

Financial Accounting
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Lecture – 18
Cash Flow Statement 5

Namaste. In the last session, we were discussing case number 2 of Cash Flow Statement. Those of who have missed it, I will request you to see the session, also take the printout of the case which we were solving. We were half way through so, we will continue from there, but just we will look at the case once again.


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Case 2.

Prepare cash flow statement from the following details of Keshav Ltd.

Profit and Loss A/c for the year ending 31 March 2020 is as follows

Sales	90000
Profit on sale of investment	2000
Revenue from Services	6000
Total	98000

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So, this is a we are asked to prepare cash flow statement for Keshav Limited. Now, profit or loss account for March 2020 was given ok.

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Total	98000
Consumption of Materials	40000
Manufacturing Expenses	17000
Wages	1400
Depreciation	5000
General Expenses	3000
Discount on issue of debenture	3000
Tax	6000
Interim Dividend	5000
Profit Retained	17600



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Balance Sheet of Keshav Ltd

	2019	2020
Liabilities		
Share Capital	50000	50000
General Reserve	10000	10000
Profit and Loss A/c	8000	25600
Debentures	10000	27000
Creditors	16000	10000
Differed Tax Liability	7000	12000
	101000	134600



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Then, the balance sheet was given for last year and this year or opening balances and closing balances ok. So, this is liabilities, assets.

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	2019	2020
Assets		
Land	40000	40000
Equipment	21000	55600
Investment Long Term	5000	3000
Sundry Debtors	15000	14300
Bank	5000	6700
Goodwill	15000	15000
	101000	134600

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And, now based on this figure information we were asked to prepare cash flow statement. Now, as a process of preparing it as a working note what I had ask you to do was take every item of balance sheet then P and L mark the change and mark it as O, I or F.

Once that marking is done the rest of the work is very simple; actual preparation of cash flow. So, we have done marking last time just have a look once again.

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Cash Flow statement				
	2019	2020	change	OIF
Liabilities				
Share Capital	50000	50000	0	
General Reserve	10000	15000	0	
Profit and Loss A/c	8000	20600	17600	O
Debentures	10000	27000	17000	F
Creditors	16000	10000	-6000	CACL
Differed Tax Liability	7000	12000	5000	O
	101000	134600	33600	

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So, we started with balance sheet liabilities, these were the markings. So, profit and loss account was marked as O, debenture being a financing item F, creditors CACL, differed tax liability O.

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Cash Flow statement				
	2019	2020	Change	OIF
Assets				
Land	40000	40000	0	
Equipments	21000	55600	34600	I
Investment Long Term	5000	3000	-2000	I
Sundry Debtors	15000	14300	-700	CACL
Bank	5000	6700	1700	C
Goodwill	15000	15000	0	
	101000	134600	33600	

Assets, equipment and long term investments were I and sundry debtors CACL bank balance, this is a cash and cash equivalent item. So, it should be marked as C. It will not be shown as a flow in the cash flow statement.

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Keshav Ltd. Profit and Loss A/c for the year ending 31 March 2020 Marking relevant items

Sales	90000	No adj	
Profit on sale of investment	2000	IO	+-
Revenue from Services	6000	No adj	
Total	98000		

Now, P and L; P and L items like sales or revenue from services are not to be shown in cash flow. So, I have written here as no adjustment or you can say no item of cash flow. For items like profit on sale of investment there will be two adjustments.

Now, this is related to investment so, it is I, profit is there so, money is coming in so, it is plus. But, it has a second effect in O, keep in mind. O because it is already added in P and L we want to remove it from P and L. It is not regular day to day activity. So, we will reduce it from O that is why I have marked it as I and O and plus and minus ok. This plus and minus etcetera is not to be written in cash flow, but it will help us in making the cash flow, getting it?

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Total	98000		
Consumption of Materials	40000	NA	
Manufacturing Expenses	17000	NA	
Wages	1400	NA	
Depreciation	5000	O	+
General Expenses	8000	NA	
Discount on issue of debenture	3000	OF	+
Tax	6000	OO	+ -
Interim Dividend	5000	FO	- +
Profit Retained	17600	O	+

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Now, all these are expense items in P and L. So, day-to-day items like consumption, manufacturing, wages, general expenses are NA, but depreciation it is a non cash expense, so, O plus. Discount on issue of debentures OF plus taxation OO, because it will come under operating items twice plus and minus interim dividend FO plus and minus. If you have still not understood it please read it two three times. It is very important; once that is done remaining job is simple.

