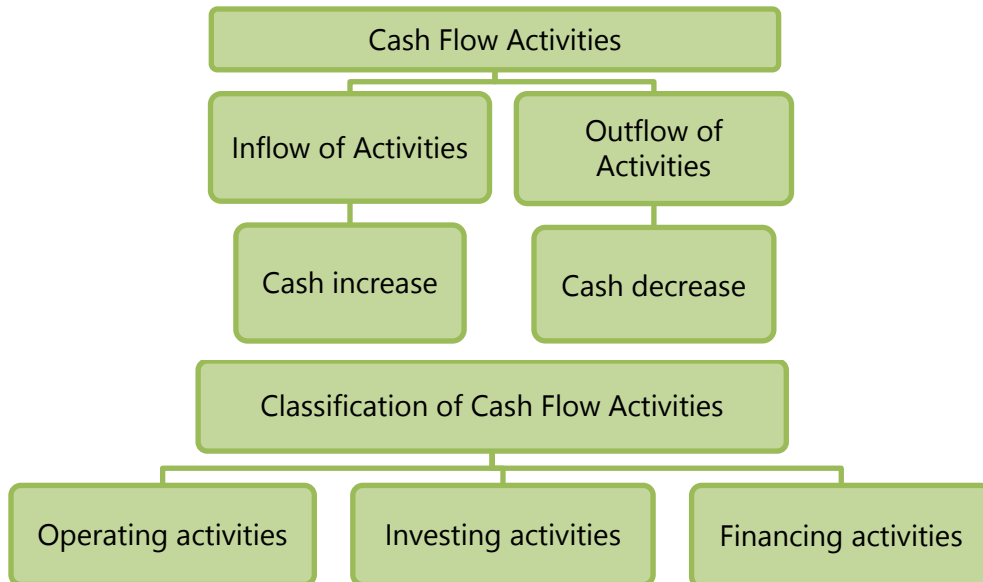


# UNIT 2: CASH FLOW STATEMENTS

## LEARNING OUTCOMES

**After studying this unit, you will be able to–**

- ❑ Define cash flow statement as per AS 3 “Cash Flow Statements”.
- ❑ Differentiate operating, investing and financing activities.
- ❑ Learn the various elements of cash and cash equivalents.
- ❑ Prepare cash flow statement both by direct method and indirect method.

**CHAPTER OVERVIEW**  **2.1 INTRODUCTION**

Information about the cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation.

The Standard deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

This statement provides relevant information in assessing a company's liquidity, quality of earnings and solvency.

**Benefits:**

- (a) Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise.

- (b) Identifies cash generated from trading operations.
- (c) The operating cash surplus which can be applied for investment in fixed assets.
- (d) Portion of cash from operations is used to pay dividend and tax and the other portion is ploughed back.
- (e) Very useful tool of planning.

### **Purpose:**

Cash flow statements are prepared to explain the cash movements between two points of time.

### **Sources of Cash:**

1. Issue of shares and debentures and raising long-term loan.
2. Sale of investments and other fixed assets.
3. Cash from operations(Net Operating Profit)

### **Applications of Cash**

1. Redemption of preference shares and debentures and repayment of long-term loan.
2. Purchase of investments and other fixed assets.
3. Payment of tax.
4. Payment of dividend.
5. Loss on Operation (Net Operating Loss)

**Note** – Cash includes Bank A/c also. Increase in cash or decrease in cash is put in the applications and the sources respectively just to balance the cash flow statement.

At this juncture students may note that in cash flow statement changes in all balance sheet items are to be taken into consideration separately for explaining movement of cash.

## **2.2 ELEMENTS OF CASH**

As per AS 3, issued by the Council of the ICAI,

'Cash' include:

- (a) Cash in hand,
- (b) Demand deposits with banks, and

Cash equivalents include:

- (a) Components
  - 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
  - Securities with short maturity period of, say, three months or less from the date of acquisition
- (b) Objective
  - Deploy, for a short period, idle cash required to meet short-term cash-commitments.
- (c) Examples
  - Acquisition of preference shares, shortly before their specified redemption date, bank deposits with short maturity period, etc.

**Conclusion:** Thus, cash flow statement deals with flow of cash funds but does not consider the movements among cash, bank balance payable on demand and investment of excess cash in cash equivalents. Examples are cash withdrawn from current account, cash deposited in bank for 60 days, etc.

## 2.3 CLASSIFICATION OF CASH FLOW ACTIVITIES

AS 3 provides explanation for changes in cash position of the business entity. As per Accounting Standard 3, cash flows during the period are classified as Operating; Investing and Financing activities.

### 2.3.1 Operating Activities

1. *Definition:* These are the principal revenue generating activities of the enterprise.
2. *Net Impact:* Net impact of operating activities on flow of cash is reported as 'Cash flows from operating activities' or 'cash from operation'.
3. *Key Indicator:* The amount of cash flows from operating activities is a key indicator of the extent to which the operations of the enterprises have

generated sufficient cash flows to :

- (a) Maintain the operating capability of the enterprise,
  - (b) Pay dividends, repay loans, and
  - (c) Make new investments without recourse to external sources of financing.
4. *Information Provided:* It provides useful information about financing through working capital.
  5. *Benefits:* Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

### 2.3.2 Investing activities

1. *Definition:* These are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
2. *Separate Disclosure:* Separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which the expenditures have been made for resources intended to generate future incomes and cash flows.

### 2.3.3 Financing activities

1. *Definition:* These are the activities that result in changes in the size and composition of the owner's capital (including preference share capital) and borrowings of the enterprise.
2. *Separate Disclosure:* 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 funds (both capital and borrowings) to the enterprise.

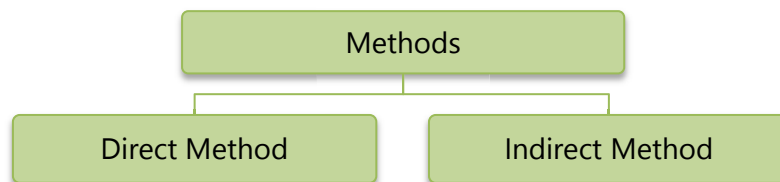
## 2.4 CALCULATION OF CASH FLOWS FROM OPERATING ACTIVITIES

1. *Components:* Cash flows from operating activities result from the transactions and other events that enter into the determination of net profit or loss.

## 2. Examples

- (a) cash receipts from the sale of goods and the rendering of services;
- (b) cash receipt from fees, commission and other revenue;
- (c) cash payments to suppliers for goods; cash payments to employees and so on.

## 3. Methods: An enterprise can determine cash flows from operating activities using either:



- (a) **Direct Method:** The direct method, whereby major classes of gross cash receipts and gross cash payments are considered; or
- (b) **Indirect Method:** The indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing activities.

### 2.4.1 Direct Method

#### 1. Information Required

- (a) Gross receipts and gross cash payments may be obtained from the accounting records to ascertain cash flows from operating activities.
- (b) For example,
  - (i) information about cash received from trade receivables,
  - (ii) payment to trade payables, cash expenses etc., which may be obtained by an analysis of cash book.
- (c) In actual practice, the relevant information is obtained by adjusting sales, cost of sales and other items in the profit and loss accounts for:
  - Changes during the period in inventories and operating receivables and payables;
  - Other non-cash items such as depreciation on fixed assets,

goodwill written off, preliminary expenses written off, loss or gain on sale of fixed assets etc.; and

- Other items for which the cash effects are investing or financing cash flows. Examples are interest received and paid, dividend received and paid etc., which are related to financing or investing activities and are shown separately in the cash flow statement.
2. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method.
  3. However, indirect method of determining the cash from operating activities is more popular in actual practice.

### 2.4.2 Indirect Method

Under the indirect method, the net cash from operating activities is determined by adjusting net profit or loss instead of individual items appearing in the profit and loss account. Net profit or loss is also adjusted for the effect of:

- (a) changes during the period in inventories and operating receivables and payables;
- (b) non-cash items such as depreciation; and
- (c) all other items for which the cash effects are financing or investing cash flows.

