Educational Material on Indian Accounting Standard (Ind AS) 7 Statement of Cash Flows

(Revised 2016)

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

This Educational Material has been formulated in accordance with the Ind AS notified by the Ministry of Corporate Affairs (MCA) as Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015 and other amendments finalised subsequent to the notification.

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Foreword

Considering the global developments and expected benefits of convergence with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), which are widely recognised as global financial reporting standards, India decided to converge with IFRS. The notification of IFRS-converged Indian Accounting Standards (Ind AS) and roadmap for implementation of Ind AS by MCA as Companies (Indian Accounting Standards) Rules, 2015, is a significant milestone towards bringing Indian financial reporting at par with global financial reporting. Further, The MCA has also issued a Press Release on January 18, 2016, announcing the Ind AS roadmap for Scheduled Commercial Banks (excluding RRBs), Insurers/Insurance companies and Non-banking Financial Companies (NBFCs) from the financial year 2018-19.

With the objective of educating the members and other stakeholders about Ind AS, the Ind AS (IFRS) Implementation Committee had been constituted by the ICAI. The Committee is making every possible effort to enhance knowledge-base of members and stakeholders at large about Ind AS. For this purpose, the Committee is engaged in formulation of Educational Materials on Ind AS. The Committee has already issued Educational Materials on various Ind AS.

The Committee has now revised its Educational Material on Ind AS 7, Statement of Cash Flows. I am confident that this publication will provide significant guidance in preparing Statement of Cash Flows in accordance with the provisions of this Standard by explaining the principles enunciated in the Standard through Frequently Asked Questions (FAQs).

I would like to place on record my sincere thanks to CA. S. B. Zaware, Chairman, CA. Vijay Kumar Gupta, Vice Chairman and other members of the Ind AS (IFRS) Implementation Committee including co-opted members and special invitees for formulating this Educational Material.

I am sure that this Educational Material will be very useful to the members in discharging their professional duties. It will also be useful to others concerned in the application and implementation of Ind AS.

New Delhi — **CA. Manoj Fadnis**
February 9, 2016 — ***President, ICAI***

Preface

In the impending era of IFRS environment, in line with move of various global jurisdictions towards International Financial Reporting Standards (IFRS), where India has also decided to converge with IFRS. With notification of IFRS-converged Indian Accounting Standards (Ind AS) by Ministry of Corporate Affairs (MCA), a great need has been felt to educate the members and other stakeholders about these Standards. The Ind AS (IFRS) Implementation Committee of the ICAI is working relentlessly to provide guidance to the members and other stakeholders on these notified Ind ASs. For this purpose, Educational Materials on Ind ASs covering various issues are being formulated by the Committee. The Committee is also conducting IFRS Certificate Course, various workshops, seminars, awareness programmes, webcasts etc., to impart knowledge about Ind ASs/IFRSs.

During the Council Year 2015-16, the Committee decided to revise certain Educational Materials already issued since there are substantial changes in certain Ind AS notified in 2015 compared to the Ind AS notified in 2011. Working in this direction, the Committee has brought this revised Educational Material on Ind AS 7, Statement of Cash Flows.

Ind AS 7 prescribes principles and guidance on preparation and presentation of cash flows of an entity from operating activities, investing activities and financing activities for a reporting period. Information on cash flows is useful in assessing the ability of an entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.

This revised Educational Material contains summary of Ind AS 7 discussing the key requirements of the Standard in brief and the Frequently Asked Questions (FAQs) covering the issues, which are expected to be encountered frequently while implementing this Standard.

I may mention that the views expressed in this publication are the views of the Ind AS (IFRS) Implementation Committee and are not necessarily the views of the Council of the Institute. The purpose of this publication is to provide guidance for implementing this Ind AS effectively by explaining the principles enunciated in the Standard with the help of examples. However, while applying Ind ASs in a practical situation, reference should be made to the text of the Standards.

I would like to convey my sincere gratitude to our Honourable President CA. Manoj Fadnis and Vice-President CA. M. Devaraja Reddy for providing me this opportunity of bringing out implementation guidance on Ind ASs in the form of Educational Materials. I wish to place on record my sincere appreciation of CA. Vijay Kumar Gupta, Vice-Chairman, CA. Sanjeev Singhal, CA. R. Sankaraiah, CA. Akshat Kedia and other members of the Study Group, for preparing the revised draft of this Educational Material. I would also like to thank all members, co-opted members, special invitees of the Ind AS (IFRS) Implementation Committee for their invaluable suggestions and contributions for finalising this publication.

I am sure that this revised Educational Material will be of immense use in understanding the provisions of Ind AS 7 and in implementation of the same.

New Delhi
February 9, 2016

CA. S. B. Zaware
Chairman
Ind AS (IFRS) Implementation Committee

Foreword to the First Edition

The Institute of Chartered Accountants of India (ICAI) being the premier accounting body in the country has always played a proactive role in establishing a sound financial reporting system in India. As a step in this direction, it was decided to converge national Accounting Standards with International Financial Reporting Standards (IFRS). For smooth transitioning to IFRS-converged Indian Accounting Standards (Ind AS), Ind AS (IFRS) Implementation Committee had been constituted by the ICAI. The primary objective of the Committee is to educate the members and other stakeholders about Ind AS/IFRS so that these Standards may be implemented from a future date, as may be announced by the Ministry of Corporate Affairs (MCA), in the same spirit in which these have been formulated.

