<u>**B. Com. (Hons.): Semester- II**</u>

<u>**Paper BCH 2.2: CORPORATE ACCOUNTING**</u>

CASH FLOW STATEMENT

The income statement focuses on the economic results of the entity's *operating* activities during a period. Key concepts in the measurement of the period's income are revenue recognition and the matching of expenses. Revenue is recognized in the period in which the entity performs its revenue-generating tasks (e.g., delivering goods or providing services), irrespective of whether the customer pays cash at that time or agrees to pay later. Expenses measure the resources consumed in generating the period's revenue and in administering the entity during the period, irrespective of when cash was used to pay for those resources. Thus, the period's income bears no direct relationship to the cash flows associated with the period's operations. Also, because of its focus on the results of operations, the income statement does not provide information about the entity's investing or financing activities during the period.

The purpose of the cash flow statement is to provide information about the *cash flows associated with the period's operations* and also about the entity's *investing and financing activities* during the period. This information is important both to shareholders, part of whose investment return (dividends) is dependent on cash flows, and also to lenders, whose interest payments and principal repayment require the use of cash. The welfare of other constituencies of a company—including its employees, its suppliers, and the local communities that may levy taxes on it—depends to varying degrees on the company's ability to generate adequate cash flows to fulfill its financial obligations.

The numbers on the cash flow statement are objective: *Cash is cash,* and the amounts of cash flows are not influenced by the judgments and estimates that are made in arriving at revenues, expenses, and other accruals. Because of this objectivity, many analysts pay considerable attention to the cash flow statement. It must be remembered that despite the judgments and estimates that influence balance sheet and income statement amount, the numbers in those statements provide better information about an entity's financial status and operating performance than do cash flow statement numbers.

A cash flow statement, when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities. Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different enterprises. It also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.

'**Accounting Standard 3: Cash Flow Statement**' discusses in detail the meaning and the method of preparation of Cash Flow Statement. This has been discussed next.

Definitions

The following terms are used in this Standard with the meanings specified:

(a) *Cash* comprises cash on hand and demand deposits with banks.

(b) *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.

(c) *Cash flows* are inflows and outflows of cash and cash equivalents.

(d) *Operating activities* are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

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

(f) *Financing activities* are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

Cash and Cash Equivalents

Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent, it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition.

Investments in shares are excluded from cash equivalents unless they are, in substance, cash equivalents; for example, preference shares of a company acquired shortly before their specified redemption date (provided there is only an insignificant risk of failure of the company to repay the amount at maturity).

Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an enterprise rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

Presentation of a Cash Flow Statement

The cash flow statement should report cash flows during the period classified by operating, investing and financing activities.

An enterprise presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the enterprise and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

A single transaction may include cash flows that are classified differently. For example, when the instalment paid in respect of a fixed asset acquired on deferred payment basis includes both interest and loan, the interest element is classified under financing activities and the loan element is classified under investing activities.

Operating Activities

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

Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services;

(b) cash receipts from royalties, fees, commissions and other revenue;

(c) cash payments to suppliers for goods and services;

(d) cash payments to and on behalf of employees;

(e) cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits;

(f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and

(g) cash receipts and payments relating to futures contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.

Investing Activities

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.

Examples of cash flows arising from investing activities are:

(a) cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalised research and development costs and self-constructed fixed assets;

(b) cash receipts from disposal of fixed assets (including intangibles);

(c) cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(d) cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than receipts from those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(e) cash advances and loans made to third parties (other than advances and loans made by a financial enterprise);

(f) cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise);

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

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 funds (both capital and borrowings) to the enterprise.

Examples of cash flows arising from financing activities are:

(a) cash proceeds from issuing shares or other similar instruments;

(b) cash proceeds from issuing debentures, loans, notes, bonds, and other short or long-term borrowings; and

(c) cash repayments of amounts borrowed.

Reporting Cash Flows from Operating Activities

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.

Direct Method

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. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either: (a) from the accounting records of the enterprise; or (b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise) and other items in the statement of profit and loss for: i) changes during the period in inventories and operating receivables and payables; ii) other non-cash items; and iii) other items for which the cash effects are investing or financing cash flows.

Indirect method

Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of: (a) changes during the period in inventories and operating receivables and payables; (b) non-cash items such as depreciation, provisions, deferred taxes, and unrealised foreign exchange gains and losses; and (c) all other items for which the cash effects are investing or financing cash flows. Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the operating revenues and expenses excluding non-cash items disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

Note: Only Indirect method is prescribed for students of B. Com. (Hons.) as per the university rules.

Reporting Cash Flows from Investing and Financing Activities

An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities.

Interest and Dividends

Cash flows from interest and dividends received and paid should each be disclosed separately. Cash flows arising from interest paid and interest and dividends received in the case of a financial enterprise should be classified as cash flows arising from operating activities. In the case of other enterprises, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities. Dividends paid should be classified as cash flows from financing activities.

Taxes on Income

Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transactions. Therefore, taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities, the tax cash flow is classified as an investing or financing activity as appropriate.

