

Cash Flow Statement

Introduction

Cash Flow is the life blood of a business which plays a vital role in an entire economic life. As discussed in the previous chapter, the word 'fund' is used in a narrower sense refers to 'cash'. When cash is used as 'fund' the analysis relates to movement of cash. Cash flows refer to the actual movement of cash into and out of an organization. In other words, the movement of cash inclusive of inflow of cash and outflow of cash. When the cash flows into the organization, it represents 'Inflow of Cash.' Similarly when the cash flows out of the business concern, it called as "Cash Outflow."

In order to ensure cash flows are adequate to meet current liabilities such as tax payments, wages, amounts due to trade creditors, it is essential to prepare a statement of changes in the financial position of a firm on cash basis is called as "Cash Flow Statement." This statement depicting movement of cash position from one period to another.

Uses of Cash Flow Statement

Cash Flow Statement is a useful tool to the management for taking important financial decision making. The following are the uses of this statement :

- (1) This Statement is the most useful to the management to prepare dividend and retention policies.
- (2) It guides the management to evaluate the changes in cash position.
- (3) It presents in brief to the management about the performance of operational, financial and investment activities for effective decision.
- (4) It helps to know how the movement of cash took place and the factors which caused the changes in cash flows.
- (5) It guides the management in order to take decisions about short-term obligations.
- (6) It also presents the details about the sources of cash and applications of cash during the particular period.

Difference between Fund Flow Statement and Cash Flow Statement

Fund Flow Statement and Cash Flow Statement are the two useful tools of financial analysis and interpretations of financial statements. But at the same time both the statements differ from each other in the following manner:

- (1) Fund Flow Statement helps to measure the causes of changes in working capital whereas cash flow statement focuses on the causes for the movement of cash during a particular period.
- (2) Fund flow statement is prepared on the basis of Fund or all financial resources while cash flow statement is based on cash basis of accounting.
- (3) Cash Flow Statement guides to the management for short-term financial planning while Fund flow analysis helps to the management for intermediate and long-term financial planning.
- (4) Statement of changes in working capital is required for the preparation of Fund flow statement while for cash flow statement no such statement is required.

Limitations of Cash Flow Statement

- (1) Cash Flow Statement has limited scope as it compares with Fund flow statement. Because it discloses inflows and outflows of cash alone. It does not reveal the overall financial position of the concern.
- (2) Cash Flow Statement cannot provide a comprehensive picture of a financial position because non-cash items of expenses and incomes are excluded.
- (3) The balances as disclosed by the cash flow statement may not be treated as actual liquid position of a concern since it cannot be easily influenced by postponing purchases and other payments.

Preparation of Cash Flow Statement

Cash Flow Statement is prepared like Fund Flow Statement. Preparation of this statement is based on the movement of cash, may be an actual inflow of cash or outflow of cash, Profit and Loss Account and other relevant informations. While preparing a cash flow statement, it starts with an opening balance of cash in hand and cash at bank, all the sources of cash are added to an opening balance minus applications of cash is reconciled with the closing balance of cash. The balance represents cash and bank balances at the end of accounting period.

SOURCES AND APPLICATIONS OF CASH

Sources of Cash (Inflow of Cash)

The following are the main sources of cash such as:

- (1) Cash From Operations or Trading Profit.
- (2) Sale of Fixed Assets for Cash.
- (3) Sale of Investments for Cash.
- (4) Raising Long-Term Loans from Banks and Financial Institutions.
- (5) Issue of Shares and Debentures for Cash.

Application of Cash (Outflow of Cash)

Application of cash can be involved in the following forms :

- (1) Cash Lost in Operations or Trading Losses.
- (2) Redemption of Shares and Debentures by Cash.
- (3) Purchase of Fixed Assets.
- (4) Repayment of Long-Term Loans.

Computation of Cash Flow Statement

A comprehensive Cash Flow Statement is ascertained in two stages:

- (I) Cash From Operations, i.e., internal sources of cash calculated by preparing combined statements of adjusted profit and loss account.
- (II) External Sources and Applications of Cash, i.e., Flow of Cash involves in non-current items ascertained by the Statement of Sources and Applications of Cash.