The Committee is making every possible effort to enhance the knowledge of members and stakeholders at large about Ind ASs and IFRS. For this purpose, the Committee is engaged in formulation of Educational Materials on Ind ASs. The purpose of an Educational Material is to provide guidance on various issues, which are expected to arise while implementing an Accounting Standard. The Committee has already issued Educational Materials on various Ind ASs. The Committee has now come out with an Educational Material on Ind AS 7, Statement of Cash Flows.

I am confident that this publication will provide significant guidance in preparing statement of cash flows in accordance with the provisions of this Standard by explaining the principles enunciated in the Standard through Frequently Asked Questions (FAQs).

I congratulate CA. Shiwaji Bhikaji Zaware, Chairman, Ind AS (IFRS) Implementation Committee for formulating this Educational Material on Ind AS 7, Statement of Cash Flows. I would also like to place on record deep appreciation of efforts put in by the Committee in formulation and finalisation of this publication.

I sincerely believe that this Educational Material will be of immense use to the members and others concerned in proper understanding and implementing the Standard. I am confident that all these efforts will be very useful for smooth transitioning to Ind ASs in India.

New Delhi **CA. Subodh Kumar Agrawal**
February 5, 2014 ***President***

Preface to the First Edition

The Ind AS (IFRS) Implementation Committee of the Institute of Chartered Accountants of India (ICAI) is making every possible effort to educate the members and other concerned stakeholders to ensure that whenever IFRS-converged Indian Accounting Standards (Ind AS) become effective, the same are implemented in the same spirit in which these have been formulated. One of the initiatives undertaken by the Committee in this regard is issuance of Educational Materials on Ind ASs. An Educational Material on an Ind AS generally contains summary of the respective Standard, Frequently Asked Questions (FAQs), the text of the Standard and comparison with corresponding existing Accounting Standard.

Moving forward in this direction, the Committee has brought out Educational Material on Ind AS 7, *Statement of Cash Flows*. This Standard prescribes requirements for preparation of statement of cash flows which shall be presented as an integral part of the financial statements. This Standard prescribes principles and guidance on preparation and presentation of cash flows of an entity from operating activities, investing activities and financing activities for a reporting period. Information on cash flows is useful in assessing the ability of an entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.

This Educational Material contains summary of Ind AS 7 discussing the key requirements of the Standard in brief, Frequently Asked Questions (FAQs) covering the issues, which are expected to be encountered frequently while preparing statement of cash flows and case studies illustrating the application of the Standard. The text of Ind AS 7 and significant differences between Ind AS 7 and existing AS 3 has also been included as Appendices to make this publication comprehensive.

I may mention that the views expressed in this publication are the views of the Ind AS (IFRS) Implementation Committee and are not necessarily the views of the Council of the Institute. The purpose of this publication is to provide guidance for implementing this Ind AS effectively by explaining the principles enunciated in the Standard with the help of FAQs. However, while applying Ind ASs in a practical situation, reference should be made to the text of the Standards.

I would also like to place on record my special thanks to our Honourable

President CA. Subodh Kumar Agrawal and Vice-President CA. K. Raghu for providing me this opportunity of bringing out implementation guidance on Ind ASs in the form of Educational Materials. I gratefully acknowledge the sincere efforts put in by the Pune-based Study Group comprising CA. Chandrashekhar Balasubramaniam, CA. Prasad Paranjape, CA. C.V.Chitale, CA. Parag Pansare, CA. Nachiket Deo, CA. Ashish Khandelwal and CA. Akshay Oke for developing the draft of this Educational Material. I would like to thank my Council colleagues, co-opted members and special invitees on the Ind AS (IFRS) Implementation Committee for their valuable inputs.

I would like to thank Dr. Avinash Chander, Technical Director, CA. Parminder Kaur, Secretary, Ind AS (IFRS) Implementation Committee, CA. Bibhuti Bhusan Nayak, Executive Officer and other officers of the Secretariat for their efforts and support in bringing out this publication.

I hope this Educational Material will be of immense use in understanding and implementing the provisions of Ind AS 7.

New Delhi
February 5, 2014

CA. Shiwaji Bhikaji Zaware
Chairman
Ind AS (IFRS) Implementation Committee

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I Ind AS 7 – Summary

Introduction

The balance sheet is a snapshot of entity's financial resources and obligations at a particular point of time and the statement of profit and loss reflects the financial performance for the period. These two components of financial statements are based on accrual basis of accounting. The statement of cash flows includes only inflows and outflows of cash and cash equivalents; it excludes transactions that do not affect cash receipts and payments.

The information on cash flows is useful in assessing sources of generating and deploying cash and cash equivalents during the reporting period. The statement of cash flows can be used for comparison with earlier reporting periods of the same entity as well as comparison with other entities for the same reporting period.

Ind AS 7, *Statement of Cash Flows,* prescribes principles and guidance on preparation and presentation of cash flows of an entity from operating activities, investing activities and financing activities for a reporting period.

Objective

The information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents, and the needs of the entity to utilise those cash flows.

The objective of this Standard is to provide information about the historical changes in cash and cash equivalents of an entity during the reporting period from its operating, investing and financing activities.

Scope

An entity is required to prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each reporting period for which financial statements are prepared.

The users of an entity's financial statements are interested in how the entity generates and uses its cash and cash equivalents. All entities need cash for essentially the same reasons however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations and to provide return to their investors. Accordingly, this Standard requires entities to present a statement of cash flows.

