REVISION OF FUND FLOW AND CASH FLOW

STUDY NOTES

A funds flow statement is a consolidated statement of all the cross transactions over the period for which the flow is being analysed.

Cross Transactions i.e. transactions involving a current account and a non-current account bring about a change in the fund or working capital. Some bring about an increase in fund and others bring about a decrease in the available fund (working capital).

The cross transactions presented in the funds flow statement are classified/grouped into two as,

i. **Sources/Inflows of funds**

   Transactions which bring about an increase in the available fund (working capital)

ii. **Applications/Outflows of funds**

   Transactions which bring about a decrease in the available fund (working capital)

CASH FLOW

In its simplest form, **cash flow** is the amount of money the comes in or out of a company. A primary indicator of financial health, cash flow shows how efficiently a business is running and if that business is able to pay its bills and keep the lights on.

A business that's **cash flow positive** has enough money available to meet its current and most-pressing financial obligations. A business that's **cash flow negative** has more debt than income and might struggle to meet its financial responsibilities.

There are instances where a company is cash flow negative and is doing so intentionally, such as going through a launch or investment phase. However, in most cases, unless it's planned or managed, most businesses would prefer to be cash flow positive.

Inflows, outflows and everywhere your cash goes

Income earned through sales, assets that can easily be converted into cash and funding, are called **inflows**. Cash used to pay for expenses and investments are referred to as **outflows**.

Some more cash flow basics every business should know are the difference between recurring cash flows and one-time cash flows.

A **recurring positive cash flow** is a predictable, reliable income source, like retainer or subscription fees billed to customers, while **recurring negative cash flow** is a consistent expense, like payroll.

A **one-time positive cash flow** (sit down for this) is a singular influx of cash. One example would be cash from the sale of equipment, land or facilities. A **one-time negative cash flow** would be a large purchase or expense, such as an insurance deductible for flood damage.

In the same vein, a **fixed cost** is something like leasing costs for office or retail space. No matter how many widgets you sell, you're still paying a set rate for your kiosk. This is another shocker: A **variable cost** changes. These are things like fuel, utilities and raw materials.

Long story short, in most cases, you want your recurring positive cash flows to be greater than you recurring negative cash flows. You also want to be aware of your fixed costs and do as much as you can to control or plan for changes in variable costs.

A cash flow statement explained

There are three fundamental financial statements for tracking and measuring a business' financial health:

- Cash flow statement (statement of cash flows)
- Profit and loss statement (P&L or income statement)
- Balance sheet (statement of financial worth or net worth)

As per its name, a **profit and loss statement** compares revenues against costs and expenses to determine if a company is profitable. A **balance sheet** compares what a business owns to what it owes in order to indicate the amount of **working capital**, cash reserves available to cover near-term commitments and recurring expenses.

A **cash flow statement** brings information from the profit and loss statement and balance sheet together by analyzing the flow of cash through the company in terms of day-to-day operations, capital investments and financing activities. (This is one of those cash flow basics to remember.)

- **Operational cash flow** literally includes all the nitty gritty expenses (labor, inventory, etc.) that go into making and offering the goods and services a business provides.
    - It also includes **accounts receivable and payable** (ingoing and outgoing invoices).
    - Current assets and liabilities are two key terms related to this concept.
        - **Current assets** (counted as part of your inflows) include your cash on hand and any assets that can be quickly sold to generate cash within 12 months.
        - On the flip side, **current liabilities** (tracked as outflows) are your expenses that must be paid within 12 months.
    - **Investment cash flow** represents the purchase of long-term assets, like buildings and equipment.
    - **Cash flow from financing activities** is the money that comes from loans or lines of credit. Depending on your business model, this can also include investors.

Every business financial statement has a specific function. What a cash flow statement does differently is that it helps identify patterns in terms of how and when money is coming into or leaving a business.

Publicly traded corporations have to share their cash flow statements. The average small business doesn't. Instead, for SMEs, its cash flow basics and measurements are vital financial management tools.

While business models and structures vary, most SMEs will pay the most attention to operational cash flow as part of their cash flow analysis and forecasting.

The direct versus the indirect method of reporting cash flow

The difference between cash and accrual accounting and how each one calculates net income lies at the heart of the **direct and indirect methods** for reporting operational cash flow.

Operational cash flow is singled out because it's the main areas affected by differences in how inflows and outflows are tracked. Warning: It's a little dry for the next few paragraphs, get ready to skim…

- **Net income** is the total amount of money a company has left once all other expenses are taken out.
- The **cash method** of accounting tracks income and expenses as they take place.
- The **accrual method** includes future income and expenses before they've actually hit the company's books.

Businesses that use cash-based accounting are able to easily use the direct method. This is because they've already tracked the actual cash movements in and out of the business as part of the net income.

As most small businesses use the accrual system, the indirect method requires that flow of cash be added back in when net income is entered into the cash flow statement.

When you use the indirect method, you have to account for the actual amounts that come in and out, like **accounts receivable** (money coming in from customers) and **accounts payable** (the money you owe to others).

And that's more detail than you probably ever wanted to know about the direct and indirect method. (So much for just cash flow basics.) Big picture: Whether you scramble or poach your eggs, in the end, you're still eating eggs.

