

Cash-Flow Statement

A cash-flow statement is a statement showing inflows (receipts) and outflows (payments) of cash during a particular period. In other words, it is a summary of sources and applications of cash during a particular span of time. It analyses the reasons for changes in balance of cash between the two balance sheet dates. The term 'cash' here stands for cash and cash equivalents. A cash-flow statement includes only those items which affect cash.

A cash-flow statement can be for the past or can be projected for a future period.

Objectives or Uses of Cash Flow Statement

The main objectives behind preparing a cash-flow statement can be laid down as under :—

(1) **Useful for Short-Term Financial Planning** :— A cash-flow statement provides information for planning the short-term financial needs of the firm. Since it provides information regarding the sources and utilisation of cash during a period, it becomes easier for the management to assess whether it will have adequate cash to meet day-to-day expenses and pay the trade payables in time, whether it will have sufficient cash to pay the long-term loans and interest thereon and whether it has enough cash to pay for the purchase of fixed assets or not.

(2) **Useful in Preparing the Cash Budget** :— A cash flow statement prepared for the future period is helpful in preparing a cash budget. It informs the management about the surplus or deficit periods of cash, i.e., in which months the receipts of cash will be in excess of payments and in which months the payments will be in excess of receipts. It helps in planning the investment of surplus cash in short-term investments and to plan short-term credit in advance for deficit periods.

(3) **Comparison with the Cash Budget** :— A cash budget is prepared at the commencement of the year, whereas a cash flow statement is prepared at the end of the year. A comparison between the two helps in ascertaining the extent to which the financial resources of the firm have been generated and used according to the plan. Causes of variances between the figures of two statements can be analysed and proper corrective measures may be taken.

(4) **Study of the Trend of Cash Receipts and Payments** :— A cash-flow statement reveals the speed at which the cash is being generated from trade receivables, inventory and other current assets and the speed at which the current liabilities are being paid. It enables the management to assess the true position of the cash in future.

(5) **It Explains the Deviations of Cash from Earnings** :— A firm may earn huge profits yet it may have paucity of cash or when it suffered a loss it may still have plenty of cash. A Cash flow statement explains the reasons for it.

(6) **Helpful in Ascertaining Cash Flow from Various Activities Separately** :— A Cash flow statement aims at highlighting the Cash flow from operating, investing and financing activities separately. It indicates how much cash has been generated or used in these activities.

(7) **Helpful in Making Dividend Decisions** :— The amount of dividend must be deposited in a separate 'Dividend Bank A/c' within 5 days of the declaration of such dividend. Hence the management takes the help of cash flow statement to ascertain the position of cash generated from operating activities which can be used for payment of dividend.

(8) **Test for the Managerial Decisions** :— It is a general rule that fixed assets should be purchased from funds raised from long-term sources like issue of shares, debentures, long-term loans etc. and these should be repaid out of cash generated from operating activities. The cash flow statement shows whether this policy has been properly followed by the management or not.

(9) **Useful to Outsiders** :— Cash flow statement helps the investors, debentureholders, bankers, lenders, supplier's of credit etc. to analyse the financial position of the enterprise and they can take proper decisions on the basis of such analysis.

Limitations of Cash-Flow Statement

(1) **Not suitable for Judging the Liquidity** :— It does not present true picture of the liquidity of a firm because the liquidity does not depend upon cash alone. Liquidity also depends upon those assets which can be converted into cash easily. Exclusion of these assets obstructs the true reporting of the ability of the firm to meet its liabilities when they become due for payment.

(2) **Possibility of Window-dressing** :— The possibility of window-dressing is higher in case of cash position in comparison to the working capital position of a firm. The cash balance can be easily manoeuvred by postponing purchases and other payments and by rapidly collecting cash from trade receivables before the balance sheet date. Hence, a fund-flow statement presents a more realistic picture than a cash-flow statement.

(3) **It ignores non-cash transactions** :— Cash-flow statement ignores non-cash transactions like purchase of fixed assets by issuing shares or debentures, conversion of debentures into shares, issue of bonus shares etc. Hence, the true position of an enterprise cannot be judged by cash-flow statement.

(4) **It ignores the accrual concept of accounting** :— It is prepared on cash basis and hence ignores one of the basic concepts of accounting, namely accrual concept.