Key Requirements of Ind AS 7

The statement of cash flows is required to report cash flows classified by operating, investing and financing activities along with the components of cash and cash equivalents at the beginning and end of the reporting period.

Cash and cash equivalents include demand deposits, certain short-term investments and in some cases, bank overdrafts.

An entity shall report cash flows from operating activities using either the 'direct method' or the 'indirect method'. Under direct method, major classes of gross cash receipts and payments are presented. However, under indirect method, 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 expenses associated with investing or financing cash flows.

Ind AS 7 prescribes that alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

Generally, an entity shall report separately major classes of gross cash receipts and gross cash payments arising from , investing and financing activities, except in limited circumstances where cash flows are offset and reported on net basis.

Cash flows arising from taxes on income shall be separately disclosed and classified as cash flow from operating activities unless they can be specifically identified with financing or investing activities.

Cash flows denominated in a foreign currency are reported in a manner consistent with Ind AS 21, *The Effects of Changes in Foreign Exchange Rates.* Foreign currency cash flows are translated at the exchange rates at the dates of the cash flows or using average exchange rate when it is appropriate to do so.

Cash flows from interest and dividends received and paid shall each be disclosed separately. Interest paid and interest and dividend received are classified as operating cash flows for a financial institution. In the case of other entities, interest paid is 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 for both financial institutions and other entities.

When accounting for an investment in an associate, a joint venture or a subsidiary accounted for by use of the equity or cost method, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances.

An entity that reports its interest in an associate or a joint venture using the equity method includes in its statement of cash flows the cash flows in respect of its investments in the associate or joint venture, and distributions and other payments or receipts between it and the associate or joint venture.

Cash flows arising from obtaining or losing control of businesses shall be presented separately and classified as investing activities.

Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from the statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

Disclosures

An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its statement of cash flows with equivalent items reported in the balance sheet.

An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalents held by the entity that are restricted for specific purposes.

II Frequently Asked Questions

Question 1

Does Ind AS 7 provide any exemption with regard to its applicability like AS 3, which provides that AS 3 is not mandatory for Small and Medium Sized Companies and non-corporate entities falling in Level II and Level III?

Response

No exemption has been provided in Ind AS 7 with regard to its applicability as provided in AS 3. Like other Indian Accounting Standards (Ind ASs), this Standard will be applicable to specified class of companies as per the roadmap for implementation of Ind AS issued under Companies (Indian Accounting Standards) Rules, 2015, notified by the Ministry of Corporate Affairs (MCA) in this regard. Moreover, Ind AS 7 provides that statement of cash flows forms an integral part of financial statements for each period for which financial statements are presented. Accordingly, the class of companies which will be required to prepare financial statements as per Ind AS will be required to prepare statement of cash flows as per Ind AS 7.

Question 2

Whether statement of cash flows should be prepared only for annual reporting period?

Response

According to paragraph 1 of Ind AS 7, statement of cash flows forms an integral part of financial statements for each period for which financial statements are presented. According to Ind AS 1, *Presentation of Financial Statements,* complete set of financial statements include among other statements, a statement of cash flows for the period.

From the above, it is clear that statement of cash flows is an integral part of financial statements and the same should be prepared for each period for which financial statements are presented i.e., annual period as well as interim reporting period.

In this regard, it may be noted that Ind AS 34, *Interim Financial Reporting,* states that interim financial report shall comply with all of the requirements of Indian Accounting Standards. Ind AS 34 provides that interim financial report means a financial report containing either a complete set of financial statements or a set of condensed financial statements for an interim period. Accordingly, statement of cash flows can be presented in complete or condensed form.

Question 3

When an item qualifies to be a cash equivalent?

Response

According to paragraph 6 of Ind AS 7, cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value.

Cash equivalents are held for the purpose of meeting short-term cash requirements rather than for investment or other purposes. An investment normally qualifies to be a cash equivalent only when it has a short maturity (say not more than three months) from the date of acquisition, readily convertible to a known amount of cash and is subject to an insignificant risk of changes in value. Accordingly, readily convertible investments for which the amount of cash that will be received is known at the time of initial investment will be treated as cash equivalents for the purpose of statement of cash flows.

Examples of cash equivalents:

- Balances with bank in short-term deposits say not more than three months.
- Short-term money market instruments, such as, 91 days' treasury bills, certificate of deposit, etc.

An overriding test is that cash equivalents are held to meet short-term cash requirements of the entity rather than for investment or other purposes. For example, a three month loan or deposit given to a party to help in managing party's short-term liquidity position is not a cash equivalent because it is given for a purpose other than to manage its own short-term cash requirements.

In view of variety of cash management practices and banking arrangements, an entity is required to disclose the policy which it adopts in determining the composition of cash and cash equivalents.

Question 4

Cash is defined as cash on hand and demand deposits. What is the meaning of the term 'demand deposit'? State the treatment of demand deposits?

Response

Ind AS 7 does not define the term 'demand deposit'.

In commercial parlance, demand deposit refers to a deposit in an account held at a bank/financial institution where the amount deposited can be withdrawn at any time by the depositor without any penalty. Examples of such deposit accounts are, current accounts, savings accounts etc. The purpose of making a demand deposit is to meet the short-term fund requirements. Such deposits have same level of liquidity as cash. Accordingly, demand deposits are included in cash.