Revisional problem:

1)The following particulars pertain to Cee Ltd.:

Statement of Profit and Loss
for the year ended 31st March, 2012

₹

Particulars	*Note No.*	*Amounts as at 31st March, 2012*
Revenue from operations	1	32,00,000
Other income	2	50,000
I. *Total revenue*		32,50,000
Expenses:		
Cost of goods sold		20,00,000
Finance cost	3	15,000
Depreciation		2,10,000
Other expenses	4	7,91,000
II. *Total Expenses*		30,16,000
Profit before tax (I-II)		2,34,000
Provision for income tax		92,000
Profit for the year		1,42,000

Note:

	₹
1. **Revenue from Operations**	
Sales of goods in trade	32,00,000
2. **Other Income**	
Government compensation for loss in riots	50,000
3. **Finance Cost**	
Interest on debentures	15,000
4. **Other Expenses**	
Operating expenses	7,90,000
Cost of issue of debentures, written off	1,000
	7,91,000

	Amounts as at 31st March	
	2011	*2012*
	₹	₹
Inventories	1,80,000	2,20,000
Trade Debtors	40,000	38,000
Bills Receivable	30,000	55,000
Balance with Bank and Cash in Hand	1,17,000	2,48,000
Trade Credtors	78,000	95,000
Bills Payable	20,000	15,000
Outstanding Expenses	31,000	44,000

You are also informed that the following important transactions have taken place during the year ended 31st March, 2012:

(i) Fully paid equity shares of the face value of Rs 2,00,000 were allotted at a premium of 20%.

(ii) 10% debentures for Rs 3,00,000 were redeemed at a premium of 2%.

(iii) Land was purchased for Rs 1,50,000 and the consideration was discharged by the allotment to the vendor of zero per cent convertible debentures for the amount.

(iv) Dividend and dividend distribution tax thereon for the year ended 31st March, 2011 amounting to Rs 1,15,000 was paid.

(v) Income tax paid during the year totalled Rs 95,000.

You are required to prepare cash flow statement for the year ended 31st March, 2012 using (i) the direct method and (ii) the indirect method.

2) **From the following particulars, prepare cash flow statement for the year ended 31st March, 2012 using the indirect method:**

Balance Sheet
as at 31st March, 2012

(₹' 000)

Particulars	*Note No.*	*Amount as at 31st March, 2012*	*Amount as at 31st March, 2011*
I. Equity and Liabilities			
Shareholders' funds			
Share capital	1	6,500	6,000
Reserves and surplus	2	1,060	800
Current liabilities			
Trade payables	3	660	670
Short-term provisions	4	1,640	1,490
		9,860	8,960
II. Assets			
Non-current assets			
Fixed assets			
Tangible assets	5	3,375	3,050
Intangible assets	6	400	600
Current assets			
Inventories		3,110	2,900
Trade receivables	7	855	800
Cash and cash equivalents	8	1,170	810
Short-term loans and advances	9	950	800
		9,860	8,960

Statement of Profit and Loss
for the year ended 31st March, 2012

(₹' 000)

Particulars	*Note No.*	*Amounts for the year ended 31st March, 2012*
Revenue from operations	10	18,930
I *Total Revenue*		18,930
Expenses:		
Purchase of stock in trade		9,530
Excess of closing inventories over opening inventories ₹ (3,110 – 2,900) thousand		(210)
Employee benefit expenses	11	5,010
Depreciation	12	525
Other expenses	13	2,275
II *Total expenses*		17,130
Profit before tax (I-II)		1,800
Tax expense	14	900
Profit for the period		900

Notes

	As at 31st March, 2012 ₹	*As at 31st March, 2011* ₹
1. **Share Capital**		
Issued, Subscribed and Paid up:		
Equity Shares of ₹ 10 each, fully paid up	6,500	6,000
2. **Reserves and Surplus**		
General Reserve	1,160	1,000
Preliminary Expenses	(100)	(200)
	1060	800
3. **Trade Payables**		
Trade Creditors	622	650
Outstanding Expenses	38	20
	660	670
4. **Short-term Provisions**		
Provision for Taxation	900	800
Proposed Dividend and Dividend Distribution Tax	740	690
	1,640	1,490
5. **Tangible Assets**		
Machinery	2,295	1,700
Furniture	1,080	1,350
	3,375	3,050

6.	**Intangible Assets**		
	Goodwill	400	600
7.	**Trade Receivables**		
	Trade Debtors	830	800
	Prepaid Expenses	25	
		855	800
8.	**Cost and Cash Equivalents**		
	Balance with Bank	1,130	780
	Cash on Hand	40	30
		1,170	810
9.	**Short-term Loans and Advances**		
	Advance Payament of Income Tax	950	800
10.	**Revenue from Operations**		
	Sales of Goods in Trade	18,930	
11.	**Employee Benefit Expenses**		
	Wages	2,870	
	Salaries	2,140	
		5,010	
12.	**Depreciation**		
	Depereciation on Machinery	405	
	Depreciation on Furniture	120	
		525	
13.	**Other Expenses**		
	Power	240	
	Rent	1,500	
	Electricity	100	
	Petty Office Expenses	95	
	Loss on Disposal of Furniture	40	
	Goodwill, written off	200	
	Preliminary Expenses, written off	100	
		2,275	
14.	**Tax Expense**		
	Provision for Income Tax	900	

The following additional information is provided to you:

ADVERTISEMENTS:

(i) During the year, furniture of the book value of Rs 150 thousand was sold for Rs 110 thousand and new machinery costing Rs 1,000 thousand was purchased and put into operation.

(ii) New equity shares were allotted at par for Rs 500 thousand.

(iii) Taxation liability for the accounting year 2010-2011 was settled at Rs 800 thousand, the amount having already been paid. For the year 2011-2012 an advance tax of Rs 950 thousand was paid.

(iv) During the year, dividend with the dividend distribution tax thereon for the year 2010-11, Rs 690 thousand was paid.