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Cash Flow statement	
Retained Earning	17600
Interim Dividend Paid	5000
Net Profit After Tax	22600
Taxes Provided	6000
Net Profit Before Tax	28600
Depreciation	5000
Discount on issue of Debentures	3000
Profit on sale of investment	(2000)
Funds From operation	34600

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Now, based on this we went for preparation of cash flow statement. The first part is operating activities. There is a specific format. So, please go through the format two three times. We calculate net profit after tax, net profit before tax and then do adjustments for certain items. Now to calculate NPAT we started with retained earnings, add interim, dividend, add taxes provided, we got NPBT, then depreciation and discount and debentures was added. Keep in mind, these are non-cash items they do not bring in cash, but because we do not pay cash for it we are adding it because it is a indirect method, then profit on sale of investment is to be reduced.

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Funds From operation	34600
Decrease in Sundry Debtors	700
Increase in Sundry Creditors	(6000)
Cash generated from operation BT	29300
Income Tax Paid (6-5)	(1000)
Net Cash flow from operating activities	28300
Cash Flow from Investing Activities	
Sale of Investment (2000+2000)	4000
Purchases of Equipment	(39600)

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So, we get fund from operations 34600, to these we will make adjustment for working capital items or CA and CL items. Now, sundry debtors had gone down reduction of sundry debtor means they have paid us money so, it is added. Creditors have also gone down. Now, to creditors for them to go down we pay them money. So, reduction in creditors is in bracket so, it is a outflow ok.

So, CA and CL is be tricky, keep track of it, I will once again just remind what I told you last time. For CL it is simple; addition to CL that is current liabilities also addition to cash reduction of CL is reduction of cash I think you keep that in mind ok. For even more simple you can remember that cash and CL have affection with each other, they will go together whereas, cash and CA are competing, they would go opposite just remember CL and its opposite movement is for current assets ok.

Now, after adjusting debtors and creditors we get cash generated from operations, but before tax. So, I am marked it as BT which is 29300. Now, the income tax paid is to be reduced that is 1000. Now, from where you got 1000? 1000 was not given anywhere, but we had two figures we will go to P and L. You can see here in P and L that taxes provided was 6000. Whether Actual payment has done or not, we do not know, but that much of tax were charged in P and L.

Of that we had to go to balance sheet now. If you see balance sheet in the liability there is a item called differed tax liability and it has increased from 7 to 12; that means, there is a increase of 5000 these are taxes provided, but not paid. Do you remember what is differed tax? As the name suggests differed means this is this times item, but to be paid later on any tax which is not to be paid in the current year if it is to be paid in current year it is called current tax. If it is not to be paid in current year, but can be paid after 2, 3, 4 years it is called as a differed tax.

Now, the differed tax liability has gone up by 5000 we have marked it has O. So, out of the total taxes of 6000 for the year as you can see from P and L, 5000 are differed; that means they would be paid later on. They are not to be paid now. So, 6 minus 5 remaining 1000 is paid in the current year. Are you getting me? Here I have shown in bracket 6 minus 5 or you can say 6000 minus 5000 so, it is 1000, getting it.

So, tax you have to keep in mind always it will come two times. First, tax provided will add on net profit after tax because this is charged in the year and what is actually paid is

to be deducted. That is why taxes are to be shown twice in the cash flow because what is provided is not paid it is to be added and what is actually paid is to be deducted because it represents outflow ok. And, government also wants to keep track on at provisions and actual payments; that is also one reason why in the format specifically these items are to be shown twice. You cannot show net effect, you have to add 6 and reduce 1. Getting it? So, this was the last item this gives us net cash flow from operating activities which is 28300 positive; that means, that much cash we have got from our normal business activities.