Question 5

What is meant by 'term deposit'? State the treatment of term deposits?

Response

Term deposit is a deposit held at a bank/financial institution at an agreed rate of interest for fixed period of time. The money so deposited along with the interest at agreed rate can be withdrawn at the end of such period, or amount deposited can be withdrawn earlier along with interest at lower rate for the period for which the deposit was held.

Term deposit can be for short-term or long-term. For the purpose of presentation of term deposits in the statement of cash flows, short-term deposits (say, not more than three months) are those deposits which are held with an intention to meet the short-term fund requirements. Since short-term deposits are highly liquid investments that are readily convertible into known amounts of cash and are subject to insignificant risk of changes in value, the same qualify to be a cash equivalent.

The three months maturity period is to be determined from the date of deposit and not from the end of the reporting period, i.e., for a term deposit to qualify to be a cash equivalent, it should have original maturity of period less than three months.

However, term deposits placed for a specified long period (say, more than three months) with an intention to meet the long-term fund requirements will not satisfy the definition of cash equivalents. Further, there could be restrictions on withdrawal or early redemption. Accordingly, cash flows from these deposits are classified under investing activities.

Question 6

What do you mean by 'cash flows'? Is it necessary that there should be actual cash inflow/outflow from entity's cash/bank balances?

Response

The dictionary meaning of the word 'flow' means movement. There are two types of cash flows viz., cash inflow and cash outflow. A cash flow transaction must increase or decrease cash and cash equivalents. Examples: receipt from debtors, sale of fixed assets for cash, repayment of term loan etc.

Any transaction which does not have any effect on cash and cash equivalents is outside the purview of statement of cash flows. Examples: conversion of term loan or debt into equity, redemption of preference shares by conversion into equity, purchase of goods on credit etc.

Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of operating, investing or financing activities. Examples: cheques/demand drafts deposited in bank, withdrawal or deposit of cash from/in bank, cash invested in short-term deposit classified as cash equivalent etc.

Question 7

What is the difference between 'bank overdraft' and 'cash credit'?

Response

An overdraft is a loan arrangement between the borrower and the bank whereby the bank extends the credit to a maximum amount up to which the customer can write cheques or make withdrawals. It refers to the amount of money borrowed that exceeds the deposits. Bank overdraft facility is granted by bank usually for a short period to accommodate short-term fund requirement. It may be secured by tangible assets or may be a clean overdraft. Overdraft facilities are linked with the operations in current account.

Cash credit is a fund based facility granted by a bank to its customer to finance working capital requirements on a continuing basis. Cash credit is usually secured by hypothecation of inventory and debtors or pledge of goods. It may also be secured by a charge on fixed assets.

With regard to presentation of these items in the statement of cash flows, paragraph 8 of Ind AS 7, provides that bank borrowings are usually considered to be part of financing activities. However, where bank overdrafts which are repayable on demand form an integral part of an entity's cash management, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from positive to being overdrawn.

In accordance with the above, cash credit from bank, a facility on a continuing basis (though contractually payable on demand on violation of terms and conditions of sanction) is considered as a part of financing activities and bank overdraft forming the part of cash management is considered as cash equivalent while preparing the statement of cash flows.

Question 8

What are the examples of cash flows arising from taxes on income to be separately disclosed under cash flows from investing or financing activities?

Response

Cash flows arising from taxes on income shall be separately disclosed and classified as cash flow from operating activities, unless they can be specifically identified with financing and investing activities. Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in the statement of cash flows.

While tax expense may be identified 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 underlying transaction. Therefore, taxes paid are usually classified as cash flows from operating activities. Example: If we strictly go by classification of taxes in accordance with the nature of the related transaction, tax impact of short-term capital gain should be classified as investing activity. Suppose, the entity is incurring business losses, the same gets adjusted against short-term capital gain for tax purposes. Accordingly, showing tax impact of short-term capital gain and business losses separately is impracticable. Therefore, tax paid is usually classified as cash flows from operating activity.

However, where it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows, tax cash flows are classified as investing or financing activities. Examples: tax payment by way of long-term capital gain on sale of land which was used as property, plant and equipment (PPE), tax payment on dividend received from a foreign company shall be classified as investing activity.

Similarly, dividend distribution tax under section 115-O of Income Tax Act, 1961 viz., preference and equity dividend distribution tax is considered as an integral part of financing activities.

Question 9

What are the examples of cash flows which can be reported on a net basis?

Response

Generally, all cash flows are reported gross. Cash flows are offset and reported net only in limited circumstances. Cash flows arising from the following operating, investing and financing activities may be reported on a net basis:

- cash receipts and payments on behalf of customers when the cash flow reflect the activities of the customer rather than those of the entity; and
- cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

Examples:

(a) receipt of insurance premium from policy holders and refund of premium on cancellation of general insurance policy to policy holders (under direct method of presenting cash flows from operating activities);

(b) investment and sale of securities by wealth management companies on behalf of customers (under direct method of presenting cash flows from operating activities);

(c) receipts and payments by an agent on behalf of a principal;

(d) acceptance and repayment of deposits with short maturities;

(e) withdrawal and deposits from/in cash credit account with bank.

Cash flows arising from the following activities of a financial institution may be reported on a net basis:

- cash receipts and payments for the acceptance and repayment of deposits with fixed maturity date;
- the placement of deposits with and withdrawal of deposits from other financial institutions;
- cash advances and loans made to customers and repayment of those advances and loans.