### 2.4.3 Conclusion

1. It is worth noting that both direct and indirect methods adjust current assets and current liabilities related to operating activities to determine cash from operating activities.
2. But direct method adjust individual items of profit and loss account and indirect method adjusts overall net profit (or loss) to determine cash from operation.
3. Therefore, indirect method fails to provide break-up of cash from operations.

**Proforma of 'Cash Flow from Operating Activities' by indirect method**

		₹
Net Profit for the year		-
<i>Add:</i> Non-Cash and Non-Operating Expenses:		-
Depreciation		-
Loss on Sale of Assets		-
Provision for taxation, etc.		-
<i>Less:</i> Non-Cash and Non-Operating Incomes:		
Profit on Sale of Assets		-
Net Profit after Adjustment for Non-Cash Items		(-)
Cash from operation	=	Net Profit (after adjustment for Non-cash Items)
	-	Increase in Current Assets
	+	Decrease in Current Assets
	+	Increase in Current Liabilities
	-	Decrease in Current Liability

## 2.5 CALCULATION OF CASH FLOWS FROM INVESTING ACTIVITIES

1. These activities are related to the acquisition and disposal of long-term assets, non-operating current assets and investments which results in outflow of cash.
2. Disposal of the aforesaid assets results in inflow of cash.
3. Thus, inflows and outflows related to acquisition and disposal of assets, other than those related to operating activities, are shown under this category

## 2.6 CALCULATION OF CASH FLOWS FROM FINANCING ACTIVITIES

1. These activities are basically related to the changes in capital and borrowing of the enterprise which affect flow of cash.



2. Redemption of shares and repayment of borrowings results in outflow of cash.
3. Thus inflows and outflows related to the amount of capital and borrowings of the enterprise are shown under this head.

**Note:** Students are advised to refer full text of Accounting Standard on Cash Flow Statements (AS 3) for the better understanding of the chapter.

## 2.7 ILLUSTRATIONS

### Illustration 1

*Intelligent Ltd., a non-financial company has the following entries in its Bank Account. It has sought your advice on the treatment of the same for preparing Cash Flow Statement.*

- (i) *Loans and Advances given to the following and interest earned on them:*
  - (1) *to suppliers*
  - (2) *to employees*
  - (3) *to its subsidiaries companies*
- (ii) *Investment made in subsidiary Smart Ltd. and dividend received*
- (iii) *Dividend paid for the year*
- (iv) *TDS on interest income earned on investments made*
- (v) *TDS on interest earned on advance given to suppliers*
- (vi) *Insurance claim received against loss of fixed asset by fire*

*Discuss in the context of AS 3 Cash Flow Statement.*

### Solution

- (i) **Loans and advances given and interest earned**

(1) to suppliers	Operating Cash flow
(2) to employees	Operating Cash flow
(3) to its subsidiary companies	Investing Cash flow
- (ii) **Investment made in subsidiary company and dividend received**  
Investing Cash flow
- (iii) **Dividend paid for the year**

Financing Cash Outflow

- (iv) **TDS on interest income earned on investments made**

Investing Cash Outflow

- (v) **TDS on interest earned on advance given to suppliers**

Operating Cash Outflow

- (vi) **Insurance claim received of amount loss of fixed asset by fire**

Extraordinary item to be shown under a separate heading as 'Cash inflow from investing activities'.

### Illustration 2

Following are the extracts of Balance Sheet of Ajay Ltd.:

<b>Liabilities</b>	<b>31.3.20X1</b>	<b>31.3.20X2</b>	<b>Assets</b>	<b>31.3.20X1</b>	<b>31.3.20X2</b>
	₹	₹			₹
Share Capital	5,00,000	5,00,000	Goodwill	1,15,000	90,000
15% Debentures	5,00,000	7,50,000	Discount on issue of Debentures	90,000	1,15,000
Unpaid Interest	--	5,000			
Profit & Loss A/c	50,000	90,000			

You are required to show the related items in Cash Flow Statement, if Discount on issue of Debentures amounting to ₹ 10,000 has been written off during the year.

### Solution

#### An Extract of Cash Flow Statement for the year ending 31.3.20X2

	₹
Closing balance as per Profit & Loss A/c	90,000
Less: Opening balance as per Profit & Loss Alc.	(50,000)
Add: Goodwill amortisation	25,000
Add: Discount on issue of Debentures	10,000
Interest on Debentures	75,000
Net Cash from Operating Activities	1,50,000

**Cash flows from financing activities:**

Proceeds from debentures	2,15,000
Interest paid on Debentures [less unpaid]	(70,000)
Net Cash from Financing Activities	1,45,000

**Working Note:**

**(i) Discount on issue of Debentures Account**

<b>Particulars</b>	<b>₹</b>	<b>Particular</b>	<b>₹</b>
To Balance b/d	90,000	By Profit & Loss A/c (w/o)	10,000
To 15% Debentures A/c (Bal. fig.)	35,000	By Balance c/d	1,15,000
	1,25,000		1,25,000

**(ii) 15% Debentures Account**

<b>Particulars</b>	<b>₹</b>	<b>Particular</b>	<b>₹</b>
To Balance c/d	7,50,000	By Balance b/d	5,00,000
		By Bank A/c (Bal. fig.)	2,15,000
		By Discount on issue of Debentures A/c	35,000
	7,50,000		7,50,000

**Illustration 3**

From the following information, calculate cash flow from operating activities:

**Summary of Cash Account  
for the year ended March 31, 20X1**

<b>Particulars</b>	<b>₹</b>	<b>Particulars</b>	<b>₹</b>
To Balance b/d	1,00,000	By Cash Purchases	1,20,000
To Cash sales	1,40,000	By Trade payables	1,57,000
To Trade receivables	1,75,000	By Office & Selling Expenses	75,000
To Trade Commission	50,000	By Income Tax	30,000
To Sale of Investment	30,000	By Investment	25,000

To Loan from Bank	1,00,000	By Repay of Loan	75,000
To Interest & Dividend	1,000	By Interest on loan	10,000
		By Balance c/d	1,04,000
	5,96,000		5,96,000

### Solution

**Cash Flow Statement of .....**  
**for the year ended March 31, 20X1 (Direct Method)**

Particulars	₹	₹
<b>Operating Activities:</b>		
Cash received from sale of goods	1,40,000	
Cash received from Trade receivables	1,75,000	
Trade Commission received	50,000	3,65,000
Less: Payment for Cash Purchases	1,20,000	
Payment to Trade payables	1,57,000	
Office and Selling Expenses	75,000	
Payment for Income Tax	30,000	(3,82,000)
Net Cash Flow used in Operating Activities		(17,000)

### Illustration 4

The following summary cash account has been extracted from the company's accounting records:

**Summary Cash Account**

		(₹ '000)
Balance at 1.3.20X1		35
Receipts from customers		2,783
Issue of shares		300
Sale of fixed assets		128
		3,246
Payments to suppliers	2,047	

<i>Payments for fixed assets</i>	230	
<i>Payments for overheads</i>	115	
<i>Wages and salaries</i>	69	
<i>Taxation</i>	243	
<i>Dividends</i>	80	
<i>Repayments of bank loan</i>	250	(3,034)
<i>Balance at 31.3.20X2</i>		212

Prepare Cash Flow Statement of this company Hills Ltd. for the year ended 31st March, 20X2 in accordance with AS-3 (Revised).

The company does not have any cash equivalents.

