

CHAPTER – VI
CASH FLOW STATEMENT

1.Cash Flow Statement Cash flow statement is a statement showing the changes in financial position of a business concern during different intervals of time in terms of cash and cash equivalents. The Revised Accounting Standard-3 has made it mandatory for all listed companies to prepare and present a cash flow statement along with other financial statements on annual basis.

2.Cash Flows Cash flows are inflows and outflows of cash and cash equivalent. It implies movement-in and movement-out of cash and cash equivalents. Receipt of cash from a non-cash item is termed as 'cash inflow', while cash payment in respect of such item is termed as 'cash outflow'.

Cash Cash comprises of cash in hand and demand deposits with the bank.

Cash Equivalents Cash equivalents are 'short-term highly liquid investments that are readily convertible into known amount of cash and which are subjected to an insignificant risk of change in value'.

3.Objectives of Cash Flow Statement

- (i) Useful in short-term financial planning.
- (ii) Useful in efficient cash management.
- (iii) Helpful in formulation of business policies.
- (iv) Assists in preparation of cash budget.
- (v) Used for assessment of cash flow from various activities, viz operating, investing and financing activities.

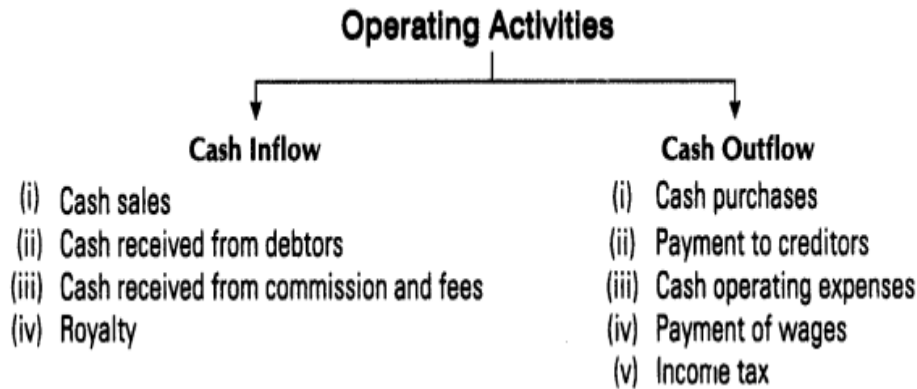
4.Limitations of Cash Flow Statement

- (i) Based on historical cost principle.
- (ii) Based on secondary data.
- (iii) Ignores non-cash transactions.
- (iv) No adherence of basic accounting principles.
- (v) Cash flow statement is not a substitute for income statement.

5.Classification of Business Activities Accounting Standard-3 (Revised) requires that the changes resulting in inflows and outflows of cash and cash equivalents will be classified into following three activities:

- (i) Cash flow from operating activities.
- (ii) Cash flow from investing activities.
- (iii) Cash flow from financing activities.

6.Cash Flow from Operating Activities Operating activities are the principal revenue producing activities of the enterprise and other activities that are not investing or financing activities.



For a Finance Company

(v) Cash received for interest and dividends (vi) Cash paid for interest
(vi) Sale of securities (vii) Purchase of securities

For an Insurance Company

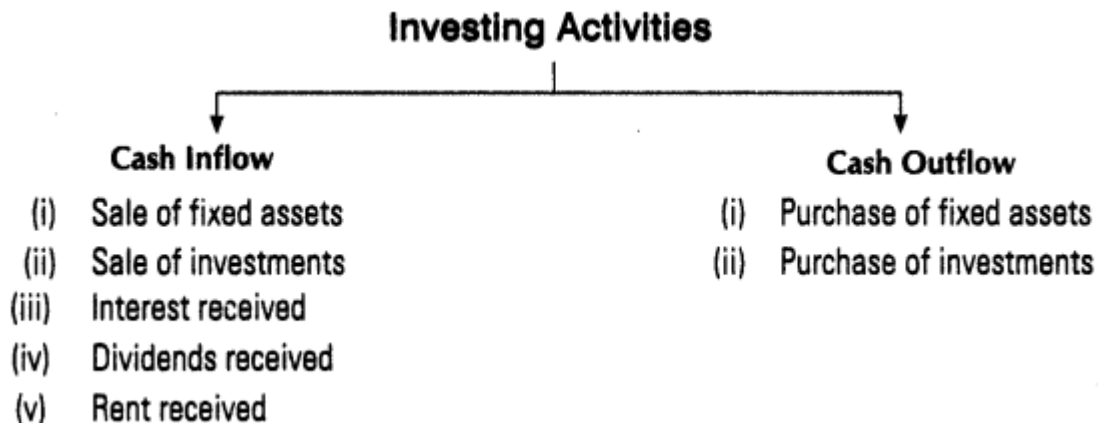
(vii) Premiums and claims received (viii) Premiums and claims paid

