



Cash Flow Statement

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Understanding of cash flow statement

- This is periodic statement showing inflow and outflow of cash
- In broader sense, it is summarized cash book
- Cash includes cash as well as cash equivalents
- Bucketing into 3 categories
- Reflects cash management efficiency of the entity
- Careful reading will establish relation with cash generation and income generation capacity of enterprise.
- Very effective tool for bankers – determines the causes of cash movement
- Due to use of accrual system of accounting, this is only tool to determine cash profitability of the enterprise.

AS – 3 : Scope

- An enterprise should prepare a cash flow statement and should present it for each period for which financial statements are presented.
- Purpose of cash flow statement is to provide information on sources and uses of cash and cash equivalents during the accounting period.
- The statement is not mandatory for small and medium sized enterprises as defined in the notification

Some issues

Financial statement have been defined to include cash flow under the Act therefore **we have to audit it and express an opinion on it.**

- ❖ Companies Act exempts preparation of cash flow statement for **One-man company , Dormant company and Small company.**

- ❖ AS 3 is applicable to all entities other than SME as per AS.

Till AS3 and Companies Act, 2013 are aligned, they are in conflict:

- *E.g. A company having > Rs.10 crore borrowing , but small company under the Companies Act, 2013 will prepare cash flow statement.*

- ❖ In case of conflict, **Companies Act would prevail**

- ❖ Format of cash flow not prescribed under Companies Act 2013.

Benefits

- Cash flow statement in conjunction with other financial statement information helps in evaluation of net assets, financial structure including liquidity, solvency etc
- It shows the actual cash position available with the company between two balance sheet dates
- Reflects ability of enterprise to generate cash and needs of enterprise to utilize cash
- It helps the company in making accurate projections regarding the future liquidity position of the company
- It acts like a filter and is used by many analyst and investors to judge whether company has prepared the financial statements properly or not
- Peer comparison

Key definitions

- CASH : comprises cash on hand and **demand deposits with banks**
- CASH EQUIVALENTS : are **short term, highly liquid investments** that
 - are readily convertible into known amounts of cash and
 - which are subject to an insignificant risk of changes in value
- CASH FLOWS : are inflows and outflows of cash and cash equivalents.

Key definitions

- OPERATING ACTIVITIES : are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities
- INVESTING ACTIVITIES : are the acquisition and disposal of long-term assets and other investments not included in cash equivalents
- FINANCING ACTIVITIES : are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise

Presentation of cash flow statement

- The cash flow statement should report cash flows during the period classified by **operating, investing and financing activities**
- OPERATING ACTIVITIES
 - ✓ Primarily derived from the principal revenue-producing activities
 - ✓ Outcome of transactions and other events that enter into the determination of net profit or loss
 - ✓ Example : cash receipts from the sale of goods and the rendering of services
 - ✓ Example : Sale of scrap

Presentation of cash flow statement

➤ INVESTING ACTIVITIES

- ✓ Represent the extent to which expenditures have been made for resources intended to generate future income and cash flows
- ✓ Example : Purchase of fixed assets
- ✓ Example : Investment of cash in FD ??
- ✓ Example : Investment in Partnership business

Presentation of cash flow statement

➤ FINANCING ACTIVITIES

- ✓ Useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise
- ✓ Reflects movement through sources of finances
- ✓ Examples – Loans
- ✓ Examples – Stock option receipts
- ✓ Example – Interest (discuss)

Reporting requirements

- Report cash flows from operating activities using either
 - ❖ Direct method or,
 - ❖ Indirect method
- Report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities(Direct method only)

Direct method

- Direct method is essentially summary cash book
- The direct method provides information which may be useful in estimating future cash flows
- Cash flow using direct method requires reconciliation to income statement
- Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:
 - From the accounting records of the enterprise
 - From other financial as well as non financial data

Indirect method

- Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:
 - Changes during the period in inventories and operating receivables and payables
 - Non-cash items such as depreciation, provisions, deferred taxes, and unrealized foreign exchange gains and losses;
 - And all other items for which the cash effects are investing or financing cash flows

Reporting requirements

Some important aspect of reporting requirements

Gross vs net

- Normally items of cash flows are presented on gross basis and individually
- Cash flows on behalf of other entities, not reflecting the activities of the enterprise may be presented on net basis
- Cash flows for items whose:
 - turnover is quick
 - amount is large
 - Maturities are shortare presented on net basis

Gross vs net

- In case of financial enterprises :
 - Cash flows of deposits with fixed maturities
 - Cash flows from other financial enterprises
 - Cash flows for advances and loans made to customersare presented on net basis

Foreign currency cash flows

- Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow.
- The effect of changes in exchange rates on cash and cash equivalents held in a foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period.

Extra-ordinary items

- ✓ The cash flows associated with extraordinary items are disclosed separately as arising from operating, investing or financing activities in the cash flow statement, to enable users to understand their nature and effect on, the present and future cash flows of the enterprise.
- ✓ These disclosures are in addition to the separate disclosures of the nature and amount of extraordinary, items required by Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

Interest and dividend

- Disclosed separately
- General rules

	Financial enterprises	Other Enterprises
Interest paid	Operating	Financing
Interest received	Operating	Investing
Dividend paid	Financing	Financing
Dividend received	Operating	Investing

Taxes on income

- Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in a cash flow statement
- Taxes paid are usually classified as cash flows from operating activities
- When tax cash flow are allocated over more than one class of activity, the total amount of taxes paid is disclosed

Others

- Investments in Subsidiaries, Associates and Joint Ventures
- Acquisitions and disposals of subsidiaries and other Business Units

Non cash transactions

- Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an enterprise
- They are excluded from cash flow statement
- Examples of non-cash transactions are:
 - the acquisition of assets by assuming directly related liabilities;
 - the acquisition of an enterprise by means of issue of shares
 - the conversion of debt to equity

Components of cash and cash equivalents

- An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.
- Disclosure of accounting policy

Disclosures

- Significant cash and cash equivalent not available for use with reasons thereof
- Any other disclosure relevant to understand the cash flows, liquidity position etc of the enterprise

Regulatory requirements – Companies Act

- Financial statement have been defined to include cash flow under the Act
- Companies Act exempts preparation of cash flow statement for One-man company , Dormant company and Small company
- Small companies are:
 - Not a public company
 - Turnover < Rs.2crore
 - Paid up capital < Rs.50lacs
 - A company governed under any special Act.

Regulatory requirements – Accounting standard

- The standard that deals with preparation and presentation of cash flow is Accounting Standard – 3 “Cash Flow Statement” [Ind AS 7 – “Statement on Cash Flows”]
- These standards are notified by ICAI and have been provided legal support under the Companies Act, 2013 (as well as Companies Act, 1956)

AS 3 vis-à-vis Companies Act

- AS 3 is applicable to all entities other than SME as per AS.
- SME is defined:
 - Turnover < Rs.50 crore
 - Borrowing < Rs 10 crores
 - Equity/debt not listed
 - Not as holding/subsidiary of non SMC
 - Not a banking , insurance, FI.
- Till AS3 and a Companies Act are aligned, there would be compliance issues for both
- A company having borrowing > Rs 10 crores, but small company under the Companies Act, 2013 will prepare cash flow statement.
- In case of conflict, Companies Act would prevail
- Format of cash flow not prescribed under Companies Act 2013.



Thank you