' comprises cash in hand and demand deposits with banks, and 'Cash equivalents' means short-term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value. An investment normally qualifies as cash equivalents only when it has a short maturity, of say, three months or less from the date of acquisition. Investments in shares are excluded from cash equivalents unless they are in substantial cash equivalents. For example, preference shares of a company acquired shortly before their specific redemption date provided there is only insignificant risk of failure of the company to repay the amount at maturity. Similarly, short-term marketable securities which can be readily converted into cash are treated as cash equivalents and is liquidable immediately without considerable change in value.

# CASH FLOWS

- 'Cash Flows' implies movement of cash in and out due to some non-cash items. Receipt of cash from a non-cash item is termed as cash inflow while cash payment in respect of such items as cash outflow. For example, purchase of machinery by paying cash is cash outflow while sale proceeds received from sale of machinery is cash inflow. Other examples of cash flows include collection of cash from trade receivables, payment to trade payables, payment to employees, receipt of dividend, interest payments, etc.
- Cash management includes the investment of excess cash in cash equivalents. Hence, purchase of marketable securities or short-term investment which constitutes cash equivalents is not considered while preparing cash flow statement.

# **CLASSIFICATION OF ACTIVITIES FOR THE PREPARATION OF CASH FLOW STATEMENT**

- (1) Operating Activities
- (2) Investing Activities
- (3) Financing Activities

# CASH FROM OPERATING ACTIVITIES

## Cash Inflows from operating activities

- Cash receipts from sale of goods and the rendering of services.
- Cash receipts from royalties, fees, commissions and other revenues.



# **CASH FROM OPERATING ACTIVITIES**

## **Cash Outflows from operating activities**

- Cash payments to suppliers for goods and services.
- Cash payments to and on behalf of the employees.
- Cash payments to an insurance enterprise for premiums and claims, annuities, and other policy benefits.
- Cash payments of income taxes unless they can be specifically identified with financing and investing activities.

# CASH FROM INVESTING ACTIVITIES

## Cash Inflows from Investing Activities

- Cash receipt from disposal of fixed assets including intangibles.
- Cash receipt from the repayment of advances or loans made to third parties (except in case of financial enterprise).
- Cash receipt from disposal of shares, warrants or debt instruments of other enterprises except those held for trading purposes.
- Interest received in cash from loans and advances.
- Dividend received from investments in other enterprises.

# CASH FROM INVESTING ACTIVITIES

## Cash Outflows from Investing Activities

- Cash payments to acquire fixed assets including intangibles and capitalised research and development.
- Cash payments to acquire shares, warrants or debt instruments of other enterprises other than the instruments those held for trading purposes.
- Cash advances and loans made to third party (other than advances and loans made by a financial enterprise wherein it is operating activities).

# **CASH FROM FINANCING ACTIVITIES**

## **Cash Inflows from financing activities**

- Cash proceeds from issuing shares (equity or/and preference).
- Cash proceeds from issuing debentures, loans, bonds and other short/ long-term borrowings.

# **CASH FROM FINANCING ACTIVITIES**

## **Cash Outflows from financing activities**

- Cash repayments of amounts borrowed.
- Interest paid on debentures and long-term loans and advances.
- Dividends paid on equity and preference capital.

# TREATMENT OF SOME PECULIAR ITEMS

- EXTRAORDINARY ITEMS
- INTEREST AND DIVIDEND
- PAYMENT OF INTERIM DIVIDENDS
- TAXES ON INCOME AND GAINS
- SHARE CAPITAL
- PROVISION FOR TAXATION
- PURCHASE OR SALE OF FIXED ASSETS
- NON-CASH TRANSACTIONS

# LIMITATIONS OF CASH FLOW STATEMENT

- It is very difficult to precisely define the term 'cash'.
- There are controversies over a number of items like Cheques, stamps, postal orders etc. to be included in cash or not.
- As the present business moves from the cash basis to accrual basis, the prepaid and credit transactions might be represented an increase in working capital and it would be misleading to equate net income to cash flow because a number of non-cash items would affect the net income.