### Solution

#### Hills Ltd.

#### Cash Flow Statement for the year ended 31st March, 20X2 (Using direct method)

		(₹'000)
<b>Cash flows from operating activities</b>		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	
<i>Net cash from operating activities</i>		309
<b>Cash flows from investing activities</b>		
Payments for purchase of fixed assets	(230)	
Proceeds from sale of fixed assets	128	
<i>Net cash used in investing activities</i>		(102)
<b>Cash flows from financing activities</b>		
Proceeds from issuance of share capital	300	
Bank loan repaid	(250)	

Dividend paid	(80)	
<i>Net cash used in financing activities</i>		(30)
<b>Net increase in cash and cash equivalents</b>		177
<b>Cash and cash equivalents at beginning of period</b>		35
<b>Cash and cash equivalents at end of period</b>		212

### Illustration 5

Prepare cash flow statement of M/s MNT Ltd. for the year ended 31<sup>st</sup> March, 20X1 with the help of the following information:

- (1) Company sold goods for cash only.
- (2) Gross Profit Ratio was 30% for the year, gross profit amounts to ₹ 3,82,500.
- (3) Opening inventory was lesser than closing inventory by ₹ 35,000.
- (4) Wages paid during the year ₹ 4,92,500.
- (5) Office and selling expenses paid during the year ₹ 75,000.
- (6) Dividend paid during the year ₹ 30,000 (including dividend distribution tax.)
- (7) Bank loan repaid during the year ₹ 2,15,000 (included interest ₹ 15,000)
- (8) Trade payables on 31<sup>st</sup> March, 20X0 exceed the balance on 31<sup>st</sup> March, 20X1 by ₹ 25,000.
- (9) Amount paid to trade payables during the year ₹ 4,60,000.
- (10) Tax paid during the year amounts to ₹ 65,000 (Provision for taxation as on 31.03.20X1 ₹ 45,000).
- (11) Investments of ₹ 7,00,000 sold during the year at a profit of ₹ 20,000.
- (12) Depreciation on fixed assets amounts to ₹ 85,000.
- (13) Plant and machinery purchased on 15<sup>th</sup> November, 20X0 for ₹ 2,50,000.
- (14) Cash and Cash Equivalents on 31<sup>st</sup> March, 20X0 ₹ 2,00,000.
- (15) Cash and Cash Equivalents on 31<sup>st</sup> March, 20X1 ₹ 6,07,500.

**Solution**

**M/s MNT Ltd.**  
**Cash Flow Statement for the year ended 31st March, 20X1**  
**(Using direct method)**

<i>Particulars</i>	₹	₹
<b><i>Cash flows from Operating Activities</i></b>		
Cash sales (₹ 3,82,500/.30)		12,75,000
Less: Cash payments for trade payables	(4,60,000)	
Wages Paid	(4,92,500)	
Office and selling expenses	(75,000)	(10,27,500)
Cash generated from operations before taxes		2,47,500
Income tax paid		(65,000)
Net cash generated from operating activities (A)		1,82,500
<b><i>Cash flows from investing activities</i></b>		
Sale of investments (7,00,000 + 20,000)	7,20,000	
Payments for purchase of Plant & machinery	(2,50,000)	
Net cash used in investing activities (B)		4,70,000
<b><i>Cash flows from financing activities</i></b>		
Bank loan repayment(including interest)	(2,15,000)	
Dividend paid(including dividend distribution tax)	(30,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,07,500
<b>Cash and cash equivalents at beginning of the period</b>		<b>2,00,000</b>
<b>Cash and cash equivalents at end of the period</b>		<b>6,07,500</b>

**Illustration 6**

The following data were provided by the accounting records of Ryan Ltd. at year-end, March 31, 20X1:

**Income Statement**

	₹
Sales	6,98,000
Cost of Goods Sold	(5,20,000)

Gross Margin		1,78,000
Operating Expenses (including Depreciation Expense of ₹ 37,000)		(1,47,000)
		31,000
Other Income / (Expenses)		
Interest Expense paid	(23,000)	
Interest Income received	6,000	
Gain on Sale of Investments	12,000	
Loss on Sale of Plant	(3,000)	
		(8,000)
		23,000
Income tax		(7,000)
		16,000

**Comparative Balance Sheets**

₹

	31st March	31st March
<b>Assets</b>		
Plant Assets	7,15,000	5,05,000
Less: Accumulated Depreciation	(1,03,000)	(68,000)
	6,12,000	4,37,000
Investments (Long term)	1,15,000	1,27,000
Current Assets:		
Inventory	1,44,000	1,10,000
Accounts receivable	47,000	55,000
Cash	46,000	15,000
Prepaid expenses	1,000	5,000
	9,65,000	7,49,000
<b>Liabilities</b>		
Share Capital	4,65,000	3,15,000
Reserves and surplus	1,40,000	1,32,000
Bonds	2,95,000	2,45,000
Current liabilities:		
Accounts payable	50,000	43,000
Accrued liabilities	12,000	9,000



<i>Income taxes payable</i>	3,000	5,000
	9,65,000	7,49,000

**Analysis of selected accounts and transactions during 20X0-X1**

1. Purchased investments for ₹78,000.
2. Sold investments for ₹1,02,000. These investments cost ₹90,000.
3. Purchased plant assets for ₹1,20,000.
4. Sold plant assets that cost ₹10,000 with accumulated depreciation of ₹2,000 for ₹5,000.
5. Issued ₹1,00,000 of bonds at face value in an exchange for plant assets on 31st March, 20X1.
6. Repaid ₹50,000 of bonds at face value at maturity.
7. Issued 15,000 shares of ₹10 each.
8. Paid cash dividends ₹8,000.

Prepare Cash Flow Statement as per AS-3 (Revised), using indirect method.

**Solution**

**Ryan Ltd.**  
**Cash Flow Statement**  
**for the year ending 31st March, 20X1**

	₹	₹
<b>Cash flows from operating activities</b>		
Net profit before taxation	23,000	
Adjustments for:		
Depreciation	37,000	
Gain on sale of investments	(12,000)	
Loss on sale of plant assets	3,000	
Interest expense	23,000	
Interest income	(6,000)	
Operating profit before working capital changes	68,000	
Decrease in accounts receivable	8,000	
Increase in inventory	(34,000)	
Decrease in prepaid expenses	4,000	

Increase in accounts payable	7,000	
Increase in accrued liabilities	3,000	
Cash generated from operations	56,000	
Income taxes paid*	(9,000)	
<i>Net cash generated from operating activities</i>		47,000
<b>Cash flows from investing activities</b>		
Purchase of plant	(1,20,000)	
Sale of plant	5,000	
Purchase of investments	(78,000)	
Sale of investments	1,02,000	
Interest received	6,000	
<i>Net cash used in investing activities</i>		(85,000)
<b>Cash flows from financing activities</b>		
Proceeds from issuance of share capital	1,50,000	
Repayment of bonds	(50,000)	
Interest paid	(23,000)	
Dividends paid	(8,000)	
<i>Net cash from financing activities</i>		69,000
<b>Net increase in cash and cash equivalents</b>		31,000
<b>Cash and cash equivalents at the beginning of the period</b>		15,000
<b>Cash and cash equivalents at the end of the period</b>		46,000

**\*Working Note:**

	₹
Income taxes paid:	
Income tax expense for the year	7,000
Add: Income tax liability at the beginning of the year	<u>5,000</u>
	12,000
Less: Income tax liability at the end of the year	<u>(3,000)</u>
	<u>9,000</u>

**Illustration 7**

The balance sheets of Sun Ltd. for the years ended 31st March 20X1 and 20X0 were summarised as:

	<b>20X1</b>	<b>20X0</b>
	₹	₹
<i>Equity Share Capital</i>	60,000	50,000
<i>Reserves:</i>		
<i>Profit and Loss Account</i>	5,000	4,000
<i>Current Liabilities:</i>		
<i>Trade payables</i>	4,000	2,500
<i>Taxation</i>	1,500	1,000
<i>dividends payable</i>	2,000	1,000
	72,500	58,500
<i>Fixed Assets (at w.d.v.)</i>		
<i>Premises</i>	10,000	10,000
<i>Fixtures</i>	17,000	11,000
<i>Vehicles</i>	12,500	8,000
<i>Short-term investments</i>	2,000	1,000
<i>Current Assets</i>		
<i>Inventory</i>	17,000	14,000
<i>Trade receivables</i>	8,000	6,000
<i>Bank and Cash</i>	6,000	8,500
	72,500	58,500

The profit and loss account for the year ended 31st March, 20X1 disclosed

	₹
<i>Profit before tax</i>	4,500
<i>Taxation</i>	<u>(1,500)</u>
<i>Profit after tax</i>	3,000
<i>Declared dividends</i>	<u>(2,000)</u>
<i>Retained profit</i>	<u>1,000</u>

Further information is available

	Fixtures ₹	Vehicles ₹
Depreciation for year	1,000	2,500
Disposals:		
Proceeds on disposal	—	1,700
Written down value	—	(1,000)
Profit on disposal		<u>700</u>

Prepare a Cash Flow Statement for the year ended 31st March, 20X1.