Question 10

What is the preferred method to report cash flows from operating activities?

Response

An entity shall report cash flows from operating activities using either the 'direct method' or the 'indirect method'.

According to Ind AS 7, the entities are encouraged to report cash flows from operating activities using the 'direct method' as it provides information which may be useful in estimating future cash flows and which is not available under the 'indirect method'.

Under direct method, major classes of gross cash receipts and payments are disclosed. However, under indirect method, 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 expenses associated with investing or financing cash flows.

Principally, final reporting conclusions under both methods are the same; an entity may follow either the direct method or indirect method.

Considering voluminous operating transactions of commercial entities, it is difficult to prepare statement of cash flows under direct method as both cash as well as non-cash transactions are recorded in the books of account under accrual system of accounting.

Existing Accounting Standard (AS) 3, *Cash Flow Statement*, permits that an enterprise may report cash flows from operating activities using either direct method or indirect method. With regard to AS 3, it may be noted that Insurance Regulatory and Development Authority (IRDA) in its master circular on preparation of financial statements of general and life insurance business has specified that all insurers are required to present the statement of cash flows as per the direct method. Further, according to Clause 32 of the listing agreement specified by SEBI, all listed companies are required to present the statement of cash flows as per the indirect method principles of AS 3.

Question 11

Which rate should be used in translating the cash flows denominated in a foreign currency? What is the treatment of unrealised gains and losses arising from changes in foreign currency exchange rates?

Response

Cash flows arising from the transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of cash flow. Cash flows denominated in a foreign currency are reported in a manner consistent with Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*. For practical reasons, Ind AS 21 permits the use of an exchange rate that approximates the actual rate, for example, an average rate for a week or a month may be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Unrealised gains and losses arising from changes in foreign exchange rates do not give rise to actual inflow or outflow of cash or cash equivalents. However, the effect of such exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported separately from cash flows from operating, investing and financing activities in the statement of cash flows in order to reconcile cash and cash equivalents as per the statement of cash flows with cash and cash equivalents as per the balance sheet.

Question 12[1]

What is the classification for interest and dividend paid and received in the statement of cash flows? How are lease payments under a lease arrangement and payment towards acquiring a fixed asset on deferred payment basis presented in the statement of cash flows?

Response

Paragraph 11 of Ind AS 7 provides that, "*An entity presents 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 entity and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.*"

Accordingly, an entity needs to make its own assessment about the classification of its cash flows into various activities that is most appropriate

[1] *The ASB at its 289th meeting held on April 17, 2023, considered the classification of 'Interest paid on delayed tax payments' and 'Interest received on tax refunds' in the Statement of cash flows and decided to amend this FAQ. Accordingly, the FAQ has been amended appropriately including changes made due to issuance of new leases Standard viz. Ind AS 116, Leases.*

considering its business and nature of the item. The entity shall apply such assessment consistently.

In the context of classification of interest and dividends, paragraphs 31 and 33 of Ind AS 7 may be noted which state as follows:

31 Cash flows from interest and dividends received and paid shall each be disclosed separately. Cash flows arising from interest paid and interest and dividends received in the case of a financial institution should be classified as cash flows arising from operating activities. In the case of other entities, 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.

33 Interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution. However, there is no consensus on the classification of these cash flows for other entities. Some argue that interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of profit or loss. However, it is more appropriate that interest paid and interest and dividends received are classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

In accordance with the above, it may be noted that for other than a financial institution, interest paid due to delay in payment is considered as costs of obtaining financial resources because the amount due but not paid by the entity acts as an alternate source of funding for the entity and hence, supports the entity in its finances. Accordingly, the same should be classified as financing activities. Where the charges paid are in the nature of 'penalty', then the same should be classified as operating activities.

Similarly, to the extent the interest received by other than a financial institution represents a compensation for the time value of money the same should be classified as investing activities, as it is considered as returns on investments.

The following are the examples of classification of various activities. This is for illustrative purpose only:

Particulars	Classification for reporting cash flows	
	Banks and financial institutions	Other entities
Interest received on loans and advances given	Operating activities	Investing activities
Interest paid on deposits and other borrowings	Operating activities	Financing activities
Interest and dividend received on investments in subsidiaries, associates and in other entities	Investing activities	Investing activities
Dividend paid on preference and equity shares, including tax on dividend paid on preference and equity shares by other entities	Financing activities	Financing activities
Finance charges paid by lessee under a lease	Financing activities	Financing activities
Payment towards reduction of outstanding lease liability	Financing activities	Financing activities
Interest paid to vendor for acquiring fixed asset under deferred payment basis	Financing activities	Financing activities
Principal sum payment under deferred payment basis for acquisition of fixed assets	Investing activities	Investing activities
Penal interest received from customers for late payments	Operating activities	Operating activities
Penal interest paid to suppliers for late payments	Operating activities	Operating activities
Interest paid on delayed tax payments	Financing activities (see note 1)	Financing activities
Interest received on tax refunds	Investing activities (see	Investing activities

	note 1)	

Note 1: Similar to other than a financial institution, the Interest paid on delayed tax payments and interest received on tax refunds for a financial institution shall be classified as 'Financing activities' and 'Investing activities' respectively, as these pertain to income taxes and are not arising from the principle revenue-producing activities of the financial institution.

Question 13

What are the examples of cash and cash equivalent balances held by the entity that are not available for use?