(5) **No substitute for an Income Statement** :— A Cash Flow Statement is not a substitute of Income Statement which takes into account both cash and non-cash items. Therefore, net cash flow does not mean net income of the business.

(6) **Historical in Nature** :— A cash flow statement is prepared on the basis of two comparative Balance Sheets of the past years. Hence, information revealed by it is

historical in nature. Information revealed by it will be more useful if it is accompanied by the projected cash flow statement.

Difference between Cash-Flow Statement and Cash Budget

There is not much difference between a cash-flow statement and a cash budget. The only difference is that a cash-flow statement is prepared for a past period whereas a cash budget is prepared for a future period. Cash-flow statement usually portray how cash was received and spent in the past period. Hence, it is of limited use as far as the future periods are concerned. A cash budget is therefore prepared showing how much cash is likely to be received and what will be the disbursements during a future period of time. Thus, a cash budget indicates in which months there will be surplus cash and in which months there will be deficiency of cash resources. The management can then take suitable decision to invest the surplus cash or make arrangement for the deficiency of cash at the required time.

Procedure of Preparing Cash-Flow Statement

The Institute of Chartered Accountants of India has issued Accounting Standard (AS)-3 Revised, for preparing a cash flow statement. This Accounting Standard has been made mandatory in respect of accounting periods commencing on or after 1st April 2001, for certain enterprises. These enterprises are :

- (i) Enterprises whose equity or debt securities are listed on a recognised inventory exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised inventory exchange in India.
- (ii) All other commercial, industrial and business enterprises, whose turnover for the accounting period exceeds ₹50 Crores.

As such, the Cash flow statement has been prepared according to AS-3 Revised in this Chapter.

According to AS-3 Revised, the cash flow statement summarizes the cash inflows and cash outflows and the net changes (increase or decrease) in cash and cash equivalents resulting from operating, investing and financing activities of a firm during a period.

The following terms are used for preparing a cash flow statement :

Cash :— It comprises cash in hand and demand deposits with bank.

Cash Equivalents :— These are short-term, highly liquid investments that are readily convertible into known amounts of cash and which present insignificant risk of changes in their values. Normally, an investment will be termed as cash equivalent only if it has a short maturity period, say three months or less, from the date of its acquisition. Examples of cash equivalents are treasury bills, commercial papers etc. which are purchased with cash that is in excess of immediate needs. Investment in shares are excluded from cash equivalents unless they are cash equivalent in reality. For example, the investment in preference shares of a company if they are redeemable within 3 months from date of purchase will be included in cash equivalents, provided there is only an insignificant risk of failure of the company in repaying the amount at the date of maturity.

Thus, Cash and Cash Equivalents include the following :

- (i) Cash in Hand

(iv) **Significant Non-Cash Transactions** :— There are some investing and financing activities which do not require the use of cash or cash equivalents. Such non-cash activities should be excluded from the cash flow statement. Examples are : the acquisition of assets by issue of debentures or shares, conversion of debentures into shares etc. Such significant non-cash transactions should be disclosed outside the cash flow statement.

Classification of Business Activities as per AS-3 showing 'Cash Inflows' and Cash Outflows'.

I. Operating Activities

Cash Inflows

- (i) Cash Sales
- (ii) Cash received from Royalty, Fees and Commission
- (iii) Cash received from Debtors/Trade Receivables

Cash Inflows

in Case of Financial Companies

- (iv) Interest and Dividend received in Cash
- (v) Proceeds from Sale of Securities
- (vi) Loans and Advances repaid by third parties

Cash Outflows

- (i) Cash Purchases
- (ii) Cash paid to Creditors/Trade Payables
- (iii) Payment of Operating Expenses like Wages, Salary, Office and Selling Expenses etc.
- (iv) Payment of Income Tax

Cash Outflows

in Case of Financial Companies

- (v) Interest paid in Cash
- (vi) Payment for Purchase of Securities
- (vii) Loans and Advances to third parties

II.

Investing Activities

Cash Inflows

- (i) Proceeds from Sale of Fixed Assets
- (ii) Proceeds from Sale of Non-Current Investments
- (iii) Interest received on Debentures
- (iv) Dividend received on Shares

Cash Outflows

- (i) Purchase of Fixed Assets
- (ii) Purchase of Non-Current Investments

III.

