Cash Flow Statement and Fund Flow Statement

(A) Cash Flow Statement

Cash flow statement spells out information of company with respect to changes in position of cash and cash equivalents. It helps the company to formulate corporate strategies and plan investments for future. It essentially describes the usage and sources of cash flow generation for the business.

Cash comprises cash on hand and demand deposits with banks.
Cash equivalents are short term, highly liquid investments that are readily convertible into known amount of cash and which are subject to insignificant risks of changes in value.
Operating activities – Revenue generating activities of the enterprise and other activities that are not investing or financing activities.
Investing activities – Acquisition and disposal of long term assets and other investments not included in cash equivalents.
Financing activities- Result in changes in the size and composition of owners' capital (including preference share capital) and borrowings.

Components of Cash flow Statement

Cash from Operating Activities

- Cash receipts from sale of goods and rendering of services
- Cash receipts from royalties, fees commissions and other revenue.
- Cash payments to suppliers for goods and services
- Cash payments to and on behalf of employees
- Cash payments or refund of income tax

Cash from Investing Activities

- Cash payments to acquire fixed assets (including intangibles)
- Cash receipts from sale of fixed assets (including intangibles)
- Cash payments to purchase investments (other than cash equivalents)
- Cash receipts from sale of investments (other than cash equivalents)
- Cash advances and loans made to third parties.
- Cash receipts from loans extended to third parties. (Other than loans given by bank)
- Interest and dividend received

Cash from Financing Activities

- Cash proceeds from issue of shares – equity and preference
- Cash proceeds from issue of debentures, bonds and any other borrowings
- Cash repayment (interest and installment) of amount borrowed
- Dividend paid.

Transaction	**Impact**	**Adjustment**
Decrease in Current Assets	Cash inflow	Add
Increase in Current Liabilities	Cash inflow	Add

Decrease in Current Liabilities	Cash outflow	Less
Increase in Current Assets	Cash outflow	Less

Steps in preparing cash flow statement

- Calculate cash flow from operating activities
- Analyze changes in non-current assets and non-current liabilities to find inflow or outflow of cash not related to operating activities
- Compute cash flows from investing activities and financing activities
- Prepare cash flow statement.

Points to Remember:

1) Cash flow statement measures actual inflow and outflow of cash. It does not consider any accruals.

2) Cash flow is calculated by **adjusting the net profit** by adding and/ or subtracting certain items that are non-cash in nature. Depreciation, although, an operating expense, does not involve any cash outflow. **The amount of depreciation needs to be added back to net profit to arrive at cash flow.**

3) When Profit & Loss account is separately given, then calculate profit before tax directly. When Profit & Loss account is not separately provided, then opening and closing balance of P& L from the Balance Sheet must be considered for computing Profit before tax.

Particulars	Amt (Rs)	Amt (Rs)
Cash flows from operating activities		
Net Profit Before Tax		
Add: Non-cash & non-operating expenses		
Depreciation		
Loss on sale of fixed assets		
Loss on sale of investments		
Goodwill Written Off		
Preliminary expenses Written Off		
Interest Paid		
Less: Non-cash & non-operating incomes		
Profit on sale of fixed assets		
Profit on sale of investments		
Interest received		
Dividend received		
Operating Profit before working capital changes		
Add: Decrease in working capital		
Less: Increase in working capital		
Less: Income Tax paid		
Net cash flow from operating activities		
Cash flows from investing activities		
Purchase of fixed assets & investments		
Sale of fixed assets & investments		
Interest received		
Dividend received		
Net cash flows from investing activities		
Cash flows from financing activities		
Proceeds from issue of shares		
Proceeds from issue of debentures		
Proceeds from long term borrowings		
Proceeds from short term borrowings		
Redemption of preference shares		
Redemption of debentures		
Interest paid		
Dividend paid		
Net cash flows from financing activities		
Net increase/ decrease in cash & cash equivalents		
Cash & cash equivalents at beginning of the year		
Cash & cash equivalents at end of the year		

In case of <u>net profit before tax</u> is not readily available then it can be worked out as under:

Particulars	*Amt (Rs)*	*Amt (Rs)*
P&L A/c balance as per Balance Sheet at the end of the year		
Less: P&L A/c balance as per balance sheet at the beginning of the year		
<u>Add: Appropriations</u>		
Proposed Dividends		
Transfer to various reserves		
Net Profit After Tax		
Add: Provision for Tax		
Net Profit Before Tax		

Problems

<u>Problem 1:</u>

Following are balance sheets of Pioneer Ltd. Prepare statement of cash flow on the basis of the given details-

Liabilities	**31-Mar-01**	**31-Mar-02**
Equity Capital	1,500,000	2,500,000
5% Preference Capital	1,500,000	1,000,000
General Reserve	200,000	300,000
Capital Reserve	-	250,000
Profit & Loss Account	180,000	270,000
Sundry Creditors	260,000	530,000
Bills Payable	180,000	120,000
Provision for taxation	280,000	320,000
Proposed Dividend	270,000	330,000
Total	**4,370,000**	**5,620,000**
<u>Assets</u>		
Goodwill	600,000	470,000
Land & Building	1,000,000	750,000
Plant & Machinery	900,000	1,910,000
Trade Investments	100,000	350,000
Stock	850,000	780,000
Sundry debtors	600,000	900,000
Bills Receivable	150,000	180,000
Cash at bank	100,000	220,000
Cash in hand	70,000	60,000
Total	**4,370,000**	**5,620,000**

<u>Additional Information-</u>

Rs 1,80,000 has been charged as depreciation on plant & machinery. A piece of land has been sold and profit out of this sale has been transferred to Capital Reserve. A machinery was sold for Rs 1,20,000 (WDV Rs 1,50,000). An interim dividend of Rs 1,00,000 has been paid in the year 2002.