Response

Ind AS 7 requires an entity to disclose together with management commentary, the amount of significant cash and cash equivalent balances held by the entity that are not available for use. The examples are as follows:

(a) balance in unpaid dividend account;

(b) balance in bank account for share application money, pending allotment of shares;

(c) earmarked bank balances for specific purposes. Examples: bank account for debenture redemption, dividend payment etc.

(d) balance in bank account subject to legal restrictions.

Question 14

Provide illustrative examples where reconciliation statement is required to be disclosed between the amounts in the statement of cash flows with the equivalent items reported in the balance sheet.

Response

Paragraph 45 of Ind AS 7 requires the disclosure of components of cash and cash equivalents in the statement of cash flows. These amounts should be reconciled with the equivalents items reported in the balance sheet. Reconciliation may be required for certain items, such as, bank overdrafts which are repayable on demand form an integral part of an entity's cash management, are included as a component of cash and cash equivalents in the statement of cash flows. However, bank overdrafts will be included in financial liabilities in balance sheet. Accordingly, such bank overdrafts could be one element of reconciliation. Where the reporting entity holds foreign currency cash and cash equivalent balances, these are monetary items that will be restated at the reporting date in accordance with Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*. Any exchange differences arising on translation will increase or decrease these balances but will not give rise to cash flows. Accordingly, such unrealised gains or losses arising from changes in foreign currency exchange rates could be another element of reconciliation.

Question 15

How should the sale proceeds from a sale and leaseback transaction be reported in the statement of cash flows?

Response

A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The accounting treatment of cash flows arising from the sale proceeds of a sale and leaseback transaction depends upon the type of lease involved. If the leaseback is a finance lease, then the transaction is a financial arrangement between the lessor and the lessee in substance, whereby the lessor provides finance to the lessee with the asset as security. Accordingly, in such a case sale proceeds of the asset should be classified as financing activities in the statement of cash flows. Lease finance charges and repayment of lease principal in the future are also required to be reported in the statement of cash flows as financing activities.

If the leaseback is an operating lease, cash flows arising from sale proceeds of the fixed assets should be recorded as investing activities. The lease payments to be made in future would be classified as cash flows from operating activities.

Question 16

How debt securities purchased at a discount/premium are classified in the statement of cash flows?

Response

Cash flows from investing activities represent the extent to which expenditure has been made for resources intended to generate future income and cash flows. Thus, actual cash outflow irrespective of discount or premium will be presented as investing activity. Example: bonds of face value of Rs. 5,25,000 are purchased in the market at a discount for Rs. 5,21,500. In this case, cash outflow of Rs. 5,21,500 will be presented in the statement of cash flows under investing activities.

Question 17

What is the presentation of cash flows arising out of payments for manufacture or acquisition of assets held for rental to others and subsequently held for sale in the ordinary course of business?

Response

There are certain types of entities whose ordinary activities include routinely renting out assets to others and selling the assets subsequently in the ordinary course of business. The proceeds from the sale of such assets are recognised as revenue in accordance with the Ind AS 18, *Revenue*. The derecognition principles of such assets are described in paragraph 68A of Ind AS 16, *Property, Plant and Equipment*.

Paragraph 14 of Ind AS 7, inter alia, states that cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale as described in paragraph 68A of Ind AS 16, *Property, Plant and Equipment* are cash flow from operating activities. The cash receipts from rent and subsequent sale of such assets are also cash flows from operating activities.

Therefore, cash flows associated with these type of assets are classified as cash flows arising from operating activities. This is in contrast with the normal classification where cash payments made to acquire or manufacture property, plant and equipment and cash receipts from the sale of such assets are classified as investing activities.

Question 18

Whether comparative figures are required to be presented in the statement of cash flows?

Response

An entity is required to present statement of cash flows for the current period classifying the cash flows from operating, investing and financing activities with corresponding figures of earlier reporting period for comparison and analysis.

Question 19

How do you classify purchase and sale of securities in the statement of cash flows?

Response

An entity presents cash flows from operating, investing and financing activities in a manner which is most appropriate to its business.

An entity may hold securities for dealing or trading purposes as they relate to the main revenue generating activity of the entity. In this scenario, cash flows arising from the purchase and sale of such securities are classified as operating activities.

Cash flows arising from the purchase and sale of securities held as investments are classified as investing activities.

Question 20

How do you classify cash receipts and payments arising out of future contracts, forward contracts, option contracts and swap contracts?

Response

Paragraph 16 of Ind AS 7, amongst other examples of cash flows arising from investing activities, provides as follows:

"(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 trading purposes, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged."

From the above paragraphs, it is clear that classification of cash flows from future contracts, forward contracts, option contracts and swap contracts depends on whether a contract is accounted for as a hedging instrument for hedged item or not.

When such a contract is accounted for as a hedge, cash flows arising from hedging instruments are classified as operating, investing or financing activities, on the basis of the classification of the cash flows arising from the hedged item. Example: when a forward contract is taken for repayment of a foreign currency loan and hedge accounting is followed, cash payments and receipts of the aforesaid forward contract is classified as financing activities.

When these contracts are not accounted for as hedge, the classification of cash flows depends on the nature of the contract itself, i.e., if these contracts are held for dealing or trading purposes, cash flows arising from such transactions should be classified as cash flows from operating activities. Otherwise, the cash flows will be classified as investing activities except where cash flows are classified as financing activities.