### Solution

**Sun Ltd.**  
**Cash Flow Statement**  
**for the year ended 31st March, 20X1**

	₹	₹
<b>Cash flows from operating activities</b>		
Net Profit before taxation	4,500	
Adjustments for:		
Depreciation	3,500	
Profit on sale of vehicles (1,700 – 1,000)	(700)	
Operating profit before working capital changes	7,300	
Increase in Trade receivables	(2,000)	
Increase in inventories	(3,000)	
Increase in Trade payables	1,500	
Cash generated from operations	3,800	
Income taxes paid (W.N.1)	(1,000)	
<i>Net cash generated from operating activities</i>		2,800
<b>Cash flows from investing activities</b>		
Sale of vehicles	1,700	
Purchase of vehicles (W.N.3)	(8,000)	
Purchase of fixtures (W.N.3)	(7,000)	
<i>Net cash used in investing activities</i>		(13,300)

<b>Cash flows from financing activities</b>		
Issue of shares for cash	10,000	
Dividends paid (W.N.2)	(1,000)	
<i>Net cash from financing activities</i>		<u>9,000</u>
<b>Net decrease in cash and cash equivalents</b>		(1,500)
<b>Cash and cash equivalents at beginning of period (See Note )</b>		9,500
<b>Cash and cash equivalents at end of period (See Note )</b>		8,000
<b>Note to the Cash Flow Statement</b>		
<b><i>Cash and Cash Equivalents</i></b>		
	<i>31.3.20X1</i>	<i>31.3.20X0</i>
Bank and Cash	6,000	8,500
Short-term investments	2,000	1,000
Cash and cash equivalents	8,000	9,500

**Working Notes:**

			₹
1.	<b>Income taxes paid</b>		
	Income tax expense for the year		1,500
	<i>Add:</i> Income tax liability at the beginning of the year		1,000
			2,500
	<i>Less:</i> Income tax liability at the end of the year		(1,500)
			1,000
2.	<b>Dividend paid</b>		
	Declared dividend for the year		2,000
	<i>Add:</i> Amount payable at the beginning of the year		1,000
			3,000
	<i>Less:</i> Amount payable at the end of the year		(2,000)
			1,000

3. <b>Fixed assets acquisitions</b>	<i>Fixtures</i>	<i>Vehicles</i>
	₹	₹
W.D.V. at 31.3.20X1	17,000	12,500
<i>Add back:</i>		
Depreciation for the year	1,000	2,500
Disposals	—	1,000
	18,000	16,000
<i>Less: W.D.V. at 31.12.20X0</i>	(11,000)	(8,000)
Acquisitions during 20X0-20X1	7,000	8,000

### Illustration 8

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 31<sup>st</sup> March, 20X1:

	<b>(₹ in lakhs)</b>
<i>Net Profit</i>	25,000
<i>Dividend (including dividend tax) paid</i>	8,535
<i>Provision for Income tax</i>	5,000
<i>Income tax paid during the year</i>	4,248
<i>Loss on sale of assets (net)</i>	40
<i>Book value of the assets sold</i>	185
<i>Depreciation charged to Profit &amp; Loss Account</i>	20,000
<i>Profit on sale of Investments</i>	100
<i>Carrying amount of Investment sold</i>	27,765
<i>Interest income on investments</i>	2,506
<i>Interest expenses of the year</i>	10,000
<i>Interest paid during the year</i>	10,520
<i>Increase in Working Capital (excluding Cash &amp; Bank Balance)</i>	56,081
<i>Purchase of fixed assets</i>	14,560
<i>Investment in joint venture</i>	3,850

<i>Expenditure on construction work in progress</i>	34,740
<i>Proceeds from calls in arrear</i>	2
<i>Receipt of grant for capital projects</i>	12
<i>Proceeds from long-term borrowings</i>	25,980
<i>Proceeds from short-term borrowings</i>	20,575
<i>Opening cash and Bank balance</i>	5,003
<i>Closing cash and Bank balance</i>	6,988

Prepare the Cash Flow Statement for the year 20X1 in accordance with AS 3. (Make necessary assumptions).

### Solution

**Star Oils Limited**  
**Cash Flow Statement**  
**for the year ended 31st March, 20X1**

		(₹ in lakhs)
<b>Cash flows from operating activities</b>		
Net profit before taxation (25,000 + 5,000)	30,000	
Adjustments for :		
Depreciation	20,000	
Loss on sale of assets (Net)	40	
Profit on sale of investments	(100)	
Interest income on investments	(2,506)	
Interest expenses	10,000	
Operating profit before working capital changes	57,434	
Changes in working capital (Excluding cash and bank balance)	(56,081)	
Cash generated from operations	1,353	
Income taxes paid	(4,248)	
Net cash used in operating activities		(2,895)

<b>Cash flows from investing activities</b>		
Sale of assets (W.N.1)	145	
Sale of investments (27,765 + 100)	27,865	
Interest income on investments	2,506	
Purchase of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in progress	(34,740)	
Net cash used in investing activities		(22,634)
<b>Cash flows from financing activities</b>		
Proceeds from calls in arrear	2	
Receipts of grant for capital projects	12	
Proceeds from long-term borrowings	25,980	
Proceed from short-term borrowings	20,575	
Interest paid	(10,520)	
Dividend (including dividend tax) paid	<u>(8,535)</u>	27,514
Net increase in cash and cash equivalents		1,985
Cash and cash equivalents at the beginning of the period		5,003
Cash and cash equivalents at the end of the period		<u>6,988</u>

**Working note:**

1. Book value of the assets sold	185
Less : Loss on sale of assets	<u>(40)</u>
Proceeds on sale	<u>145</u>

**Assumption :**

Interest income on investments ₹ 2,506 has been received during the year.

**Illustration 9**

*From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 20X1 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.*



**Summary Cash Account for the year ended 31.3.20X1**

	₹' 000		₹' 000
<i>Balance on 1.4.20X0</i>	50	<i>Payment to Suppliers</i>	2,000
<i>Issue of Equity Shares</i>	300	<i>Purchase of Fixed Assets</i>	200
<i>Receipts from Customers</i>	2,800	<i>Overhead expense</i>	200
<i>Sale of Fixed Assets</i>	100	<i>Wages and Salaries</i>	100
		<i>Taxation</i>	250
		<i>Dividend</i>	50
		<i>Repayment of Bank Loan</i>	300
		<i>Balance on 31.3.20X1</i>	150
	3,250		3,250

**Solution****X Ltd.****Cash Flow Statement for the year ended 31st March, 20X1  
(Using direct method)**

	₹'000	₹'000
<b>Cash flows from operating activities</b>		
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
<i>Net cash generated from operating activities</i>		250
<b>Cash flows from investing activities</b>		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
<i>Net cash used in investing activities</i>		(100)
<b>Cash flows from financing activities</b>		
Proceeds from issuance of equity shares	300	

Bank loan repaid	(300)	
Dividend paid	(50)	
<i>Net cash used in financing activities</i>		(50)
Net increase in cash		100
Cash at beginning of the period		50
Cash at end of the period		150

### Illustration 10

Given below is the Statement of Profit and Loss of ABC Ltd. and relevant Balance Sheet information:

**Statement of Profit and Loss of ABC Ltd.  
for the year ended 31st March, 20X1**

	<b>₹ in lakhs</b>
<i>Revenue:</i>	
<i>Sales</i>	4,150
<i>Interest and dividend</i>	100
<i>Stock adjustment</i>	20
<i>Total (A)</i>	4,270
<i>Expenditure:</i>	
<i>Purchases</i>	2,400
<i>Wages and salaries</i>	800
<i>Other expenses</i>	200
<i>Interest</i>	60
<i>Depreciation</i>	100
<i>Total (B)</i>	3,560
<i>Profit before tax (A – B)</i>	710
<i>Tax provision</i>	200
<i>Profit after tax</i>	510
<i>Balance of Profit and Loss account brought forward</i>	50
<i>Profit available for distribution (C)</i>	560

<i>Appropriations:</i>	
<i>Transfer to general reserve</i>	200
<i>Declared dividend (including CDT)</i>	330
<i>Total (D)</i>	530
<i>Balance (C – D)</i>	30

<b>Relevant Balance Sheet information</b>	<b>31.3.20X1</b>	<b>31.3.20X0</b>
	<b>₹ in lakhs</b>	<b>₹ in lakhs</b>
<i>Trade receivables</i>	400	250
<i>Inventories</i>	200	180
<i>Trade payables</i>	250	230
<i>Outstanding wages</i>	50	40
<i>Outstanding expenses</i>	20	10
<i>Advance tax</i>	195	180
<i>Tax provision</i>	200	180

Compute cash flow from operating activities using both direct and indirect method.

### Solution

#### By direct method Computation of Cash Flow from Operating Activities

	<b>₹ in lakhs</b>	<b>₹ in lakhs</b>
<b>Cash Receipts:</b>		
Cash sales and collection from Trade receivables		
Sales + Opening Trade receivables – Closing Trade receivables (A)	4,150 + 250 – 400	<u>4,000</u>
<b>Cash payments:</b>		
Cash purchases & payment to Trade payables		
Purchases + Opening Trade payables – Closing Trade payables	2,400 + 230 – 250	2,380
Wages and salaries paid	800 + 40 – 50	790
Cash expenses	200 + 10 – 20	190

Taxes paid – Advance tax			195
(B)			3,555
Cash flow from operating activities (A – B)			445
<b>By indirect method</b>			
Profit before tax			710
Add: Non-cash items : Depreciation			100
Add: Interest : Financing cash outflow			60
Less: Interest and Dividend : Investment cash inflow			(100)
Less: Tax paid			(195)
Working capital adjustments			
Trade receivables	250–400	(150)	
Inventories	180–200	(20)	
Trade payables	250–230	20	
Outstanding wages	50–40	10	
Outstanding expenses	20–10	10	(130)
Cash flow from operating activities			<u>445</u>

### Illustration 11

Prepare Cash flow for Gamma Ltd., for the year ending 31.3.20X1 from the following information:

- (1) Sales for the year amounted to ₹ 135 crores out of which 60% was cash sales.
- (2) Purchases for the year amounted to ₹ 55 crores out of which credit purchase was 80%.
- (3) Administrative and selling expenses amounted to ₹ 18 crores and salary paid amounted to ₹ 22 crores.
- (4) The Company redeemed debentures of ₹ 20 crores at a premium of 10%. Debenture holders were issued equity shares of ₹ 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was ₹ 1.5 crores.
- (5) Dividend paid during the year amounted to ₹ 11.7 crores (including Dividend distribution tax) was also paid.
- (6) Investment costing ₹ 12 crores were sold at a profit of ₹ 2.4 crores.

- (7) ₹ 8 crores was paid towards income tax during the year.
- (8) A new plant costing ₹ 21 crores was purchased in part exchange of an old plant. The book value of the old plant was ₹ 12 crores but the vendor took over the old plant at a value of ₹ 10 crores only. The balance was paid in cash to the vendor.
- (9) The following balances are also provided:

	₹ in crores 1.4.20X0	₹ in crores 31.3.20X1
Debtors	45	50
Creditors	21	23
Bank	6	

### Solution

#### Gamma Ltd.

#### Cash Flow Statement for the year ended 31st March, 20X1 (Using direct method)

Particulars	₹ in crores	₹ in crores
Cash flows from operating activities		
Cash sales (60% of 135)	81	
Cash receipts from Debtors [45+ (135x40%) - 50]	49	
Cash purchases (20% of 55)	(11)	
Cash payments to suppliers [21+ (55x80%) - 23]	(42)	
Cash paid to employees	(22)	
Cash payments for overheads (Adm. and selling)	(18)	
Cash generated from operations	37	
Income tax paid	(8)	
Net cash generated from operating activities		29
Cash flows from investing activities		
Sale of investments (12+ 2.40)	14.4	

Payments for purchase of fixed assets (21 – 10)	(11)	
Net cash used in investing activities		3.4
Cash flows from financing activities		
Redemption of debentures (22-15)	(7)	
Interest paid	(1.5)	
Dividend paid	<u>(11.7)</u>	
Net cash used in financing activities		(20.2)
Net increase in cash		12.2
Cash at beginning of the period		6.0
Cash at end of the period		18.2

### Question 12

From the following Balance Sheets of Mr. Zen, prepare a Cash flow statement as per AS-3 for the year ended 31.3.20X1:

#### Balance Sheets of Mr. Zen

<b>Liabilities</b>	<b>As on 1.4.20X0</b>	<b>As on 1.4.20X1</b>
	₹	₹
Zen's Capital A/c	10,00,000	12,24,000
Trade payables	3,20,000	3,52,000
Mrs. Zen's loan	2,00,000	--
Loan from Bank	<u>3,20,000</u>	<u>4,00,000</u>
	<u>18,40,000</u>	<u>19,76,000</u>
<b>Assets</b>	<b>As on 1.4.20X0</b>	<b>As on 1.4.20X1</b>
	₹	₹
Land	6,00,000	8,80,000
Plant and Machinery	6,40,000	4,40,000
Inventories	2,80,000	2,00,000
Trade receivables	2,40,000	4,00,000
Cash	<u>80,000</u>	<u>56,000</u>
	<u>18,40,000</u>	<u>19,76,000</u>

**Additional information:**

A machine costing ₹ 80,000 (accumulated depreciation there on ₹24,000) was sold for ₹ 40,000. The provision for depreciation on 1.4.20X0 was ₹ 2,00,000 and 31.3.20X1 was ₹ 3,20,000. The net profit for the year ended on 31.3.20X1 was ₹3,60,000.

**Solution**

**Cash Flow Statement of Mr. Zen as per AS 3  
for the year ended 31.3.20X1**

		₹
<b>(i) Cash flow from operating activities</b>		
Net Profit (given)		3,60,000
<b>Adjustments for</b>		
Depreciation on Plant & Machinery (W.N.2)	1,44,000	
Loss on Sale of Machinery (W.N.1)	16,000	1,60,000
Operating Profit before working capital changes		5,20,000
Decrease in inventories	80,000	
Increase in trade receivables	(1,60,000)	
Increase in trade payables	32,000	(48,000)
<b>Net cash generated from operating activities</b>		4,72,000
<b>(ii) Cash flow from investing activities</b>		
Sale of Machinery (W.N.1)	40,000	
Purchase of Land (8,80,000 – 6,00,000)	(2,80,000)	
<b>Net cash used in investing activities</b>		(2,40,000)
<b>(iii) Cash flow from financing activities</b>		
Repayment of Mrs. Zen's Loan	(2,00,000)	
Drawings (W.N.3)	(1,36,000)	
Loan from Bank	80,000	
<b>Net cash used in financing activities</b>		(2,56,000)
Net decrease in cash		(24,000)
Opening balance as on 1.4.20X0		80,000
Cash balance as on 31.3.20X1		56,000

**Working Notes:****1. Plant & Machinery A/c**

	₹		₹
To Balance b/d (6,40,000 + 2,00,000)	8,40,000	By Cash – Sales	40,000
		By Provision for Depreciation A/c	24,000
		By Profit & Loss A/c – Loss on Sale (80,000 – 64,000)	16,000
		By Balance c/d (4,40,000+3,20,000)	7,60,000
	8,40,000		8,40,000