For a Real Estate (Infrastructure) Company

(viii) Rent received (ix) Rent paid

7.Cash Flow from Investing Activities As per AS-3, investing activities are the acquisition and disposal of the long-term assets and other investments, not included in cash equivalents.

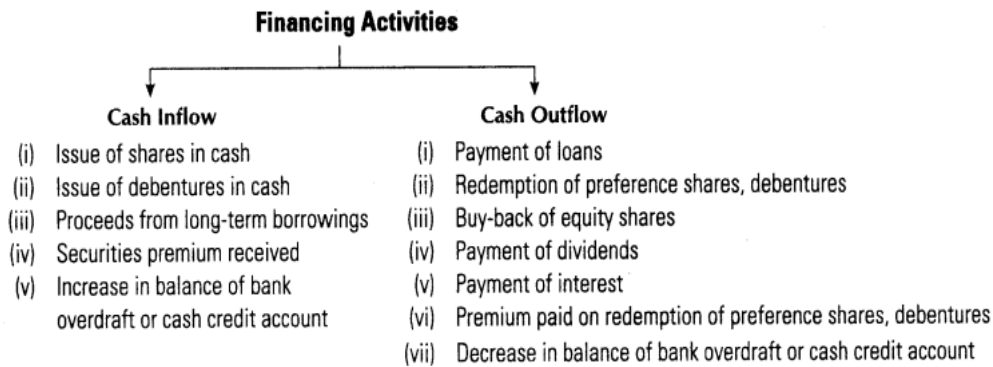
Cash flow from investing activities are exhibited as follows:



9. Cash flow from Financing Activities:

Financing activities are the activities which result in change in the size and composition of the owner's capital (including preference share capital) and borrowings (including debentures) of the enterprise from other sources.

Cash flow arising from financing activities are exhibited as follows:



BOARD EXAM QUESTIONS

1. Why is specific disclosure of cash flow from financing activities important while preparing cash flow statement? (All India 2014)

Ans. Separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise.

2. Why is separate disclosure of cash flow from investing activities important while preparing cash flow statement? (All India 2014)

Ans. Separate disclosure of cash flows from investing activities is important because they represent to which investment have been made for resources, intended to generate future income and cash flows.

3. Dividend paid by a financial company is classified under which type of activity, while preparing cash flow statement? (Compartment 2014)

Ans. It is classified under 'financing activity'.

4. State the purpose or objective of preparing a cash flow statement. (Delhi 2014, 2012, 2011C; All India 2014, 2012)

or

Why is a cash flow statement prepared? (Delhi 2010 c)

Ans. A cash flow statement provides information about the historical changes in cash and cash equivalents of an enterprise by classifying cash flows into operating, investing and financing activities between the dates of two balance sheets.

5. Give the meaning of cash (All India 2014; Delhi 2011)

Ans. 'Cash flow' implies inflow and outflow of cash and cash equivalents. Receipt of cash from an item other than cash and cash equivalents is termed as 'cash inflow' while cash payment in respect of such item is termed as 'cash outflow'.

6. What is meant by cash equivalents? (All India 2014, 2011; Delhi 2014, 2011 c)

Ans. Cash equivalents mean short-term highly liquid investments that are readily convertible into known amount of cash and which are subjected to an insignificant risk of change in value.

7.State the meaning of cash flow statement. (All India 2014,2014 c, 2011)

Ans. Cash flow statement is a statement showing the changes in financial position of a business concern during different intervals of time in terms of cash and cash equivalents.