Diagram of Sources and Applications of Cash

The summary of sources and applications of cash is presented in the chart given below :

<i>Sources of Cash (Inflow of Cash)</i>	<i>Applications of Cash (Outflow of Cash)</i>
Cash From Operations Sale of Fixed Assets Sale of Investments Issue of Shares Issue of Debentures Raising Long-Term Loans Increase in any Liabilities Decrease in any Assets	Cash Lost in Operations Purchase of Fixed Assets Purchase of Investment Redemption of Preference Shares Redemption of Debentures Decrease in any Liability Decrease in any Assets

I. CASH FROM OPERATIONS

Cash from operations is the main source of inflow of cash. The Net Profit or Net Loss is the net effect of business transactions shown by the profit and loss account. In order to find out the actual movement of cash from trading operations, it is essential to ascertaining cash from operations. It can be calculated under the following situations:

- (a) When all Transactions are Cash Transactions.
- (b) When all Transactions are not Cash Transactions.

(a) When all Transactions are Cash Transactions: It assumes that where all the expenses and losses, incomes and gains are paid or received in cash during the particular period. The Net Profit or Net Loss shown by the profit and loss account is taken as the amount of cash from operations. Thus, Net Profit or Net Loss is equal to cash from operations. When Net Profit made by a firm represents Cash Inflow or Cash Profit From Operations. Similarly, the Net Loss shown by the profit and loss account refers to Cash Outflow From Operations.

(b) When all Transactions are not Cash Transactions: In actual practice, in business transactions are made either on cash basis or credit basis. For example, goods purchased or sold on cash as well as on credit. Certain expenses are always outstanding and some of the incomes are not immediately realized

Cash Flow Statement

under such circumstances, the net profit made by a firm cannot generate equivalent amount of cash. Therefore, the charging of non-fund or non-cash items such as outstanding expenses, incomes received in advances, prepaid expenses and outstanding incomes etc. to profit and loss account should be readjusted. In such circumstances the actual cash from operations can be calculated by preparing adjusted profit and loss account.

Calculation of Cash from Operations

Cash From Operations can be calculated by either of the following methods:

- (A) Cash From Operations calculated with the help of Adjusted Profit and Loss Account. Under this method, all non-fund or non-operations items should be readjusted to cash profit from operations. The specimen form of cash from operations is given below :

Cash from Operations (Adjusted Profit and Loss Account)

Particulars	Rs.	Particulars	Rs.
To Depreciation on Fixed Assets		By Balance b/d	
To Transfer to General Reserve		(Opening Balance of P & L A/c)	
To Loss on Sale of Fixed Assets		By Profit on Sale of Fixed Assets	
To Increase in Outstanding Expenses		By Profit on Sale of Investments	
To Decrease in Prepaid Expenses		By Decrease in Outstanding Expenses	
To Preliminary Expenses written off		By Increase in Prepaid Expenses	
To Balance c/d		By Cash From Operations	
(Closing Balance of P & L A/c)		(Balancing figure)	

- (B) Cash From Operations can also be calculated on the basis of current assets and current liabilities. Under this method, the amount of changes in the various items of current assets and current liabilities other than cash and bank balances should be adjusted with the help of Adjusted Profit and Loss Account. It may be noted that, as compared to above this method may increase or decrease in items of creditors, stocks, debtors, bills receivable and bills payable are not adjusted while calculating cash profit from operations and they may be directly taken as Sources (inflow) of Cash or Application (outflow) of Cash. This method is generally adopted in practice.