Assignment Questions

Question -1: The following balances were extracted from the Balance Sheet of ABC Ltd. on 1st April, 2019 –

	Rs.
Machinery (at cost)	40,00,000
Less: Accumulated Depreciation	(5,00,000)
	35,00,000
Bank Balance	1,30,000
Other current assets	8,00,000
Current liabilities	5,50,000

The net profit after depreciation amounted to Rs. 3,00,000. The company provided for depreciation Rs. 1,60,000 for the year 2019-20. During the same year, the company purchased a machine for Rs. 4,00,000. It sold a machine costing Rs. 1,00,000 (having accumulated depreciation of Rs. 35,000) for Rs. 75,000.

The current assets and current liabilities (other than bank balance) on 31st March, 2020 were Rs. 11,30,000 and Rs. 8,00,000 respectively. Interest received on investments = Rs. 15,000

Calculate cash flows from operating activities and investing activities for the year 2019-20.

[Ans: Operating activities = Rs. 3,55,000; Cash used in Investing activities = Rs. (3,10,000)]

Question-2: The following data are provided for XYZ Ltd.

INCOME STATEMENT FOR 2019-20

	Rs.
Revenues	84,000
Less: Cost of goods sold	(48,000)
Gross Profit	36,000
Less: Expenses	
Depreciation	(4000)
Interest	(6000)
Other expenses	(22,000)
Net Income	4000

COMPARATIVE BALANCE SHEET (as on 31st March)

Particulars	Note No.	2019-20	2018-19
I. EQUITY AND LIABILITIES			
1. Shareholders' Funds			
Share Capital	1	24,000	14,000
Reserves and Surplus	2	9,600	7,000
2. Non-Current Liabilities			
Long-term Borrowings (Bonds)		20,000	20,000
3. Current Liabilities			
Trade Payables		12,000	14,000
Total		65,600	55,000
II. ASSETS			
1. Non-Current Assets			
Property, Plant and Equipment:			
Tangible Assets	3	16,000	16,000
2. Current Assets			
Inventories (Stock-in-trade)		16,000	14,000
Trade Receivables		12,000	7,000
Cash and cash equivalents (Cash at bank)		20,000	16,000
Other Current Assets	4	1600	2000
Total		65,600	55,000

Notes to Accounts

Particulars	Rs.	Rs.
1. Share Capital		
Equity Share Capital	24,000	14,000
2. Reserves and Surplus		
Surplus, i.e. Balance in the statement of profit & loss	9,600	7000
3. Tangible Assets		
Plant and Machinery	24,000	20,000
Less: Accumulated Depreciation	(8,000)	(4,000)
	16,000	16,000
4. Other Current Assets		
Discount on issue of bonds	1600	2000

Other Information: *The company paid interim dividend during the year.*

Prepare Cash Flow Statement for the year 2019-20 using Indirect Method.

[Ans: Operating Activities = Rs. 5400; Investing = Rs. (4000); Financing = Rs. 2600]

Question-3: From the following information, prepare cash flow statement.

Statement of Profit and Loss for the year ended 31st March, 2020

Particulars	**Note No.**	**Rs.**	**Rs.**
I. Revenue from operations (Cash sales)			42,50,000
II. Other Income			
Commission Accrued		40,000	
Dividend received		60,000	
Profit on sale of plant *(sale proceeds Rs. 22,40,000 less book value Rs. 20,00,000)*		2,40,000	3,40,000
			45,90,000
III. Total Revenue			
IV. Expenses:			
Purchase of stock-in-trade (cash purchase)		31,00,000	
Changes in inventory of stock-in-trade	1	(60,000)	
Employee Benefit Expenses	2	7,30,000	
Depreciation and Amortization	3	1,54,000	
Other Expenses	4	2,20,000	41,44,000
V. Profit before tax			4,46,000
VI. Tax Expense (tax paid)			20,000
VII. Profit after tax			4,26,000

Notes to Accounts

Particulars	**Rs.**	**Rs.**
1. Changes in Inventory of stock-in-trade		
Opening inventory	1,60,000	
Less: Closing inventory	(2,20,000)	(60,000)
2. Employee Benefit Expenses		
Wages paid	4,40,000	
Add: Outstanding wages	60,000	5,00,000
Salaries paid	2,20,000	
Add: Outstanding salary	20,000	
Less: Prepaid salary	(10,000)	2,30,000
		7,30,000
3. Depreciation and Amortization		
Depreciation	1,10,000	
Goodwill written off	44,000	1,54,000
4. Other Expenses		

Office expenses	80,000	
Selling expenses	1,20,000	
Preliminary expenses written off	20,000	2,20,000

[Ans: Operating activities = Rs. 2,70,000; Investing activities = Rs. 23,00,000]

Question-4: The following are the Balance Sheets of PQ Ltd. as on 31st March, 2019 and 31st March, 2020 respectively.

