Cash Flow Statement

The third key financial statement (with the Position Statement & Income Statement). It shows ~~profit~~ inflows & outflows of cash and cash equivalents over a period, classified into operating, investing & financing heads. Prepared as per AS-3 (mandatory under the Companies Act, 2013, Sec 133).

Objectives & Benefits

1. Shows ability to generate cash & needs to utilise those cash flows.
2. Helps evaluate changes in net assets & financial structure (liquidity, solvency).
3. Improves comparability (removes effect of different accounting treatments).

Cash & Cash Equivalents.

Cash = cash in hand + demand deposits.
Cash Equivalents = short-term, highly liquid investments readily convertible to known cash, with insignificant risk of change in value (maturity ~~1 yr~~ 3 months or less). Shares are excluded; preference shares near redemption may qualify.

Classification of Activities

As per AS-3, all cash flows fall under 3 categories - shown separately :

1. Operating Activities

Principal revenue-generating (main) activities; not investing or financing.

Key indicator of internal solvency.

In : sale of goods/services, royalties, fees, commission.

Out : to suppliers, employees, insurance, income tax (unless invest/finance).

2. Investing Activities

Acquisition & disposal of long-term assets & other investments (not cash eq.).

e.g. buy/sell machinery, land, building; interest & dividend received.

3. Financing Activities

Activities changing size & composition of owners' capital & borrowings.

In : issue of shares / debentures, loans.

Out : repay borrowings, interest paid, dividend paid on equity & pref. capital.

Treatment of Peculiar Items

Interest & Dividend

Financial enterprise : interest/dividend paid & received = operating activity.

Non-financial enterprise :

- interest/dividend PAID = financing
- interest/dividend RECEIVED = investing

Taxes & Non-cash Items

Tax on operating profit = operating.

Dividend tax = financing activity.

Capital gains tax on sale of fixed asset = investing activity.

Non-cash txns (e.g. asset bought by issue of shares) are EXCLUDED from the CFS.

Format (Main Heads)

$$\boxed{A + B + C = \text{net cash change}}$$ <- core <- eqn

(A) Cash flow from Operating xxx

(B) Cash flow from Investing xxx

(C) Cash flow from Financing xxx

\+ Cash & cash equiv. at beginning . xxx

= Cash & cash equiv. at the END .. xxxx

Operating Activities - Indirect

Net profit/loss is adjusted for non-cash & non-operating items + working capital changes.

Step-wise Procedure

1. Start: Net Profit before Tax & * Extraordinary Items.
2. ADD non-cash & non-operating charges : depreciation, goodwill written-off, interest paid, loss on sale of fixed assets.
3. LESS non-operating incomes : * interest/dividend ~~paid~~ received, profit on sale of fixed assets.
   = Operating Profit before WC changes.
4. Adjust Working Capital :
   ADD : decrease in current assets,
   increase in current liabilities.
   LESS : increase in current assets,
   decrease in current liabilities.
5. = Cash generated from Operations.
6. LESS : Income Tax Paid (net of refund).
7. +/- Effects of Extraordinary Items.

$\boxed{\text{= Net Cash from Operating Activities}}$

Solved : Cash from Operations

Net profit before tax & extraord. = 42,000.
Depreciation 20,000. Inc. trade recv. 3,000; inc. inventories 5,000; inc. prepaid 500; dec. trade payables 2,000; inc. o/s exp. 1,000. Income tax paid 11,000.

Solution

Net Profit before Tax & Extra. = 42,000
+ Depreciation 20,000
= Op. Profit before WC change = 62,000
- Increase in Trade Receivables (3,000)
- Increase in Inventories ...... (5,000)
- Increase in Prepaid Insurance (500)
- Decrease in Trade Payables ... (2,000)
+ Increase in O/s Empl. Benefits +1,000
= Cash generated from Operations 52,500
- Income Tax Paid .... (11,000)

$\boxed{\text{Net Cash from Operating} = 41,500}$ <-same as <-direct mtd

Note : answer is identical whether direct or indirect method is used - only the presentation of operating section differs.

Investing & Financing Flows

Investing - example

Machine sold for 13,000; new machine purchased 35,000 (balancing figure).

Sale of Machinery 13,000

Purchase of Machinery .... (35,000)

Net cash used in Investing = (22,000)

Financing - example

Long-term loan : 2,00,000 -> 2,50,000; loan of 1,00,000 repaid in the year.

Proceeds from borrowings 1,50,000

Repayment of borrowings ..... (1,00,000)

Net cash from Financing = 50,000

Quick Recap

* CFS prepared per AS-3 ; indirect method is used by most companies in practice.
* Start operating section from Net Profit before tax & extraordinary items.
* Proposed dividend of previous year is added back to profit & shown as outflow under financing activities.