**2. Provision for depreciation on Plant and Machinery A/c**

	₹		₹
To Plant and Machinery A/c	24,000	By Balance b/d	2,00,000
To Balance c/d	<u>3,20,000</u>	By Profit & Loss A/c (Bal. fig.)	<u>1,44,000</u>
	<u>3,44,000</u>		<u>3,44,000</u>

**3. To find out Mr. Zen's drawings:**

	₹
Opening Capital	10,00,000
Add: Net Profit	<u>3,60,000</u>
	13,60,000
Less: Closing Capital	<u>(12,24,000)</u>
Drawings	<u>1,36,000</u>



## SUMMARY

- Cash flow statement dealt under AS 3.
- Benefits include providing information relating to changes in cash and cash equivalents of an enterprise.
- Cash include:
  - (a) Cash in hand
  - (b) Demand deposits with banks
- Cash equivalents are 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.
- Cash flow activities may be classified as inflow and outflow but as per AS-3 they are classified as Operating Activities, Investing activities, Financing activities.
- Operating activities are principal revenue generating activities.
- Investing Activities relate to acquisition and disposal of long-term assets and other investments.
- Financing Activities include the ones which result in changes in the size and composition of the owner's capital (including preference share capital) and borrowings of the enterprise.
- Methods to calculate cash flow from operating activities include:
  - (a) Direct Method
  - (b) Indirect Method
- In order to calculate cash flow from investing activities inflows and outflows related to acquisition and disposal of assets, other than those related to operating activities, are shown under this category.
- In order to calculate cash flow from financing activities inflows and outflows related to the amount of capital and borrowings of the enterprise are shown under this head.

## TEST YOUR KNOWLEDGE

### MCQ

- While preparing cash flow statement, conversion of debt to equity
  - Should be shown as a financing activity.
  - Should be shown as an investing activity.
  - Should not be shown as it is a non-cash transaction.
- Which of the following would be considered a 'cash-flow item from an "investing" activity'?
  - Cash outflow to the government for taxes.
  - Cash outflow to purchase bonds issued by another company.
  - Cash outflow to shareholders as dividends.
- All of the following would be included in a company's operating activities except:
  - Income tax payments
  - Collections from customers or Cash payments to suppliers
  - Dividend payments.
- Hari Uttam, a stock broking firm, received ₹ 1,50,000 as premium for forward contracts entered for purchase of equity shares. How will you classify this amount in the cash flow statement of the firm?
  - Operating Activities.
  - Investing Activities.
  - Financing Activities.
- As per AS 3 on Cash Flow Statements, cash received by a manufacturing company from sale of shares of ABC Company Ltd. should be classified as
  - Operating activity.
  - Financing activity.
  - Investing activity.
- Which of the following activities would generally be regarded as a financing activity in preparing a cash flow statement?

- (a).. Dividend distribution.
- (b) Proceeds from the sale of shares of other companies.
- (c) Loans made by the financial enterprise to other businesses entities.
7. All of the following are examples of cash flows arising from investing activities except
- (a) Cash payments to acquire fixed assets.
- (b) Cash receipts from disposal of fixed assets.
- (c) Cash payments to suppliers for goods and services.
8. Cash repayments of amounts borrowed will be disclosed in the cash flow statement as
- (a) An operating activity.
- (b) A financing activity
- (c) An investing activity.
9. In the cash flow statement, 'cash and cash equivalents' include
- (a) Bank balances and Cash balances.
- (b) Short-term investments readily convertible into Cash are subject to an insignificant risk of changes in value.
- (c) Both (a) and (b).

### Theoretical Questions

1. What is the significance of cash flow statement? Explain in brief.
2. Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to Accounting Standard 3, (AS 3) revised.

### PRACTICAL QUESTIONS

#### Question 1

From the following details relating to the Accounts of Grow More Ltd. prepare Cash Flow Statement:

Liabilities	31.03.20X1 (₹)	31.03.20X0 (₹)
Share Capital	10,00,000	8,00,000
Reserve	2,00,000	1,50,000

Profit and Loss Account	1,00,000	60,000
Debentures	2,00,000	–
Provision for taxation	1,00,000	70,000
Dividend payable	2,00,000	1,00,000
Trade payables	7,00,000	8,20,000
	25,00,000	20,00,000
<b>Assets</b>		
Plant and Machinery	7,00,000	5,00,000
Land and Building	6,00,000	4,00,000
Investments	1,00,000	–
Trade receivables	5,00,000	7,00,000
Inventories	4,00,000	2,00,000
Cash on hand/Bank	2,00,000	2,00,000
	25,00,000	20,00,000

- (i) Depreciation @ 25% was charged on the opening value of Plant and Machinery.
- (ii) At the year end, one old machine costing 50,000 (WDV 20,000) was sold for ₹ 35,000. Purchase was also made at the year end.
- (iii) ₹ 50,000 was paid towards Income tax during the year.
- (iv) Building under construction was not subject to any depreciation.

Prepare Cash flow Statement.

### Question 2

From the following Balance Sheet and information, prepare Cash Flow Statement of Ryan Ltd. by Indirect method for the year ended 31st March, 20X1:

#### Balance Sheet

	31 <sup>st</sup> March, 20X1	31 <sup>st</sup> March, 20X0
Liabilities		
Equity Share Capital	6,00,000	5,00,000
10% Redeemable Preference Share Capital	–	2,00,000

Capital Redemption Reserve	1,00,000	–
Capital Reserve	1,00,000	–
General Reserve	1,00,000	2,50,000
Profit and Loss Account	70,000	50,000
9% Debentures	2,00,000	–
Trade payables	1,15,000	1,10,000
Liabilities for Expenses	30,000	20,000
Provision for Taxation	95,000	60,000
Dividend payable	90,000	60,000
	15,00,000	12,50,000
	<b>31<sup>st</sup>March, 20X1</b>	<b>31<sup>st</sup>March, 20X0</b>
<b>Assets</b>		
Land and Building	1,50,000	2,00,000
Plant and Machinery	7,65,000	5,00,000
Investments	50,000	80,000
Inventory	95,000	90,000
Trade receivables	2,50,000	2,25,000
Cash and Bank	65,000	90,000
Voluntary Separation Payments	1,25,000	65,000
	15,00,000	12,50,000

**Additional Information:**

- (i) A piece of land has been sold out for ₹1,50,000 (Cost – ₹1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on sale and profit on revaluation.
- (ii) On 1st April, 20X0 a plant was sold for ₹90,000 (Original Cost – ₹70,000 and W.D.V. – ₹50,000) and Debentures worth ₹1 lakh was issued at par as part consideration for plant of ₹4.5 lakhs acquired.
- (iii) Part of the investments (Cost – ₹50,000) was sold for ₹70,000.
- (iv) Pre-acquisition dividend received ₹5,000 was adjusted against cost of investment.

- (v) Directors have declared 15% dividend for the current year.
- (vi) Voluntary separation cost of ₹50,000 was adjusted against General Reserve.
- (vii) Income-tax liability for the current year was estimated at ₹1,35,000.
- (viii) Depreciation @ 15% has been written off from Plant account but no depreciation has been charged on Land and Building.

### Question 3

The Balance Sheet of New Light Ltd. for the years ended 31st March, 20X0 and 20X1 are as follows:

<b>Liabilities</b>	<b>31st March 20X0 (₹)</b>	<b>31st March 20X1 (₹)</b>	<b>Assets</b>	<b>31st March 20X0 (₹)</b>	<b>31st March 20X1 (₹)</b>
Equity share capital	12,00,000	16,00,000	Fixed Assets	32,00,000	38,00,000
10% Preference share capital	4,00,000	2,80,000	Less: Depreciation	9,20,000	11,60,000
Capital Reserve	–	40,000	Investment	22,80,000	26,40,000
General Reserve	6,00,000	7,60,000	Cash	4,00,000	3,20,000
Profit and Loss A/c	2,40,000	3,00,000	Other current assets	10,000	10,000
9% Debentures	4,00,000	2,80,000		11,10,000	13,10,000
Current liabilities	4,80,000	5,20,000			
Dividend payable	1,20,000	1,60,000			
Provision for Tax	3,60,000	3,40,000			
	38,00,000	42,80,000		38,00,000	42,80,000

Additional information:

- (i) The company sold one fixed asset for ₹ 1,00,000, the cost of which was ₹ 2,00,000 and the depreciation provided on it was ₹ 80,000.
- (ii) The company also decided to write off another fixed asset costing ₹ 56,000 on which depreciation amounting to ₹ 40,000 has been provided.