Now, this was bit complicated remaining is very simple. Next is cash flow from investing activities. Now, go to balance sheet, we had marked many items as I. So, just take those items I means investing and put them here. So, now we will go back to balance sheet. Balance sheet if you remember there was investment long term. It was marked as I minus 2000 minus means from 5000 it has gone down to 3000.

So, we have sold investment and we have received 2000, but we cannot directly write this 2000 in cash flow because there will be some profit or loss on sale of investment; getting it? So, these 2000 plus in P and L there was one item called as profit on sale of investment 2000; we had marketed it as I O plus minus. See, in I it is plus so, 2000 rupees is the cost of investment plus 2000 rupees of profit, total sale value is 4000. You were not given the sale value; we have to calculate the sale value. So, sale of investment 2000 plus 2000, 4000 is the inflow for the year. Getting it? Ok.

Next is purchase of equipment. If you go to balance sheet there was equipment 21000 increasing to 55600 so, 34600 of increase. We had marked it as I. This represents purchase; getting it? But, this may not be the actual amount of purchase. increased means there is which have been purchase but it is reducing because of depreciation. So, we have to consider both the effect of purchase and that is the addition and reduction due to depreciation and the net effect will be this 34600.

So, let us calculate the purchase amount, getting it? I have worked out 39600. How it is worked out, can you guess? See, the net effect is 34600 and if you go to P and L there was a depreciation of 5. So, 34 plus 5 you get 39600.

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Cash & Cash Equivalents	at Beginning	at End
Bank	5000	6700
Total	5000	6700

Equipment A/c			
Balance B/d	21000	Depreciation	5000
Cash/Bank A/c (purchases)	39600	Balance C/d	55600
	60600		60600

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I have also shown equipment account here. Those of who are familiar with ledger accounts have a look at the account. The opening balance was 21, closing balance was 55, reduction due to depreciation is 5. We don't know how much is a purchase. We only knows that there is a reduction overall increase of 34600 plus 5000; that means, there is a cash bank for purchase of 39600. So, either you make a account like I have made it here or you can make a working note, but arrive at this amount of 39600. It is in bracket because it is a minus, it is a reduction in cash flow; are you getting?

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Net cash flows from Investing Activities	(35600)
Cash Flow from Financing Activities	
Issue of Debentures (17-3)	14000
Interim Dividend Paid	(5000)
Net cash flows from Financing Activities	9000
Net increase in cash	1700
Cash & Cash Equivalents at the beginning	5000
Cash & Cash Equivalents at the end	6700

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So, two items in investing plus 4000 and minus 39600 net cash flow from investing activities 35600, are you getting? So, from operating there was an addition or positive figure of 28300 that is cash generated from operating activities. This is the cash invested in investing activities 35600 in minus.

Now, the third heading is financing activity. So, go to balance sheet look at F type of items ok. Balance sheet normally you have to go to liabilities because that is where you will get F items you can see there is only one item debenture 10000 was opening, 27 was closing, increase of 17 F. So, it represents what? A financing inflow, We issue debentures. So, we have got cash and we have given debentures; getting it? So, inflow is 17, but do not write 17 directly in cash flow because there could be some item in P and L.

If you remember in P and L there was one item called as discount on issue of debentures. We had marked it as OF plus, getting it? It is F because it is a financing item of 3000 it is related to issue of debenture; that means debentures of the face value of 17 are issued at discount. Company did not receive 17. Company received 17 minus 3 that is 14, that is your inflow of from debentures; getting it? So, I have written it here as issue of debentures 17 minus 3, 14000, got it?

So, only one item was there in the balance sheet, but there was one item in P and L, that is this interim dividend we had marked as FO minus plus. What is F? Because dividend is always a financing activity. We have issued shares and we are giving dividend to the shareholders during the same here it is given. So, it is called interim; that means, it is declared and paid. See the amount is 5000, that 5000 we added here in P operating and we will reduce it in financing, got it? So, in financing there are only two items issue of debentures and interim dividend paid plus 14 minus 5. So, net cash flow from financing activities 9.

So, you have got all the three headings now, 28300 plus minus 35600 plus 9000. So, net increase in cash this is a total of O plus I plus F that is 1700, are you getting it? Now, this can be cross checked with the balances in the balance sheet. So, to this we add cash and cash equivalents at the beginning which is 5000 cash and cash equivalents at the end are 6700. So, has it tallied?