Financing Activities

Cash Inflows

- (i) Proceeds from Issue of Shares in Cash
- (ii) Proceeds from Issue of Debentures in Cash
- (iii) Proceeds from Long-term Borrowings

Cash Outflows

- (i) Payment for Buy-back of Equity Shares
- (ii) Payment for Redemption of Preference Shares
- (iii) Payment for Redemption of Debentures
- (iv) Repayment of Loans
- (v) Payment of Dividend
- (vi) Payment of Interest

FORMAT OF CASH FLOW STATEMENT

(as per CBSE Circular No. Acad-43/2013 dated 2nd July, 2013
issued by the CBSE New Delhi)

A cash flow statement may be prepared either by direct or indirect method. Cash flow statement under direct method is not under the purview of existing syllabus. Format under the indirect method is given below :

XYZ Ltd.

CASH FLOW STATEMENT for the year ended

(Indirect Method)

(as per Accounting Standard — 3 Revised)

	₹	₹
A. Cash Flows from Operating Activities :		
Net Profit before Tax (See Note No. 1)	.....
Adjustments for non cash and non operating items :		
Add : Depreciation	.....
Preliminary Expenses/Discount on issue of Shares and Debentures written off	.....
Goodwill, Patents and Trademarks Amortised	.....
Interest on long-term Borrowings	.....
Loss on Sale of Fixed Assets	.....
Less : Interest Income	(.....)	
Dividend Income	(.....)	
Rental Income	(.....)	
Profit on Sale of Fixed Assets	(.....)	(.....)
Operating Profit before Working Capital Changes	.....
Add : Decrease in Current Assets	.....
Increase in Current Liabilities	.....
Less : Increase in Current Assets	(.....)	
Decrease in Current Liabilities	(.....)	(.....)
Cash generated from operations	.....
Less : Income Tax paid (Net of Tax Refund received)	(.....)	
Net cash from (or used in) operating activities	.....	.....
B. Cash flows from Investing Activities :		
Proceeds from Sale of Tangible Fixed Assets	.....
Proceeds from Sale of Intangible Fixed Assets like goodwill	.....
Proceeds from Sale of Non-Current Investments	.....
Interest and Dividend Received	.....
Rent Received	.....
Purchase of Tangible Fixed Assets	(.....)	
Purchase of Intangible Fixed Assets like goodwill	(.....)	
Purchase of Non-Current Investments	(.....)	
Net cash from (or used in) Investing Activities	.....	.....
C. Cash flows from Financing Activities :		
Proceeds from issue of Shares and Debentures	.....
Proceeds from Other Long-term Borrowings	.....

Final Dividend Paid	(.....)
Interim Dividend Paid	(.....)
Interest on Long-term Borrowings paid	(.....)
Repayment of Loans	(.....)
Redemption of Debentures	(.....)
Net cash from (or used in) financing activities	.....
Net Increase (or Decrease) in Cash & Cash Equivalents (A+B+C)	.....
Add: Cash and Cash Equivalents in the beginning of the year	.....
Cash and Cash Equivalents at the end of the year	.....

Note No. 1 : Calculation of Net Profit before Tax :

Particulars	
Net Profit of the current year (after appropriations)	.....
Add: Transfer to Reserves (all transfers to Reserves from balances of the Statement of Profit & Loss)	.....
Proposed Dividend for Current year	.....
Interim Dividend paid during the year	.....
Provision for Tax made during the current year	.....
Less: Refund of Tax	(.....)
Net Profit before Tax	.....

Note : Amounts in brackets denote negative items, i.e. amounts that are to be deducted.

ILLUSTRATION 1.

Classify the following into (i) Operating Activities, (ii) Investing Activities, (iii) Financing Activities and (iv) Cash Equivalents while preparing a Cash Flow Statement :

- Cash Sales
- Cash received from Trade Receivables (C.B.S.E. 2010, Set III)
- Purchase of Building
- Sale of Building (C.B.S.E. 2010 Outside Delhi, Set I)
- Issue of Share Capital or Debentures (C.B.S.E. 2010, Set I)
- Buy-back of Equity Shares
- Dividend paid
- Interest paid on Debentures or Long-term Loans by (a) Finance Company
(b) Non-finance company
- Cash Purchases
- Cash paid to trade payables
- Redemption of Debentures
- Repayment of Long-term Loan
- Office Expenses
- Selling and Distribution Expenses
- Manufacturing Expenses
- Purchase of Goodwill
- Sale of Patents
- Purchase of Investments