

SEM: VI
Chapter: CASH FLOW STATEMENT
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Definition of Cash Flow Statement:

Cash Flows are inflows and outflows of cash and cash equivalents. Information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilize those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation. Cash comprises cash on hand and demand deposits. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.

Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

The cash flow statement is a statement which reveals the Impact of all business transaction over a period of time on cash position of the firm. It summarizes the cost leading to change in cash balances between dates of two balance sheets. It gives Information regarding amount of the cash generated from various sources, their different uses and ultimately net impact on cash balance during the period. Thus, it is the Statement where cash came from during a period and where it was spent and thereby shows changes in cash balance.

Cash Flow Statement as per AS-3 and Ind AS-7

Accounting Standard AS-3 Cash Flow Statement Issued by Institute of Chartered Accountants of India (ICAI) has not specified any specific format for the preparation of Cash Flow Statement. The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.

CASH FROM OPERATING ACTIVITES

It generally includes, the operating activities which primarily arise from the principles of revenue producing activities of the enterprise. The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity have generated sufficient cash flows to repay loans, maintain the operating capability of the entity, pay dividends and make new investments without recourse to external sources of financing. Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

Cash flows from operating activities are primarily derived from the principal revenue producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss.

Examples of Operating Activities are:

- Cash receipts from sale of goods or rendering of service.
- Cash receipts from royalty, fees and other revenue.
- Cash paid to suppliers for goods and services.
- Cash paid to Income Tax dept.

CASH FROM INVESTING ACTIVITES

The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities. Cash Flow Arising out Acquisition and Disposal of the long term Assets and Investment are classified under the Investing activities.

Examples of Investing Activities are:

- Cash receipts from the disposal of the Fixed Assets including intangible.
- Cash paid to purchase Fixed Assets , to acquire shares, debenture of any companies
- Cash received from dividend and Interest from the other sources.
- Cash paid for purchase of investments to other companies.

CASH FROM FINANCING ACTIVITIES

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 capital to the entity. It includes Inflow and Outflow of the capital funds.

Examples of Operating Activities are:

- Issue of share
- Buy back of share
- Redemption of preference share
- Issue/Redemption of Debenture
- Paid to interest and dividend
- Paid long term loan

Applicability of Ind AS:

Indian Accounting Standards, (Ind AS) are a set of Accounting Standards notified by the Ministry Of Corporate Affairs which are converged with International Financial Reporting standards (IFRS). These Accounting Standards are formulated by Accounting Standard Board of Institute of Chartered Accountants of India. Now India will receive two Sets of Accounting Standards.

1. Existing Accounting Standards under companies (Accounting Standards) Rules, 2006
2. IFRS converged with Indian Accounting Standards (Ind AS).

The Ind AS named and numbered in the same way as the corresponding IFRS. As on the date of Ministry Of Corporate Affairs notifies 35 Indian Accounting Standards (Ind AS).

Convergence with IFRS:

The Inception of the Idea of Convergence of Indian GAAP with IFRS was made by India's commitment in G20 to align Indian Accounting Standards with IFRS. Thereafter ICAI has decided to converge its Accounting Standards with IFRS.

As per Ind AS-7, there is some Accounting treatment different from AS-3.

<u>Ind As-7</u>	<u>AS-3</u>
Bank borrowings are generally considered to be financing activities. However, where bank overdrafts which are repayable on demand form an integral part of an entity's cash Management, bank overdrafts are included as a component of cash and cash equivalents.	Not Mention on this Aspect.
Treatment of Cash Payments to Manufacture or Acquire Assets held for Rental to others and Subsequently held for sale to ordinary Course of business is treated as Cash Inflow from Operating Activities.	Does not contain Such Requirements.

Significance Cash Flow Statement:

1. **Indication of Profitability and Liquidity:-**The virtue of Cash Flow Statement lies in its ability to reveal firm's liquidity as well as profitability simultaneously. Liquidity position of the firm refers to its capacity to meet short term obligation such as payment of wages and other operating Expenses, creditors' payment, repayment of loan maturing in the current year etc. From cash flow statement we are able to understand how well the firm is meeting these obligations. At the same the ability of the firm in cash Earning can be known from cash flow statement. As a matter of fact, firm's profitability is ultimately dependent upon its cash earning capacity.
2. **Planning and Co-ordination:-** With the help of projected cash flow statement the management can plan and co-ordinate its financing activities effectively. In the absence of planning and co-ordination, situations might crop up to land the firm in acute cash crisis. Again sometimes the firm might have surplus cash. Neither of these situations is desirable. The projected cash flow statement can prevent this kind of situations. Management can streamline its financing activities before hand prevent such events.
3. **Performance Evaluation:-**The management can evaluate its performance by means of comparison of actual cash flow statement with projected cash flow statement. In this process performance of the firm can be improved.