Particulars	**Note No.**	**31st March, 2020**	**31st March, 2019**
I. EQUITY AND LIABILITIES			
1. Shareholders' Funds			
Share Capital	1	27,00,000	25,00,000
Reserves and Surplus	2	62,75,000	57,95,000
2. Non-Current Liabilities			
Long-term Borrowings (15% debentures)		5,00,000	10,00,000
3. Current Liabilities			
Short term borrowings (bank overdraft)		-	1,00,000
Trade Payables		13,25,000	12,75,000
Other Current Liabilities	3	8,55,000	6,45,000
Total		1,16,55,000	1,13,15,000
II. ASSETS			
1. Non-Current Assets			
Property, Plant and Equipment:			
Tangible Assets	4	59,25,000	50,50,000
Intangible Assets (Patents)		70,000	50,000
Non-current Investments (Investments)		7,25,000	12,50,000
2. Current Assets			
Inventories (Stock-in-trade)		23,10,000	22,70,000
Trade Receivables	5	19,25,000	20,65,000
Cash and cash equivalents (Cash at bank)		6,75,000	6,00,000
Other Current Assets (Preliminary expenses)		25,000	30,000
Total		1,16,55,000	1,13,15,000

Notes to Accounts

Particulars	Rs.	Rs.
1. Share Capital		
Equity Share Capital	27,00,000	25,00,000
2. Reserves and Surplus		
Securities Premium	7,70,000	7,50,000
Surplus, i.e. Balance in the statement of profit & loss	55,05,000	50,45,000
	62,75,000	57,95,000
3. Other Current Liabilities		
Outstanding expenses	1,05,000	1,30,000
Income tax payable	7,50,000	5,15,000
	8,55,000	6,45,000
4. Tangible Assets		
Plant and Machinery	27,50,000	22,50,000
Less: Accumulated Depreciation	(4,50,000)	(3,75,000)
	23,00,000	18,75,000
Building	41,25,000	35,75,000
Less: Accumulated depreciation	(12,50,000)	(11,50,000)
	28,75,000	24,25,000
Land	7,50,000	7,50,000
Total	59,25,000	50,50,000
5. Trade Receivables		
Debtors (All good)	20,00,000	21,25,000
Less: Provision for doubtful debts	(1,25,000)	(1,00,000)
Bills Receivable	50,000	40,000
	19,25,000	20,65,000

Additional Information:

1. Debentures were redeemed at premium of 10% on 1st October, 2019.
2. Investments were sold at a profit of 50% on cost.
3. During the year, a machine costing Rs, 5,00,000 (having accumulated dep Rs. 2,00,000) was sold at a profit of 20% on book value.
4. During the year, a building costing Rs. 10,50,000 was purchased by issue of 20,000 equity shares of Rs. 10 each at a premium of Re. 1 per share and balance by cash.
5. A building costing Rs. 5,00,000 (acc dep Rs. 3,50,000) was sold for Rs. 1,70,000.
6. Tax paid during the year Rs. 1,15,000.

Prepare Cash flow statement as per AS-3 (Revised).

[Ans: Operating activities = Rs. 13,70,000; Investing = Rs. (5,32,500); Financing = Rs. (6,62,500)]

Question-5: The following information of XYZ Ltd. for the years ended 31st March, 2018 and 2019 is available:

Particulars	2018	2019
I. EQUITY & LIABILITIES		
Equity Share Capital	12,00,000	16,00,000
10% Preference Share Capital	4,00,000	2,80,000
Capital reserve	-	40,000
General Reserve	6,80,000	8,00,000
Profit & Loss A/c	2,40,000	3,00,000
9% Debentures	4,00,000	2,80,000
Current Liabilities	4,80,000	5,20,000
Provision for Tax	3,60,000	3,40,000
Unpaid Dividend	-	16,000
TOTAL	**37,60,000**	**41,76,000**
II. ASSETS		
Fixed Assets	32,00,000	38,00,000
Less: Depreciation	(9,20,000)	(11,60,000)
	22,80,000	26,40,000
Investments	4,00,000	3,20,000
Cash & Cash Equivalent (Cash in hand)	10,000	10,000
Other Current Assets	9,90,000	11,66,000
Preliminary expenses	80,000	40,000
TOTAL	**37,60,000**	**41,76,000**
Note:		
Proposed Dividend	1,20,000	1,44,000

Additional Information:

1. The company sold one fixed asset for Rs. 1,00,000 (having cost Rs.2,00,000 and depreciation thereon Rs. 80,000).
2. The company also decided to write off another fixed asset costing Rs. 56000 on which depreciation amounted to Rs. 40,000.
3. Depreciation on fixed assets provided Rs. 3,60,000.
4. Company sold some investment @ profit of Rs. 40,000 which was credited to Capital Reserve.
5. Debentures and preference share capital redeemed @ 5% premium on 31st March, 2019 and 31st March, 2018 respectively.
6. Company decided to value stock at cost, whereas previously the practice was to value stock at cost less 10%. The stock according to books on 31st March, 2018 was Rs. 2,16,000. The stock was correctly valued on 31st March, 2019 at Rs. 3,00,000.
7. The proposed dividend of Rs. 1,20,000 was paid during the year 2018-19 for the year ended 31st March, 2018.

Prepare cash flow statement.