Question 21

An entity invests in a 10 year bond with a face value of Rs. 6,00,000 by paying Rs. 2,31,500. The effective rate of interest is 10%. An entity recognises proportionate interest income in its statement of profit and loss over the period of bond.

How the interest income will be treated in the statement of cash flows during the period of bond?

How the maturity proceeds of Rs. 6,00,000 will be treated in the statement of cash flows?

The entity is not in the business of dealing in securities.

Response

In the given case, since the entity is not in the business of dealing in securities, a sum of Rs. 2,31,500 invested in a bond will be classified as investing activities. There is no cash flow of interest during bond period, as there is no cash receipt. On maturity, proceeds of Rs. 6,00,000 will be classified as investing activity with a bifurcation of Rs. 3,68,500 as interest and Rs. 2,31,500 as proceeds towards redemption of bond.

Question 22

Ind AS 7 requires disclosure of non-cash transactions in the financial statements. Give examples of non-cash transactions?

Response

Investing and financing transactions that do not require the use of cash and cash equivalents are excluded from the statement of cash flows. Such transactions are however required to be disclosed elsewhere in the financial statements in a way that provides all the relevant information. The disclosure of these significant non-cash transactions is made by way of notes to the financial statements.

Examples of non-cash transactions:

(a) acquisition of an enterprise by means of issue of equity shares;

(b) conversion of debentures or preference shares into equity shares;

(c) conversion of term loan into equity shares;

(d) issue of bonus shares;

(e) reduction of capital under restructuring or reduction of capital;

(f) exchange of assets.

Question 23

What is the meaning of 'contributed equity' used in the definition of financing activities?

Response

Ind AS 7 defines financing activities as activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

In accounting and finance terms, equity is the residual interest of shareholders in assets after deducting all liabilities. Thus, equity = shareholders' funds or total assets – liabilities.

Shareholders' funds = share capital + reserves and surplus + money received against share warrants

Thus, equity is built up by two ways:

- Contributed equity
- Retained earnings

Thus, contributed equity is paid up capital contributed by shareholders of the company. Cash flows arising from changes in contributed equity on account of issue of additional capital, buy back of shares etc. are classified as financing activities.

The change in retained earnings is primarily on account of profit or loss earned by the entity. Profits are earned from principal revenue-producing activities and other activities.

Question 24

Ind AS 7 uses the term 'financial institution', which has not been defined in the Standard. What is the meaning of this term?

Response

The term 'financial institution' is not defined in the Standard. In the absence of a specific definition, following definitions of 'financial institution' can be taken as a basis to determine whether the activities of an entity are in the nature of financial institution or not:

Section 2(39) of the Companies Act, 2013, states that 'financial institution' includes a scheduled bank, and any other financial institution defined or notified under the Reserve Bank of India Act, 1934.

Section 45-I of the Reserve Bank of India Act, 1934, defines financial institution as under:

"financial institution" means any non-banking institution which carries on as its business or part of its business any of the following activities, namely:

(i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own;

(ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;

(iii) letting or delivering of any goods to a hirer under a hire- purchase agreement as defined in clause (c) of section 2 of the Hire-Purchase Act, 1972;

(iv) the carrying on of any class of insurance business;

(v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;

(vi) collecting, for any purpose or under any scheme or arrangement by whatever name called monies in lump sum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person, but does not include any institution, which carries on as its principal business:

    (a) agricultural operations; or

    (b) (aa) industrial activity; or;

    (c) the purchase or sale of any goods (other than securities) or the providing of any services; or

(d) the purchase, construction or sale of immovable property, so however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons.

[Explanation — For the purpose of this clause, ''industrial activity'' means any activity specified in sub-clauses (i) to (xviii) of clause (c) of Section 2 of the Industrial Development Bank of India Act, 1964]

Question 25

Explain how securitisation of receivables is presented in the statement of cash flows in the books of originator?

Response

There is no guidance in Ind AS 7 with regard to presentation of cash flows from securitisations. In this regard, it may be noted that derecognition of receivables in the books of the originator in accordance with the requirements laid down in Ind AS 109, *Financial Instruments* implies that, in substance it is similar to sale of receivables. Amount received from such securitisations can be considered as early collection of amounts due from customers. Accordingly, cash flows arising from proceeds from securitisation activities derecognised in accordance with the requirements of Ind AS 109 should be classified as part of operating activities even if the entity does not enter into such transactions regularly.

In other cases, where the receivables are not derecognised in the books of the originator in accordance with the requirements of Ind AS 109, the proceeds from securitisation arrangement are recognised as a liability. Therefore, cash flows arising from such transactions should be classified as part of financing activities.