4. **Capital Budgeting Decision**:-Most of the techniques of taking capital Budgeting decisions which has long run Implications for the firm are based on Projected cash flow of the proposed project.
5. **Objectivity**:-Cash Flow Information is more objective and Authentic the Actual based Accounting. A lot of Subjectivity is involved in the technical Adjustments made in the traditional Accrual Accounting.
6. **Answer of Intricate Questions**:-Cash Flow Statement is Able to Explain Some Intricate Questions often solved by Management Such as- Why the Company unable to pay dividend In spite of Making Profit.

DIRECT METHOD:

- The information is shown which is not shown elsewhere in the financial statement.
- The method shows true cash flows trading operations in the entity.
- The knowledge of the specific sources of cash inflows purpose of cash payment in made in past, which might be useful to the future cash flows.

INDIRECT METHOD:

- It Reconciles the Operating profit to Net cash flows from operating activities.
- The cost involved in preparation relatively less.

CASH FLOW STATEMENT (DIRECT METHOD):-

Particulars	Amount	Amount	Amount
<u>CASH FROM OPERATING ACTIVITIES:-</u>			
Collection from debtors	**		
Cash sale	**		
		**	
(-) Cash paid to creditors	**		
Cash paid for operating expenses	**	(**)	
		**	
(-) Income tax paid		(**)	
(+) Any Extra Ordinary Income		**	
NET CASH FLOW FROM OPERATION			**
<u>CASH FROM INVESTING ACTIVITES</u>			
Sale of fixed assets	**		
Sale of long term investment	**		
Interest collected	**		
Dividend collected	**		
		**	
(-) Purchase of fixed asset		(**)	
purchase of long term investment		(**)	
NET CASH FLOW FROM INVESTING ACTIVITIES:-			**
<u>CASH FROM FINANCING ACTIVITES</u>			
Issue of shares debentures	**		
(-)Redemption of Preference share and debentures	(**)		
(-)Interest paid	(**)		
Dividend paid	(**)		
NET CASH FLOW FROM FINANCING ACTIVITIES:-		**	
NET INCREASE OR DECREASE CASH OR CASH EQUIVALENTS			**
(+) Opening Cash or cash equivalents			**
Closing Cash or cash equivalents			**

CASH FLOW STATEMENT (INDIRECT METHOD):-

Particulars	Amount	Amount	Amount
<u>CASH FROM OPERATING ACTIVITIES:-</u>			
Net Profit as per Adjusted P/L A/C	**		
(+)decrease in Current Assets/Increase in Current Liability	**		
		**	
(-)Increase In Current Assets/Decrease In Current Liability	(**)		
(+) Any Extra Ordinary Receipt	**		
(-) Income tax paid	(**)		
(+) Any Extra Ordinary Income	**		
		**	
NET CASH FLOW FROM OPERATION			**
<u>CASH FROM INVESTING ACTIVITES</u>			
Sale of fixed assets	**		
Sale of long term investment	**		
Interest collected	**		
Dividend collected	**		
		**	
(-) Purchase of fixed asset		(**)	
purchase of long term investment		(**)	
NET CASH FLOW FROM INVESTING ACTIVITIES:-			**
<u>CASH FROM FINANCING ACTIVITES</u>			
Issue of shares debentures	**		
(-)Redemption of Preference share and debentures	(**)		
(-)Interest paid	(**)		
Dividend paid	(**)		
NET CASH FLOW FROM FINANCING ACTIVITIES:-		**	
NET INCREASE OR DECREASE CASH OR CASH EQUIVALENTS			**
(+) Opening Cash or cash equivalents			**
Closing Cash and cash equivalents			**

Cash From Operation under Direct Method:

Cash From Operating Activities:

Particulars	Amount	Amount
Collection from Customers		**
Other operating Receipt		**
		**
Less:-Cash Disbursement		
Cash Payment To Suppliers	**	
Payment Of Salaries and Wages	**	
Payment of Other Operating Expenses	**	(**)

Less:- Payment of Taxes		(***)
Net Cash Operating Activities		***

Collection From Debtors:

<u>Particulars</u>	<u>Amount</u>
Total Sales	**
Add:- Decrease In Debtors/Bills Receivable	**
OR	
Less:- Increase In Debtors/Bills Receivable	(**)
Collection From Debtors	***

Cash Paid For Purchases:

<u>Particulars</u>	<u>Amount</u>
Total Purchase	**
Add:-Decrease in Creditors and Other Payables	**
OR	
Less:-Increase in Creditors and Other Payables	(**)

Add:- Cost of goods sold	**

Less:- Opening Inventory	(**)
Purchase	***

Cash Paid For Expenses:

<u>Particulars</u>	<u>Amount</u>
Cash paid for outstanding Expenses	**
Add:- Decrease in outstanding Expenses	**
Add:-Increase in prepaid Expenses	**

Less:-Depreciation	(**)
Less:-Increase in Outstanding Expenses	(**)
Less:-Decrease in prepaid Expenses	(**)

Cash From Operation:

<u>Particulars</u>	<u>Amount</u>	<u>Amount</u>
Cash Collected from Debtors		***
Less:- <u>Cash Disbursement</u>		
Cash Payment to Suppliers	**	
Cash Payment For Expenses	**	
		(***)
<i>CASH FROM OPERATION</i>		***

Cash From Operation under Indirect Method:

Adjusted P/L A/C:

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<u>Particulars</u>	<u>Amount</u>	<u>Particulars</u>	<u>Amount</u>
To Depreciation	***	By Balance b/d	***
To Loss on sale on Fixes Assets	***	By Profit on sale of Fixed Assets	***
To PreliminaryExpense	***	By Interest Received	***
To Provision For Bad Debt	***	By Operating Profit (Balancing figure)	***
To Financing Expenses	***		
To Interim Dividend	***		
To Proposed Dividend	***		
To General Reserve	***		
To Sinking Fund	***		
To Provision For Taxation	***		
	***		***

Cash From Operation:

<u>Particulars</u>	<u>Amount</u>	<u>Amount</u>
Operating Profit (As Calculated Above)		***
Add:- Decrease in Debtors	**	
Decrease in Stock	**	
Decrease in Prepaid Expenses	**	
Increase in Creditors	**	
Increase In outstanding Expenses	**	

Less:- Increase in Debtors	**	
Increase In Prepaid Expenses	**	
Decrease in Creditors	**	
Decrease In outstanding Expenses	**	
		(***)
<i>CASH FROM OPERATION</i>		<i>***</i>

Interpretations of Cash Flow Statement:

In Order to Analyze and Interpreted the Cash Flow statement the Following Ratio might be Used:-

- ***Debt Service Coverage ratio= Operating Cash Flow After Interest and Dividend Payment/ Total Debt***

This Ratio Indicates the Extent to which existing Debt can be redeemed at once by the Net Cash Generated from Operations, so a high Debt Coverage Ratio is the sign of sound solvency position. However the too high Debt Coverage Ratio indicates that the firm is conservative in using cheaper Debt Capital.

- ***Interest Coverage Ratio=Cash Flow From Operating Activities/ Interest Payment***

This Ratio Indicates firm's ability to meet its Interest obligation. It shows how many times Interest payment is covered by the Cash Generated from Operation. So a high coverage Ratio is generally desirable. However, too high Interest Coverage Ratio might mean that the firm is availing the benefit of using cheaper Debt Capital.

- ***Ratio of Dividend to Operating Cash Flow=Dividend/ Operating Cash Flow***

This ratio indicates the portion of cash generated through operation which is disbursed in the form of Dividend. Higher the ratio, higher would be the rate of cash of the non earning purpose.

- ***Earning Cash Flow ratio=(Operating Cash Flow-Interest)/ (Operating Profit-Interest)***

This Ratio indicates that the extent to which Operating Profit has been Realized in Cash. So It Indicates the Quality of Earning Cash Flow ratio is always desirable for sound Quality Position.

- ***Ratio of Depreciation to cash Flow of New Assets=Depreciation/ Cash Flow for New Assets***

This ratio is the Indicator of the rate of setting aside funds for the assets Replacement.

- ***Rate of dependence of Capital Investment on Internal Fund= Operating Cash Flow (OCF) after Interest and Dividend/ Investing Cash Flow***

The high ratio is the Indicator of the stability of the firm.

- ***Cash return on Total Assets=Operating Cash Flow/ Total Assets***

This ratio indicates how efficiently the firm has utilized its total Assets in Generating Cash. The Objective of the firm would be to raise this ratio as high as possible.

- ***Cash Return on Net Worth=(Operating Cash Flow-Interest payment)/ Net Worth***

This ratio Indicates the degree of Efficiency with which Shareholders' Fund has been utilized in Earning Cash.

- ***Cash Flow Per Share=(Operating Cash Flow-Interest)/ No of shares***
It generates Cash Generating capacity per unit of share.