# IMPORTANT NOTES

- Bonus share always calculated on the basis of opening balance of equity share capital.
- Right share always calculated on the basis of opening balance of equity share capital + Bonus share.
- $\text{Capital Profit} = \text{Sale Value} - \text{Book Value}$
- $\text{Revenue Profit} = \text{Total Profit} - \text{Capital Profit}$
- $\text{Total Profit} = \text{Sale Value} - \text{W.D.V. (Written Down Value)}$



# CASH FLOW STATEMENT

PARTICULARS	AMT.RS.	AMT.RS.	AMT.RS.
<b>[A]CASH FLOW FROM OPERATING ACTIVITIES:</b>			
Profit (P&L A/c) (Closing Balance – Opening Balance)		####	
ADD: Written off Goodwill, Patent, Trademark, Copyright	####		
Written off Preliminary Expenses	####		
Written off Discount on Debenture	####		
Provision For Taxation	####		
Proposed Dividend	####		
General Reserve	####		
Depreciation on Fixed Assets	####		
Premium on Redemption of Pref. share	####		
Premium on Redemption of Debenture	####		
Interim Dividend	####		
Loss on Sale of Assets	####	####	
Less: Profit on Sale of Assets/Investment	(####)	(####)	
Profit before Changes in Working Capital		####	
<u>Changes in Working Capital</u>			
ADD: Decrease in Current Assets	####		
Increase in Current Liabilities	####	####	
LESS: Increase in Current Assets	(####)		
Decrease in Current Liabilities	(####)	(####)	
Profit Before Tax		(####)	
Less: Tax Paid		(####)	
<b>NET CASH FLOW FROM OPERATING ACTIVITIES [A]</b>			####

# CASH FLOW STATEMENT

PARTICULARS	AMT. RS.	AMT. RS.	AMT. RS.
<b>[B] CASH FLOW FROM INVESTMENT ACTIVITIES</b>		####	
ADD: Sale of Fixed Assets			
Sale of Investment	####		
	####	####	
LESS: Purchase of Fixed Assets		####	
Purchase of Investment	(####)		
	(####)	(####)	
<b>NET CASH FLOW FROM INVESTMENT ACTIVITIES [B]</b>			####

# CASH FLOW STATEMENT

PARTICULARS	AMT. RS.	AMT. RS.	AMT. RS.
<b>[C] CASH FLOW FROM FINANCING ACTIVITIES</b> <b>ADD: Issue of Equity Shares, Pref. Shares,</b> <b>Debenture, Right Share etc.</b>	####	####	
<b>LESS: Redemption of Pref. Share, Debenture</b> <b>Dividend Paid, Interim Dividend Paid</b>	(####)	(####)	
<b>NET CASH FLOW FROM FINANCING ACTIVITIES [C]</b>			####
<b>TOTAL (A+B+C)</b>			####
<b>ADD: Opening Balance Cash/Bank</b>			####
<b>Closing Balance Cash/Bank</b>			####

## GOODWILL PATENT, TRADEMARK, COPYRIGHT, PRELIMINARY EXPENSES, DEBENTURE DISCOUNT ACCOUNT

PATICULARS	AMT. RS.	PARTICULARS	AMT. RS.
<b>To Balance B/d (Opening Balance)</b>	####	By P&L A/c (Written off)	####
		By Balance C/d (Closing Balance)	####
	####		####

# FIXED ASSETS ACCOUNT (IF DEPRECIATION ACCOUNT IS NOT GIVEN)

PARTICULARS	AMT. RS.	PARTUCULARS	AMT. RS.
To Balance B/d (Opening Balance)	####	By Bank A/c (Sale)	####
To Bank A/c (Purchase)	####	By P&L A/c (Loss on Sale of Assets)	####
To P&L A/c (Revenue Profit on Sale of Assets)	####	By P&L A/c (Depreciation of C.Y.)	####
To P&L A/c (Capital Profit on Sale of Assets)	####	By Balance C/d (Closing Balance)	####
	####		####