III Case Studies

Case Study 1: Foreign currency cash flows

Entity A, whose functional currency is Indian Rupee, had a balance of cash and cash equivalents of Rs. 2,00,000, but no trade receivables or trade payables on January 1, 20X2. During 20X2, the entity entered into the following foreign currency transactions:

- Entity A purchased goods for resale from Europe for €1,00,000 when the exchange rate was €1 = Rs. 50. This balance is still unpaid at December 31, 20X2 when the exchange rate is €1 = Rs. 45. An exchange gain on retranslation of the trade payable of Rs. 5,00,000 is recorded in profit or loss [€1,00,000 x (50 – 45) = Rs. 5,00,000].
- Entity A sold the goods to an American client for $ 1,50,000 when the exchange rate was $1 = Rs. 40. This amount was settled when the exchange rate was $1 = Rs. 42. A further exchange gain of Rs. 3,00,000 regarding the trade receivable is recorded in the statement of profit or loss [$ 1,50,000 x (42 – 40) = Rs. 3,00,000].
- Entity A also borrowed €1,00,000 under a long-term loan agreement when the exchange rate was €1 = Rs. 50 and immediately converted it to Rs. 50,00,000. The loan was retranslated at December 31, 20X2 @ Rs. 45 = Rs. 45,00,000, with a further exchange gain of Rs. 5,00,000 recorded in the statement of profit or loss.
- Entity A therefore records a cumulative exchange gain of Rs. 13,00,000 (5,00,000 + 3,00,000 + 5,00,000) in arriving at its profit for the year.

In addition, Entity A records a gross profit of Rs. 10,00,000 (Rs. 60,00,000 – Rs. 50,00,000) on the sale of the goods.

How cash flows arising from above transactions would be reported in the statement of cash flows under indirect method?

Response

Indirect method of statement of cash flows

Cash flows from operating activities

Particulars	**Amount (Rs.)**
Profit before taxation (10,00,000 + 13,00,000)	23,00,000
Adjustment for unrealised exchange gains/losses:	
Foreign exchange gain on long term loan	(5,00,000)
Decrease in trade payables	(5,00,000)
Operating Cash flow before working capital changes Changes in working capital (Due to increase in trade payables) ***Net cash inflow from operating activities***	**13,00,000** 50,00,000 **63,00,000**
Cash inflow from financing activity	**50,00,000**
Net increase in cash and cash equivalents	**1,13,00,000**
Cash and cash equivalents at the beginning of the period	2,00,000
Cash and cash equivalents at the end of the period	**1,15,00,000**

Note: Taxation is ignored

Case Study 2: Subsidiary acquired in the year

Entity A acquired a subsidiary, entity B, during the year. Summarised information from the consolidated statement of profit and loss and balance sheet is provided, together with some supplementary information, to demonstrate how the statement of cash flows under the indirect method is derived.

Consolidated statement of profit and loss		**Amount (Rs.)**
Revenue		3,80,000
Cost of sales		(2,20,000)
Gross profit		1,60,000
Depreciation		(30,000)
Other operating expenses		(56,000)

Interest cost		(4,000)
Profit before taxation		**70,000**
Taxation		(15,000)
Profit after taxation		**55,000**

Consolidated balance sheet	**2016**	**2015**
Assets	**Amount (Rs.)**	**Amount (Rs.)**
Cash and cash equivalents	8,000	5,000
Trade receivables	54,000	50,000
Inventories	30,000	35,000
Property, plant and equipment	1,60,000	80,000
Goodwill	18,000	—
Total assets	2,70,000	1,70,000
Liabilities		
Trade payables	68,000	60,000
Income tax payable	12,000	11,000
Long term debt	1,00,000	64,000
Total liabilities	**1,80,000**	**1,35,000**
Shareholders' equity	**90,000**	**35,000**
Total liabilities and shareholders'	**2,70,000**	**1,70,000**

Other information

All of the shares of entity B were acquired for Rs. 74,000 in cash. The fair values of assets acquired and liabilities assumed were:

Particulars	**Amount (Rs.)**
Inventories	4,000
Trade receivables	8,000
Cash	2,000
Property, plant and equipment	1,10,000
Trade payables	(32,000)

Long term debt	(36,000)
Goodwill	18,000
Cash consideration paid	**74,000**
Prepare statement of cash flows.	

Response

This information will be incorporated into the consolidated statement of cash flows as follows:

Statement of cash flows for 2016 (extract)	**Amount (Rs.)**	**Amount (Rs.)**
Cash flows from opening activities		
Profit before taxation		
Adjustments for non-cash items:	70,000	
Depreciation	30,000	
Decrease in inventories (Note 1)	9,000	
Decrease in trade receivables (Note 2)	4,000	
Decrease in trade payables (Note 3)	(24,000)	
Interest paid to be included in financing activities	23,000	
Taxation (11,000 + 15,000 – 12,000)	(14,000)	
Net cash inflow from operating activities		79,000
Cash flows from investing activities		
Cash paid to acquire subsidiary (74,000 – 2,000)	(72,000)	
Net cash outflow from investing activities		(72,000)
Cash flows from financing activities		
Interest paid	(4,000)	
Net cash outflow from financing activities		(4,000)
Increase in cash and cash equivalents		**3,000**
Cash and cash equivalents, beginning of year		**5,000**
Cash and cash equivalents, end of year		**8,000**

Note 1:

Total inventories of the Group at the end of the year	Rs. 30,000
Inventories acquired during the year from subsidiary	(Rs. 4,000)
	Rs. 26,000

Opening inventory	Rs. 35,000
Decrease in inventory	Rs. 9,000

Note 2:

Total trade receivable of the Group at the end of the year	Rs. 54,000
Trade receivables acquired during the year from subsidiary	(Rs. 8,000)
	Rs. 46,000
Opening trade receivable	Rs. 50,000
Decrease in trade receivable	Rs. 4,000

Note 3:

Trade payables at the end of the year	Rs. 68,000
Trade payables of the subsidiary assumed during the year	(Rs. 32,000)
	Rs. 36,000
Opening trade payable	Rs. 60,000
Decrease in trade payables	Rs. 24,000