8.State with reason whether the issue of 9% debentures to the vendors for the purchase of machinery of Rs 50,000 will result into inflow, outflow or no flow of cash.(All India 2014 (C), 2009)

Ans. There is no flow of cash by the issue of 9% debentures to the vendors for the purchase of machinery of Rs 50,000 because this transaction will not change the balance of cash and cash equivalents.

9.What is meant by 'cash from operating activities'? (Delhi 2013)

Ans. 'Cash from operating activities' are the principal revenue producing activities of the enterprise and other activities that are not investing or financing activities.

10.Under which type of activity will you classify 'dividend received by a finance company' while preparing cash flow statement? (Delhi 2013; hots)

Ans. Dividend received by a finance company is an operating activity.

11.State with reason whether 'purchase of fixed asset on long-term deferred payment' would result in inflow, outflow or no flow of cash.(Delhi 2013; hots)

Ans. No flow of cash because no cash is involved in this transaction.

12.Under which type of activity will you classify 'refund of income tax received' while preparing the cash flow statement? (Delhi 2013)

Ans. Operating activity.

13.When does the flow of cash take place? (Delhi 2013)

Ans. Cash flow arises when the net effect of a transaction either increases or decreases the amount of cash or cash equivalent.

14.State with reason whether 'discount received on making payment to suppliers' would result into inflow, outflow or no flow of cash. (All India 2013)

Ans. Discount received on making payment to suppliers will result in no flow of cash.

15.Under which type of activity will you classify 'interest paid on long-term borrowings' while preparing cash flow statement?(AllIndia2013)

Ans. Interest paid on long-term borrowings is a financing activity.

16.State with reason whether 'old furniture written-off' would result into inflow/outflow or no flow of cash.(All India 2013)

Ans. Old furniture written-off will result in no flow of cash.

17.Under which type of activity will you classify 'proceeds from sale of investment' while preparing cash flow statement?(Delhi 2013)

Ans. Proceeds from sale of investments is an investing activity.

18.Under which type of activity will you classify 'proceeds from sale of patents' while preparing cash flow statement? (All India 2013)

Ans. Proceeds from sale of patents is an investing activity.

19. Give an example of the activity which remains financing activity for every enterprise. (All India 2013; HOTS)

Ans. Dividend paid.

20. Under which type of activity will you classify 'commission and royalty received' while preparing cash flow statement? (All India 2013)

Ans. Commission and royalty received is an operating activity.

21. While preparing cash flow statement which type of activity is, 'payment of cash to acquire debenture by an investment company'? (Delhi 2012)

Ans. Operating activity.

22. While preparing cash flow statement which type of activity is, 'payment of cash to acquire shares by a trading company'? (Delhi 2012)

Ans. Investing activity.

23. State with reason whether 'deposit of cash into bank' will result into, inflow, outflow or no flow of cash. (Delhi 2011; HOTS)

Ans. 'Deposit of cash into bank' does not result in cash flow. It is simply a movement between two components of cash and cash equivalents.

24. List any two investing activities which result into outflow of cash. (All India 2011; Delhi 2011 C)

Ans. Two investing activities which result into outflow of cash are:

- (i) Building purchased.
- (ii) Investments purchased.

25. 'Payment of dividend' will come under which type of activity while preparing a cash flow statement? (All India 2011; Delhi 2008)

Ans. 'Payment of dividend' is classified as 'financing activity' while preparing a cash flow statement.

26. List any two financing activities that will result into outflow of cash. (All India 2011; Delhi 2011 C)

Ans. Two financing activities that result into outflow of cash are:

- (i) Redemption of debentures.
- (ii) Interest paid on debentures.

27. Name any two financing activities that result into inflow of cash. (All India 2011)

Ans. The two financing activities that result into inflow of cash are:

- (i) Cash proceeds from issue of shares
- (ii) Cash proceeds from issue of debentures

28. Name any two investing activities that result into inflow of cash. (All India 2011)

Ans. Two investing activities that result into inflow of cash are:

- (i) Cash proceeds from sale of building.
- (ii) Cash proceeds from sale of investments.

29. State with reason whether 'withdrawal of cash from bank' will result into, inflow, outflow or no flow of cash. (Foreign 2011; HOTS)

Ans. 'Withdrawal of cash from bank' does not result in cash flow. It is simply a movement between two components of cash and cash equivalents.