# FIXED ASSETS ACCOUNT (IF DEPRECIATION ACCOUNT IS GIVEN)

PARTICULAR	AMT. RS.	PARTICULARS	AMT. RS.
To Balance B/d (Opening Balance)	####	BY Bank A/c (Sale)	####
To Bank A/c (Purchase)	####	By P&L A/c (Loss on Sale of Assets)	####
To P&L A/c (Revenue Profit on Sale of Assets)	####	By Depreciation Fund A/c (Dep. Of sold Assets)	####
To Capital Reserve A/c (Capital Profit on Sale of Assets)	####	By Balance C/d (Closing Balance)	####

# DEPRECIATION FUND ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Fixed Assets A/c (Dep. Of Sold Assets)	####	By Balance B/d (Opening Balance)	####
To Balance C/d (Closing Balance)	####	By P&L A/c (Depreciation of C.Y.)	####
	####		####

# INVESTMENT ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Balance B/d (Opening Balance)	####	By Bank A/c (Sale)	####
To Bank A/c (Purchase)	####	By P&L A/c (Loss on Sale of Investment)	####
To P&L A/c (Revenue Profit on Sale of Assets)	####		
To Capital Reserve A/c (Capital Profit on sale of Assets)	####	By Balance C/d (Closing Balance )	####
	####		####



# EQUITY SHARE CAPITAL ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
By Balance C/d		By Balance B/d	####
		By Bonus to Share Holder A/c	####
		By Bank A/c (Right Share)	####
	####	By Bank A/c (Issue of share)	####
	####		####

# SECURITY PREMIUM ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To premium on Redeemable Preference Share A/c	####	By Balance B/d	####
By Balance C/d	####	By Bank A/c (Issue at Premium)	####
	####		####

# CAPITAL RESERVE ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Fixed Assets A/c (Capital Profit on Sale of Fixed Assets)	####	By Balance B/d	####
To Investment A/c (Capital Profit on sale of investment)	####		
To Balance C/d	####		

# REDEEMABLE PREFERENCE SHARE CAPITAL ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Preference Share Holders A/c	####	By Balance B/d	#### ####
To Balance C/d	####	By Bank A/c (Last Call )	
	####		####

# PREFERENCE SHARE HOLDERS ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Bank A/c	####	By Preference Share Capital A/c	####
	####	By Premium on Red.pref. share A/c	####
	####		####

# PREMIUM ON REDEEMABLE PREFERENCE SHARE ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Preference Share Holders A/c	####	By Security Premium A/c	####
		By P&L A/c	####
	####		####

# GENERAL RESERVE ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Capital Redemption Reserve A/c  To Balance C/d	####	By Balance B/d	####
	####	By P&L A/c	####
	####		####

# CAPITAL REDEMPTION RESERVE ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Bonus to Share Holders A/c	####	By Balance B/d	####
To Balance C/d	####	By General Reserve A/c	####
	####		####



# BONUS TO SHAREHOLDERS ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Equity Share Capital A/c	####	By Capital Redemption Reserve A/c	####
	####		####

# RIGHT SHARE ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
By Equity Share Capital A/c	####	By Bank A/c	####
	####		####

# PROVISION FOR TAXATION ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Bank A/c (Paid)	####	By Balance B/d	####
To Balance C/d	####	By P&L A/c	####
	####		####

# PROPOSED DIVIDEND ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Bank A/c (Paid)	####	By Balance B/d	####
To Balance C/d	####	By P&L A/c	####
	####		####

# PROPOSED DIVIDEND ACCOUNT (IF UNPAID DIVIDEND ACCOUNT)

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
To Unpaid Dividend A/c	####	By Balance B/d	####
To Bank A/c (Paid) (Opening-Unpaid)	####	By P&L A/c	####
To Balance C/d	####		
	####		####

# UNPAID DIVIDEND ACCOUNT

PARTICULARS	AMT. RS.	PARTICULARS	AMT. RS.
By Balance C/d	####	By Proposed Dividend A/c	####
	####		####