- (iii) Depreciation on fixed assets provided ₹ 3,60,000.
- (iv) Company sold some investment at a profit of ₹ 40,000, which was credited to capital reserve.
- (v) Debentures and preference share capital redeemed at 5% premium.
- (vi) Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31.3.20X0 was ₹ 2,16,000. The inventory on 31.3.20X1 was correctly valued at ₹ 3,00,000.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

**Question 4**

ABC Ltd. gives you the following information. You are required to prepare Cash Flow Statement by using indirect methods as per AS 3 for the year ended 31.03.20X1:

**Balance Sheet as on**

Liabilities	31 <sup>st</sup> March 20X0	31 <sup>st</sup> March 20X1	Assets	31 <sup>st</sup> March 20X0	31 <sup>st</sup> March 20X1
	₹	₹		₹	₹
Capital	50,00,000	50,00,000	Plant & Machinery	27,30,000	40,70,000
Retained Earnings	26,50,000	36,90,000	Less: Depreciation	(6,10,000)	(7,90,000)
Debentures	—	9,00,000		21,20,000	32,80,000
<i>Current Liabilities</i>			<i>Current Assets</i>		
Trade payables	8,80,000	8,20,000	Trade receivables	23,90,000	28,30,000
Bank Loan	1,50,000	3,00,000	Less: Provision	(1,50,000)	(1,90,000)
Liability for expenses	3,30,000	2,70,000		22,40,000	26,40,000
Dividend payable	1,50,000	3,00,000	Cash	15,20,000	18,20,000
			Marketable	11,80,000	15,00,000

		securities		
		Inventories	20,10,000	19,20,000
		Prepaid Expenses	90,000	1,20,000
	91,60,000	1,12,80,000	91,60,000	1,12,80,000

Additional Information:

- (i) Net profit for the year ended 31st March, 20X1, after charging depreciation ₹ 1,80,000 is ₹ 22,40,000.
- (ii) Trade receivables of ₹ 2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account during the year.
- (iii) ABC Ltd. declared dividend of ₹ 12,00,000 for the year 20X0-20X1.

## ANSWERS/ HINTS

### MCQ

1. (c) 2. (b) 3. (c) 4. (a) 5. (c) 6. (a) 7. (c) 8. (b) 9. (c)

### Theoretical Questions

- 1 Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise. It identifies cash generated from trading operations and is very useful tool of planning.
2. As per Para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either:
  - (a) The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
  - (b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.



**Practical Questions****Answer 1**

**Grow More Ltd**  
**Cash Flow Statement**  
**for the year ended 31<sup>st</sup> March, 20X1**  
**Cash Flow from Operating Activities**

		₹
Increase in balance of Profit and Loss Account (1,00,000 – 60,000)	40,000	
Dividend payable	2,00,000	
Provision for taxation (W.N.1)	80,000	
Transfer to General Reserve (2,00,000 – 1,50,000)	50,000	
Depreciation (W.N.2)	1,25,000	
Profit on sale of Plant and Machinery	(15,000)	
Operating Profit before Working Capital changes	4,80,000	
Increase in Inventories	(2,00,000)	
Decrease in Trade receivables	2,00,000	
Decrease in Trade payables	(1,20,000)	
Cash generated from operations	3,60,000	
Income tax paid	(50,000)	
Net Cash from operating activities		3,10,000

**Cash Flow from Investing Activities**

Purchase of fixed assets	(3,45,000)	
Expenses on building (6,00,000 – 4,00,000)	(2,00,000)	
Increase in investments	(1,00,000)	
Sale of old machine	35,000	
Net Cash used in investing activities		(6,10,000)

**Cash Flow from Financing activities**

Proceeds from issue of shares (10,00,000 – 8,00,000)	2,00,000	
Proceeds from issue of debentures	2,00,000	
Dividend paid	<u>(1,00,000)</u>	
Net cash used in financing activities		<u>3,00,000</u>
Net increase in cash or cash equivalents		NIL
Cash and Cash equivalents at the beginning of the year		<u>2,00,000</u>
Cash and Cash equivalents at the end of the year		<u>2,00,000</u>

**Working Notes:****1. Provision for taxation account**

	₹		₹
To Cash (Paid)	50,000	By Balance b/d	70,000
To Balance c/d	1,00,000	By Profit and Loss A/c	80,000
	—	(Balancing figure)	—
	<u>1,50,000</u>		<u>1,50,000</u>

**2. Plant and Machinery account**

	₹		₹
To Balance b/d	5,00,000	By Depreciation	1,25,000
To Profit and Loss A/c (profit on sale of machine)	15,000		
To Cash (Balancing figure)	3,45,000	By Cash (sale of machine)	35,000
	—	By Balance c/d	<u>7,00,000</u>
	<u>8,60,000</u>		<u>8,60,000</u>

**Answer 2**

**Cash Flow Statement of Ryan Limited  
For the year ended 31st March, 20X1**

	₹	₹
Cash flow from operating activities		
Net Profit before taxation (W.N.1)	2,45,000	
Adjustment for		
Depreciation (W.N.3)	1,35,000	
Profit on sale of plant (W.N.3)	(40,000)	
Profit on sale of investments (W.N.3)	(20,000)	
Interest on debentures (W.N.4)	18,000	
Operating profit before working capital changes	3,38,000	
Increase in inventory	(5,000)	
Increase in trade receivables	(25,000)	
Increase in Trade payables	5,000	
Increase in accrued liabilities	10,000	
Cash generated from operations	3,23,000	
Income taxes paid (W.N.8)	(1,00,000)	
	2,23,000	
Voluntary separation payments (W.N.9)	(1,10,000)	
Net cash generated from operating activities		1,13,000
Cash flow from investing activities		
Proceeds from sale of land (W.N.2)	1,50,000	
Proceeds from sale of plant (W.N.3)	90,000	
Proceeds from sale of investments (W.N.4)	70,000	
Purchase of plant (W.N.3)	(3,50,000)	
Purchase of investments (W.N.4)	(25,000)	
Pre-acquisition dividend received (W.N.4)	5,000	
Net cash used in investing activities		(60,000)

Cash flow from financing activities		
Proceeds from issue of equity shares (6,00,000 – 5,00,000)	1,00,000	
Proceeds from issue of debentures (2,00,000 – 1,00,000)	1,00,000	
Redemption of preference shares	(2,00,000)	
Dividends paid	(60,000)	
Interest paid on debentures	(18,000)	
Net cash used in financing activities		(78,000)
Net decrease in cash and cash equivalents		(25,000)
Cash and cash equivalents at the beginning of the year		90,000
Cash and Cash equivalents at the end of the year		65,000

**Working Notes:**

1.

	₹
Net profit before taxation	
Retained profit	70,000
Less: Balance as on 31.3.20X0	(50,000)
	20,000
Provision for taxation	1,35,000
Dividend payable	90,000
	2,45,000

2.

