

CASH FLOW STATEMENT

In the previous lesson, you have learnt various types of analysis of financial statements and its tools such as comparative statements, common size statement and trend analysis, etc. You have also learnt various kinds of accounting ratios such as liquidity, activity, profitability, solvency, etc. You have learnt that accounts are mainly maintained on accrual basis but cash also plays significant role. Cash is mainly generated for operating activities which is buying assets and discharging liabilities. Cash is also raised from the issue of shares and debentures or loans but adequate cash should be available for use in time and no cash should remain idle. For this another tool of analysis is used which is cash flow statement.. In this lesson, you will learn about cash flow statement and its methods of preparation.



After studying this lesson, you will be able to :

- state the meaning of cash flow statement;
- explain objectives of cash flow statement;
- explain the method of preparing cash flow statement as per format;
- state the limitations of cash flow statement.

30.1 MEANING AND OBJECTIVES

Cash plays a very important role in the economic life of a business. A firm needs cash to make payment to its suppliers, to incur day-to-day expenses and to pay salaries, wages, interest and dividends etc. In fact, what blood is to a human body, cash is to a business enterprise. Thus, it is very essential for a business to maintain an adequate balance of cash. For example, a concern operates profitably but it does not have sufficient cash balance to



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pay dividends, what message does it convey to the shareholders and public in general. Thus, management of cash is very essential. There should be focus on movement of cash and its equivalents. Cash means, cash in hand and demand deposits with the bank. Cash equivalent consists of bank overdraft, cash credit, short term deposits and marketable securities.

Cash Flow Statement deals with flow of cash which includes cash equivalents as well as cash. This statement is an additional information to the users of Financial Statements. The statement shows the incoming and outgoing of cash. The statement assesses the capability of the enterprise to generate cash and utilize it. *Thus a Cash-Flow statement may be defined as a summary of receipts and disbursements of cash for a particular period of time. It also explains reasons for the changes in cash position of the firm.* Cash flows are cash inflows and outflows. Transactions which increase the cash position of the entity are called as inflows of cash and those which decrease the cash position as outflows of cash. Cash flow Statement traces the various sources which bring in cash such as cash from operating activities, sale of current and fixed assets, issue of share capital and debentures etc. and applications which cause outflow of cash such as loss from operations, purchase of current and fixed assets, redemption of debentures, preference shares and other long-term debt for cash. In short, a cash flow statement shows the cash receipts and disbursements during a certain period. The statement of cash flow serves a number of objectives which are as follows :

- 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.



Notes

- 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.

Cash and relevant terms as per AS-3 (revised)

As per AS-3 (revised) issued by the Accounting Standards Board

1. (a) Cash fund :

Cash Fund includes (i) Cash in hand

(ii) Demand deposits with banks, and

(iii) cash equivalents.

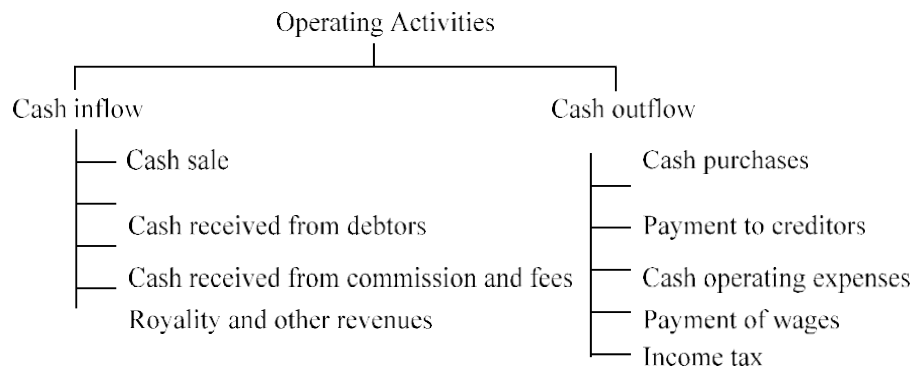
(b) Cash equivalents are short-term, highly liquid investments, readily convertible into cash and which are subject to insignificant risk of changes in values.

2. Cash Flows are inflows and outflows of cash and cash equivalents.

The statement of cash flow shows three main categories of cash inflows and cash outflows, namely : operating, investing and financing activities.