Now, from where we got this 5 and 6700, we will go back to balance sheet. See there is a item in balance sheet, bank, which we had marked as C and we had discussed that this 1700 is not inflow or outflow. This is the change of balance; in fact, we are calculating whole cash flow statement to see whether our total matches with the changes in the cash flow statement in the cash and cash equivalent. So, all other changes together was 1700. It matches with the change in the bank; that means our statement is correct. It is tallying; are you getting? So, 1700 plus 5000 you get 6700.

Now, there is something more also. Now, go to cash and cash equivalent we have to make a reconciliation statement. Show the cash and cash equivalent at the beginning and at the end. Here we have only one. This problem only has one item, but sometime there can be two, three items of cash and cash equivalent. So, show them take the total; so, bank opening 5, closing 6700 the total is same 5 and 6700 and equipment was a working note.

So, for the whole cash flow statement as for the format start with operating item, show them here, then go for investing, go for financing, add opening, less closing and also show the reconciliation of cashless of cash and cash equivalent then our cash flow statement is over; is it clear?

Now, also we would discuss just a bit from the financing angle. What are your comments? Is it a good cash flow statement for the company? Does it represent sound and well running company? What do you feel from these three totals? Operating activities is a positive figure, is it a good sign? Of course, yes, we are getting cash, what is bad in it. We are able to generate 28300 from our normal business. You can see here. This is a very good sign. This shows the strength of business. Now, we have a negative cash flow in investing; is it a good sign? We are giving cash. cash is going out, is it a good sign? Some may fail it is not good sign our cash is going outside, but actually it is a positive sign because unless we make investment how will business grow.

So, you can see here company is generating cash 28300 and they are investing in purchase of new equipment. So, if you want a healthy growth of the company, company has to continuously make investments in new equipment, new software, new technology or at least in new investments. So, you can see here they have sold some of the old investments at profit which is also good sign and all that money they have put in the new

equipments that would give them coming years it will be good for generating more profits and more cash flows.

So, keep in mind negative cash flow of investing activities not bad. In fact, that should be negative if it is positive; that means, you are selling your existing asset which may not be good. It is good if new assets are getting created. So, negative cash flow in investing activities healthy. Next is financing. Financing is plus 9000, is it good? Should be Positive negative? Actually both is fine in financing because sometimes it will be negative because of payments of dividend like here they have paid 5000 shareholder should get some money. So, is it is a positive sign, but company has to grow.

So, you can see here they have raised some new money by the way of debentures. That 14000 is used to finance the purchase of investment partly. Partly it has come from the operating flows and partly from this. So, no problem this 9000 can be either or positive or negative it is a healthy sign, overall looking at the and also look at the cash and cash equivalents at the beginning and end it also shows a good sign. If you have too much of cash it is not good, if you have too little cash not even the money to pay regular activities that is also not sound. So, you can see here company has slightly increased their balances, but not too much of cash not too less of cash.

So, overall from the cash flow statement I am not looking at P and L and balance sheet. We will later on discuss the ratios and how to analyze the segments, but just by looking at the cash flow which we have made overall comments if you make we can say that it is a healthy sign. They have generated a positive cash flow from operations, they have invested during the year so, negative cash flow from investing and a small positive from financing. So, company as a healthy cash policy they are able to have a good cash flow from operations. So, I hope you have over all understood cash flow statement.

Now, we have already discussed balance sheet first, then we discussed P and L, today we have also discuss cash flow. I hope now the basic financial statements are clear to you. In coming sessions we will discuss some conceptual and theoretical aspects, like corporate governance, like ethical part of accounting or like how was the accounting evolved, how are the entries recorded. And, in last part of our course, in last 4-5 sessions we will again go back to financial statements wherein we will go for preparation of balance sheet, P and L and cash flow and we will also try to analyze them by way of ratios.

But, to do all that you need to do a lot of homework. Now, that you have understood all the three statements please read the statements of various companies, at least of your company and also try to prepare simple P and Ls and balance sheets and maybe after one or two weeks we will go for preparation of some more statements ok.

Thank you so much. Namaste.