While applying this method, the following general principles may be taken for measuring cash from operations :

Increase in Current Assets	→	Decrease in Cash
Decrease in Current Assets	→	Increase in Cash
Increase in Current Liability	→	Increase in Cash
Decrease in Current Liability	→	Decrease in Cash

Specimen Form

The specimen form for computation of cash from operations is given below :

Calculation of Cash from Operations :

(Combining Current Assets & Current Liabilities & Non-Cash & Non-Operating Items)

<i>Particulars</i>	<i>Rs.</i>	<i>Rs.</i>
Net Profit		
(Closing Balance of Profit & Loss A/c)		* * *
Add:		
Depreciation on Fixed Assets	* * *	
Transfer to General Reserve		
Loss on Sale of Fixed Assets		
Loss on Sale of Investments		
Goodwill Written off		
Increase in Outstanding Expenses		
Decrease in Prepaid Expenses		
Decrease in Current Assets		
(Other than Cash and Bank)		
Increase in Current Liabilities		
Preliminary Expenses Written off	* * *	* * *
Less :	* * *	
Profit on Sale of Fixed Assets		
Profit on Sale of Investments		
Decrease in Outstanding Expenses		
Increase in Prepaid Expenses		
Increase in Current Assets		
(Other than Cash and Bank)		
Increase in Current Liabilities		
Opening Balance of Profit & Loss A/c		* * *
Cash From Operations		* * *

Illustration: 1

From the following Balance Sheet of ABC Ltd., you are required to calculate Cash From Operations:

<i>Particulars</i>	<i>2002 Rs.</i>	<i>2003 Rs.</i>
Capital and Liabilities :		
Share Capital	20,000	20,000
Profit made during the year	14,100	17,300
Provision for Depreciation	1,000	1,400
Long-Term Loans	2,000	3,000
Trade Creditors	6,450	5,300
Outstanding Expenses	850	150
	44,400	47,150
Assets :		
Plant and Machinery	28,500	30,000
Stocks	9,800	11,300
Trade Debtors	3,950	2,850
Cash Balances	2,150	3,000
	44,400	47,150

Solution :**Calculation of Cash from Operations**

<i>Particulars</i>	<i>2002 Rs.</i>	<i>2003 Rs.</i>
Profit made during the year (Closing Balance of P & L A/c)		17,300
Add :		
Provision for Depreciation	400	
Decrease in Debtors	1,100	1,500
		18,800
Less :		
Decrease in Creditors	1,150	
Decrease in Outstanding Expenses	700	
Increase in Stock	1,500	
Net Profit (Opening Balance of P & L A/c)	14,100	17,450
Cash From Operations		1,350

Illustration: 2

From the following balance you are required to calculate cash from operations

<i>Particulars</i>	<i>2002 Rs.</i>	<i>2003 Rs.</i>
Trade Debtors	1,00,000	94,000
Bills Receivable	20,000	25,000
Trade Creditors	40,000	50,000
Bills Payable	16,000	12,000
Outstanding Expenses	2,000	2,400
Prepaid Expenses	1,600	1,400
Accrued Income	1,200	1,500
Income Received in Advance	600	500
Profit made during the year	—	2,60,000

Solution:**Calculation of Cash from Operations**

<i>Particulars</i>	<i>Rs.</i>	<i>Rs.</i>
Net Profit (Closing Balance)		2,60,000
Add :		
Decrease in Debtors	6,000	
Increase in Creditors	10,000	
Increase in Outstanding Expenses	400	
Decrease in Prepaid Expenses	200	16,600
		2,76,600
Less :		
Increase in Bills Receivable	5,000	
Decrease in Bills Payable	4,000	
Increase in Accrued Income	300	
Decrease in Income Received in Advance	100	9,400
Cash From Operations		2,67,200

II. EXTERNAL SOURCES AND APPLICATIONS OF CASH

External Sources of Cash

The following are the external sources of cash such as:

(1) **Fresh Issue of Shares:** Cash is received by issue of fresh shares to the public, after deducting necessary expenses and discount on issue of shares will be treated as sources of cash.

(2) **Issue of Debentures:** The Net Cash is received by the issue of debentures is source of cash.

(3) **Raising Long-Term Borrowings:** Long-term loans received from banks and financial institutions refer to inflow of cash.

(4) **Sale of Fixed Assets and Investments:** Net cash received from the sale of permanent assets and investments are treated as sources of cash.

Applications of Cash

Applications of cash or cash outflows or uses of cash may take any of the following forms:

(1) **Redemption of Shares and Debentures:** When redeemable preference shares and debentures are redeemed by paid in cash. It refers to as application or outflow of cash.