**Land and Building Account**

	₹		₹
To Balance b/d	2,00,000	By Cash (Sale)	1,50,000
To Capital reserve (Profit on sale)	30,000	By Balance c/d	1,50,000
To Capital reserve (Revaluation profit)	70,000		
	3,00,000		3,00,000

3. **Plant and Machinery Account**

	₹		₹
To Balance b/d	5,00,000	By Cash (Sale)	90,000
To Profit and loss account	40,000	By Depreciation	1,35,000
To Debentures	1,00,000	By Balance c/d	7,65,000
To Bank	3,50,000		
	<u>9,90,000</u>		<u>9,90,000</u>

4. **Investments Account**

	₹		₹
To Balance b/d	80,000	By Cash (Sale)	70,000
To Profit and loss account	20,000	By Dividend	
To Bank (Balancing figure)	25,000	(Pre-acquisition)	5,000
		By Balance c/d	50,000
	<u>1,25,000</u>		<u>1,25,000</u>

5. **Capital Reserve Account**

	₹		₹
To Balance c/d	1,00,000	By Profit on sale of land	30,000
		By Profit on revaluation of land	70,000
	<u>1,00,000</u>		<u>1,00,000</u>

6. **General Reserve Account**

	₹		₹
To Voluntary separation cost	50,000	By Balance b/d	2,50,000
To Capital redemption reserve	1,00,000		
To Balance c/d	1,00,000		
	<u>2,50,000</u>		<u>2,50,000</u>

7. ... **Dividend payable Account**

	₹		₹
To Bank (Balancing figure)	60,000	By Balance b/d	60,000
To Balance c/d	90,000	By Profit and loss account	90,000
	1,50,000		1,50,000

8. **Provision for Taxation Account**

	₹		₹
To Bank (Balancing figure)	1,00,000	By Balance b/d	60,000
To Balance c/d	95,000	By Profit and loss account	1,35,000
	1,95,000		1,95,000

9. **Voluntary Separation Payments Account**

	₹		₹
To Balance b/d	65,000	By General reserve	50,000
To Bank (Balancing figure)	1,10,000	By Balance c/d	1,25,000
	1,75,000		1,75,000

**Answer 3****New Light Ltd.****Cash Flow Statement for the year ended 31st March, 20X1**

A.	Cash Flow from operating activities	₹	₹
	Profit after appropriation		
	Increase in profit and loss A/c after inventory adjustment [ $₹3,00,000 - (₹2,40,000 + ₹24,000)$ ]	36,000	
	Transfer to general reserve	1,60,000	
	Dividend payable	1,60,000	
	Provision for tax	3,40,000	
	Net profit before taxation and extraordinary item	6,96,000	

	Adjustments for:		
	Depreciation	3,60,000	
	Loss on sale of fixed assets	20,000	
	Decrease in value of fixed assets	16,000	
	Premium on redemption of preference share capital	6,000	
	Premium on redemption of debentures	6,000	
	Operating profit before working capital changes	11,04,000	
	Increase in current liabilities (₹5,20,000 – ₹4,80,000)	40,000	
	Increase in other current assets [₹13,10,000 – (₹ 11,10,000 + ₹24,000)]	(1,76,000)	
	Cash generated from operations	9,68,000	
	Income taxes paid	(3,60,000)	
	Net Cash generated from operating activities		6,08,000
<b>B.</b>	<b>Cash Flow from investing activities</b>		
	Purchase of fixed assets (W.N.3)	(8,56,000)	
	Proceeds from sale of fixed assets (W.N.3)	1,00,000	
	Proceeds from sale of investments (W.N.2)	1,20,000	
	Net Cash from investing activities		(6,36,000)
<b>C.</b>	<b>Cash Flow from financing activities</b>		
	Proceeds from issuance of share capital	4,00,000	
	Redemption of preference share capital (₹1,20,000 + ₹6,000)	(1,26,000)	
	Redemption of debentures (₹ 1,20,000 + ₹ 6,000)	(1,26,000)	
	Dividend paid	(1,20,000)	
	Net Cash from financing activities		28,000
	Net increase/decrease in cash and cash equivalent during the year		Nil
	Cash and cash equivalent at the beginning of the year		10,000
	Cash and cash equivalent at the end of the year		10,000

**Working Notes:**

1. Revaluation of inventory will increase opening inventory by ₹ 24,000.

$$2,16,000/90 \times 100 = ₹ 24,000$$

Therefore, opening balance of other current assets would be as follows:

$$₹ 11,10,000 + ₹ 24,000 = ₹ 11,34,000$$

Due to under valuation of inventory, the opening balance of profit and loss account be increased by ₹ 24,000.

The opening balance of profit and loss account after revaluation of inventory will be

$$₹ 2,40,000 + ₹ 24,000 = ₹ 2,64,000$$

2. **Investment Account**

	₹		₹
To Balance b/d	4,00,000	By Bank A/c	1,20,000
To Capital reserve A/c (Profit on sale of investment)	40,000	By (balancing figure being investment sold)	3,20,000
	4,40,000	By Balance c/d	4,40,000

3. **Fixed Assets Account**

	₹		₹	₹
To Balance b/d	32,00,000	By Bank A/c (sale of assets)	1,00,000	
To Bank A/c (balancing figure being assets purchased)	8,56,000	By Accumulated depreciation	80,000	
		By A/c Profit and loss A/c (loss on sale of assets)	20,000	2,00,000
		By Accumulated depreciation A/c	40,000	



...		By Profit and loss A/c (assets written off)	<u>16,000</u>	56,000
		By Balance c/d		<u>38,00,000</u>
	<u>40,56,000</u>			<u>40,56,000</u>

4. **Accumulated Depreciation Account**

	₹		₹
To Fixed assets A/c	80,000	By Balance b/d	9,20,000
To Fixed assets A/c	40,000	By Profit and loss A/c	3,60,000
To Balance c/d	11,60,000	(depreciation for the period)	
	<u>12,80,000</u>		<u>12,80,000</u>

**Answer 4**

**Cash Flow Statement of ABC Ltd. for the year ended 31.3.20X1**

<b>Cash flows from Operating Activities</b>	₹	₹
<b>Net Profit</b>	22,40,000	
Add: Adjustment For Depreciation (₹7,90,000 – ₹6,10,000)	1,80,000	
Operating Profit Before Working Capital Changes	24,20,000	
Add: Decrease in Inventories (₹ 20,10,000 – ₹ 19,20,000)	90,000	
Increase in Provision for Doubtful Debts (₹ 4,20,000 – ₹1,50,000)	2,70,000	
	<u>27,80,000</u>	
<b>Less: Increase in Current Assets</b>		
Trade Receivables (₹ 30,60,000 – ₹23,90,000)		6,70,000
Prepaid Expenses (₹ 1,20,000 – ₹90,000)		30,000
Decrease in Current Liabilities:		

Trade Payables (₹ 8,80,000 – ₹ 8,20,000)	60,000		
Expenses Outstanding (₹ 3,30,000 – ₹ 2,70,000)	<u>60,000</u>	(8,20,000)	
<i>Net Cash from Operating Activities</i>			19,60,000
<b>Cash Flows from Investing Activities</b>			
Purchase of Plant & Equipment (₹ 40,70,000 – ₹ 27,30,000)		13,40,000	
<i>Net Cash Used in Investing Activities</i>			(13,40,000)
<b>Cash Flows from Financing Activities</b>			
Bank Loan Raised (₹ 3,00,000 – ₹ 1,50,000)		1,50,000	
Issue of Debentures		9,00,000	
Payment of Dividend (₹ 12,00,000 – ₹ 1,50,000)		(10,50,000)	
<b>Net Cash Used in Financing Activities</b>			NIL
Net Increase in Cash During the Year			6,20,000
<i>Add: Cash and Cash Equivalents as on 1.4.20x0</i> (₹ 15,20,000 + ₹ 11,80,000)			27,00,000
Cash and Cash Equivalents as on 31.3.20x1 (₹ 18,20,000 + ₹ 15,00,000)			33,20,000

**Note:** Bad debts amounting ₹ 2,30,000 were written off against provision for doubtful debts account during the year. In the above solution, Bad debts have been added back in the balances of provision for doubtful debts and trade receivables as on 31.3.20X1. Alternatively, the adjustment of writing off bad debts may be ignored and the solution can be given on the basis of figures of trade receivables and provision for doubtful debts as appearing in the balance sheet on 31.3.20X1.