30. Under which type of activity will you classify 'issuing 9% debentures' while preparing cash flow statement? (Delhi 2010)

Ans. Financing activity.

31. Declaration of final dividend would result into inflow, outflow or no flow of cash. Give your answer with reason. (Delhi 2010)

Ans. No flow of cash as final dividend is only declared, not yet paid.

32. Under which type of activity will you classify 'proceeds from sale of machinery' while preparing cash flow statement? (Delhi 2010)

Ans. Investing activity.

33. Interest received on debentures would result into inflow, outflow or no flow of cash. (All India 2010)

Ans. Cash inflow, because cash comes in due to interest received on debentures.

34. Give one difference between an operating activity and a financing activity. (Delhi 2010 C)

Ans. Operating activity is the principal revenue producing activity of an enterprise whereas, financing activity are those activities which change the size and composition of owner's equity and borrowings of an enterprise.

35. Give any two transactions which result into 'inflow of cash'. (All India 2010)

Ans. (i) Cash proceeds from sale of investments. (ii) Cash proceeds from issue of debentures.

36. Give one difference between an operating activity and an investing activity. (All India 2010)

Ans. Operating activity is the principal revenue producing activity of an enterprise whereas, investing activity includes the acquisition and disposal of fixed assets.

37. Give one transaction which may result into outflow of cash and one which may result into no flow of cash. (All India 2010)

Ans. Outflow of cash Purchase of investments. No flow of cash Cash deposited into the bank.

38. State why non-cash transactions are ignored while preparing a cash flow Statement? (Delhi; All India 2009)

Ans. Non-cash transactions are ignored while preparing a cash flow statement because cash flow statement shows flow of cash and cash equivalents during a given period.

39. When is dividend received considered as an operating activity? (Delhi 2009; All India 2009; HOTS)

Ans. Dividend received is considered as an operating activity when company is a financing or investing company.

40. State why cash flow statement is not a substitute for income statement? (Delhi 2009; All India 2009)

Ans. An income statement shows both cash and non-cash items. It shows net income of the firm. Cash flow represents only net cash inflow or outflow of cash. So, cash flow statement can't be taken as substitute for income statement.

41. When is interest received considered as financing activity? (Delhi 2009; All India 2009)

Ans. Interest received is never considered as a financing activity.

42. State with reason whether charging of depreciation on furniture will result into inflow, outflow or no flow of cash. (Delhi 2009c)

Ans. There will be no flow of cash because depreciation on furniture is a non-cash expense.

43. 'Cash receipts from sale of goods by a trading company' will come under which activity while preparing cash flow statement? (Delhi 2009c)

Ans. At the time of preparing cash flow statement, 'cash receipts from sale of goods by a trading company' will come under operating activity because sale of goods is the main revenue producing activity for a trading company.

44. Dividend received by a finance company will come under which activity while preparing a cash flow statement? (All India 2009; hots)

Ans. 'Dividend received by a financing company' is classified under operating activity because dividend received is the receipt from principal revenue producing activities of the business.

45. State whether 'conversion of debentures into equity shares' by a financing company will result into inflow, outflow or no flow of cash? (Delhi 2008)

Ans. 'Conversion of debentures into equity shares' does not result in cash flow. It is simply a movement between two components of financing activities.

46. State whether 'the payment of cash to creditors' will result into inflow, outflow or no flow of cash. (All India 2008)

Ans. It will result in outflow of cash.

47. 'Dividend paid by a manufacturing company' is classified under which kind of activity while preparing a cash flow statement? (All India 2008)

Ans. 'Dividend paid by a manufacturing company' is classified as a financing activity.

48. State whether 'depreciation charged by a company' will result into inflow, outflow or no flow of cash. (All India 2008)

Ans. There will be no flow of cash because depreciation is a non-cash expense.

49. 'Interest paid by an investment company' will come under which activity while preparing a cash flow statement? (All India 2008; hots)

Ans. 'Interest paid by an investment company' is classified as an operating activity.

50. State whether the 'purchase of goods on credit' will result into inflow, outflow or no flow of cash. (Foreign 2008)

Ans. There is no flow of cash because purchase of goods on credit will not affect cash.