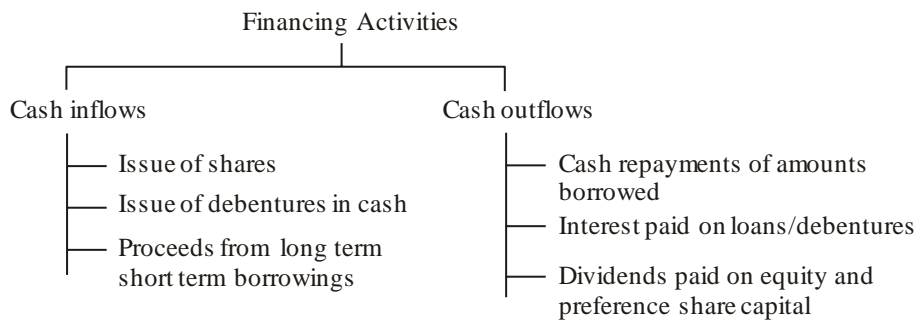
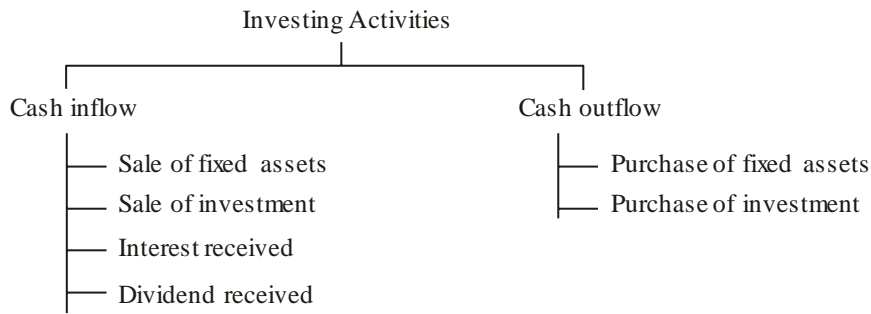
- (a) **Operating activities** are the principal revenue generating activities of the enterprise.
- (b) **Investing activities** include the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
- (c) **Financing activities** are activities that result in change in the size and composition of the owner's capital (including Preference share capital in the case of a company) and borrowings of the enterprise.

As per AS-3 the inflow and outflow of cash are :





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INTEXT QUESTIONS 30.1

Fill in the blanks with suitable word/words

- (i) Cash flow statement deals with flow of cash which includes cash and
- (ii) Cash flow statement is a statement.
- (iii) Cash flow statement shows cash and during a particular period.
- (iv) As per AS 3 (revised), cash fund includes cash, demand deposit with bank and

30.2 METHOD OF PREPARING CASH FLOW STATEMENT

There are two methods of preparing the Cash Flow Statement. Both methods give the same results in respect of the final total as well as sub-totals of the three sections – operating, investing and the financing. They differ only in the manner the information regarding cash flow from operating activities is presented.



Notes

• **Indirect Method**

**Format of Cash Flow Statement for the year ended
As per Accounting Standard - 3 (Revised)**

Particulars	Rs
(i) Cash flows from operating Activities	xxx
Net Profit as per Profit and Loss A/c or difference between closing balance and opening balance of Profit and Loss A/c	xxx
Add : Transfer to reserve	xxx
Proposed dividend for current year	xxx
Interim dividend paid during the year	xxx
Provision for tax made during the current year	xxx
Extraordinary items, if any, debited to Profit and Loss A/c	xxx
	xxx
Less : Extraordinary Items, if any, credited to Profit and Loss A/c	xxx
Refund of Tax credited to Profit and Loss A/c	xxx
	xxx
A. Net profit before taxation and Extra ordinary items Adjustment for Non-Cash and Non-Operating Items.	
B. Add :	
– Depreciation	xxx
– Preliminary expenses	xxx
– Discount on issue of shares and debentures written off	xxx
– Interest on borrowings and debentures	xxx
– Loss on sale of fixed assets	xxx
	xxx
C. Less :	
– Interest income/received	xxx
– Dividend income received	xxx
– Rental income received	xxx
– Profit on sale of fixed asset	xxx
	xxx

Cash Flow Statement

D. Operating profits before working capital changes (A + B – C)	xxx	xxx
E. Decrease in current assets and increase in current liabilities		xxx
F. Less : Increase in current assets and decrease in current liabilities		xxx
G. Cash generated from operations (D + E – F)		xxx
H. Less : Income tax paid (Net tax refund received)		xxx
I. Cash flow from before extraordinary items		xxx
Adjusted extraordinary items (+/-)		xxx
J. Net cash from operating activities		xxx
(ii) Cash from investing accounting		
Add :		
– Proceeds from sale of fixed assets		xxx
– Proceeds from sale of investments		xxx
– Proceeds from sale of intangible assets		xxx
– Interest and dividend received		xxx
		xxx
Less :		
– Rent income	xxx	
– Purchase of fixed assets	xxx	
– Purchase of investment	xxx	
– Purchase of intangible assets like goodwill	xxx	xxx
		xxx
Advanced extraordinary items (+/-)		xxx
Net cash from (or used in) investing activities		xxx
		xxx
(iii) Cash flows from financing activities		
Add :		
Proceeds from issue of shares and debentures	xxx	
Proceeds from other long term borrowings	xxx	
	xxx	
Less :		
Final dividend fund	xxx	
Interim dividend fund	xxx	
Interest on debentures and loans paid	xxx	

MODULE - 6A

Analysis of Financial Statements



Notes

MODULE - 6A

Analysis of Financial Statements



Notes

Cash Flow Statement

Repayment of loans	xxx	
Redemption of debenture preference shares	xxx	xxx
Adjust extraordinary items (+/-)	xxx	xxx
Net cash from (or used in) financing activities		xxx
		xxx
(iv) Net increase/Decrease in cash and cash equivalent (i + ii + iii)		xxx
(v) Add : cash and cash equivalents in the beginning of the year		
– cash in hand	xxx	
– cash at bank overdraft	xxx	
– short term deposit	xxx	
– marketable securities	xxx	
(vi) Less : cash and cash equivalents in the end of the year		
– cash in hand	xxx	
– cash at Bank (by bank overdraft)	xxx	
– short term deposits	xxx	
– Cash flow from operation	xxx	xxx
		xxx