(2) **Purchase of Fixed Assets:** Cash used for purchase of plant and machinery, land and building, furniture and fixtures etc., or renewals and replacement of fixed assets are to be treated as outflow of cash.

(3) **Payment of Long-Term Loans:** The repayment or discharge of long-term loans received from banks and financial institutions results in outflow of cash.

Specimen From of Cash Flow of Statement

Cash Flow Statement is prepared in any one of the following two ways :

(1) Account Form.

(2) Report Form.

(1) Account Form:

Cash Flow Statement

<i>Sources or Inflow of Cash</i>	<i>Rs.</i>	<i>Applications or Outflow of Cash</i>	<i>Rs.</i>
Opening Balances : Cash Bank Fresh Issue of Shares Issue of Debentures Raising Long-Term Loans Sale of Fixed Assets Sale of Investments Dividends Received Cash From Operations		Cash Lost in Operations Redemption of Preference Shares Redemption of Debentures Repayment of Long-Term Loans Purchase of Fixed Assets Purchase of Investments Tax Paid Dividend Paid Closing Balance : Cash Bank	
	***		***

(2) Report Form:**Cash Flow Statement**

<i>Particulars</i>	<i>Rs.</i>	<i>Rs.</i>
Opening Balances :		
Cash		* * *
Bank		* * *
Add : Sources of Cash :		
Fresh Issue of Shares		
Issue of Debentures		
Long-Term Loans from Bank and Financial Institutions		
Sale of Fixed Assets		
Sale of Investments		
Dividends Received	* * *	
Cash From Operations		* * *
Total Inflow of Cash (A)		* * *
Less : Applications of Cash :		
Redemption of Preference Shares		
Redemption of Debentures		
Repayment of Long-Term Loans		
Purchase of Fixed Assets		
Payment of Dividends		
Payment of Tax		
Cash Lost of in Operations	* * *	* * *
Total Outflow of Cash (B)		* * *
Closing Balance of Cash and Bank		* * *

Illustration:

From the following Balance sheets of ABC Ltd., you are required to prepare a Cash Flow Statement:

Balance Sheet

<i>Liabilities</i>	<i>2002 Rs.</i>	<i>2003 Rs.</i>	<i>Assets</i>	<i>2002 Rs.</i>	<i>2003 Rs.</i>
Share Capital	20,000	30,000	Fixed Assets	20,000	30,000
Profit & Loss A/c	10,000	16,000	Good Will	10,000	8,000
General Reserve	6,000	8,000	Stock	10,000	16,000
Debenture	10,000	12,000	Trade Debtors	10,000	16,000
Trade Creditors	6,000	8,000	Bills Receivable	2,000	4,000
Outstanding Expenses	2,000	3,000	Bank Balance	2,000	3,000
	54,000	77,000		54,000	77,000

Solution:**Calculation of Cash from Operations**

<i>Particulars</i>	<i>Rs.</i>	<i>Rs.</i>
Net Profit during the year (Closing Balance of Profit & Loss A/c)		16,000
<i>Add :</i>		
General Reserve (6000 – 8000)	2,000	
Good Will Written off (10,000 – 8000)	2,000	
Increase in Outstanding Expenses	1,000	
Increase in Trade Creditors	2,000	7,000
		23,000
<i>Less :</i>		
Increase in Stock (10000 – 16000)	6,000	
Increase in Debtors (10000 – 16000)	6,000	
Increase in Bills Receivable	2,000	
Opening Balance of P & L A/c	10,000	24,000
Cash Lost in Operations		1,000

Cash Flow Statement

<i>Sources of Cash</i>	<i>Rs.</i>	<i>Applications of Cash</i>	<i>Rs.</i>
Opening Balances :		Purchase of Fixed Assets	10,000
Cash at Bank	2,000	Cash lost in Operations	1,000
<i>Add :</i>		Closing Balance :	
Issue of Shares	10,000	Cash at Bank	3,000
Issue of Debenture	2,000		
	14,000		14,000