Problem 2:

Draft Cash Flow Statement on the basis of following details. Balance Sheets of Moonlight Ltd are given as under:

Liabilities	2001	2002	Assets	2001	2002
Share Capital	420,000	1,000,000	Net Block of assets	800,000	1,800,000
Securities Premium	280,000	400,000	Investments	280,000	400,000
Reserves & Surplus	758,000	1,005,000	Cash	750,000	525,000
Debentures	900,000	750,000	Debtors	375,000	310,000
Creditors	229,000	210,000	Stock	692,000	785,000
Bank Borrowings	112,000	120,000	Prepaid expenses	18,000	15,000
Outstanding expenses	36,000	50,000			
Provision for tax	180,000	300,000			
	2,915,000	**3,835,000**		**2,915,000**	**3,835,000**

Income Statement for 2002	**Amt (Rs)**
Sales	3,400,000
Cost of Goods Sold	1,920,000
Gross Profit	1,480,000
Operating Expenses	640,000
Depreciation	140,000
Interest Expense	60,000
Profit Before Taxes	640,000
Income Tax	293,000
Net Profit	347,000
Dividend	100,000
Balance carried to B/S	**247,000**

Problem 3- Prepare cash flow statement of Acme Engineering Ltd from foll. Information

	2001	2002		2001	2002
Shareholders` Funds			Fixed Assets		
Share Capital	75,000	145,000	Land & Building	100,000	150,000
Securities Premium	7,500	12,500	Machinery	200,000	220,000
Reserves & Surplus	17,500	62,500	Less: Accumulated Depreciation	80,000	82,000
Long term liabilities			Net Fixed Assets	120,000	138,000
Institutional Loans	15,000	23,000	Current Assets		
Debentures	150,000	150,000	Cash	50,000	70,000
Current Liabilities			Debtors	45,000	40,000
Creditors	30,000	25,000	Inventory	90,000	125,000
Salaries Payable	10,000	15,000			
Provision for tax	60,000	50,000			
Provision for dividend	40,000	40,000			
	405,000	**523,000**		**405,000**	**523,000**

Income Statement for the year ended March 31, 2002.

	Rs	Rs
Sales		500,000
Less: Cost of goods sold		210,000
Gross Profit		**290,000**
Less: Operating expenses		
Administrative cost	45,000	
Marketing cost	25,000	
Interest	12,000	
Depreciation	22,000	104,000
Operating Profit		**186,000**
Add: Profit on sale of plant & machinery		6,000
Profit Before Tax		**192,000**
Less: Provision for tax		87,000
Profit After Tax		**105,000**

- During the year plant costing Rs 50,000 (accumulated depreciation Rs 20,000) was sold.
- The company declared cash dividend of Rs 40,000 and bonus shares of Rs 20,000
- It also issued 5,000 additional shares of Rs 10 each at premium of Re 1 per share.

(B) Fund Flow Statement

Fund flow statement reflects the changes in position of working capital of the company. The statement is prepared to determine the sources and uses of working capital between two balance sheet dates. Working capital determines the liquidity of the business.

Working capital flow arises when the net effect of a transaction leads to increase or decrease working capital. The concept of working capital flow is –

- Net working capital **increases or decreases** when a transaction involves a c**urrent account and non-current account**.
- Net working capital remains **unaffected** when a transaction involves **only** c**urrent account.**
- Net working capital remains **unaffected** when a transaction involves **only non-current account.**

Sources and Uses of Working Capital

Sources of Working Capital

- Funds from operations (Adjusted Net Profit)
- Sale of fixed (non-current) assets
- Long term borrowings
- Issue of equity and preference shares
- Short term financing like bank borrowings

Uses of Working Capital

- Funds lost from operations (Adjusted Net Loss)
- Purchase of fixed (non-current) assets
- Repayment of long term debt
- Redemption of preference shares
- Payment of cash dividends.

Concept of Funds from Operations

The profit & loss account comprises transactions, which do not impact working capital position of the company. Therefore, while arriving at working capital generated through operations, the figure of net profit must be adjusted. Any expenses or losses that do not involve working capital must be added back to net profit. Any gains from sale of non-current assets must be deducted from net profit. Sale of non-current asset is shown as source of working capital. If there is loss from operations, it consumes the firm's working capital.

Funds from Operations

Net Profit as per P& L Account Add: **Expenses /losses not impacting working capital** **Depreciation** Goodwill written off Loss on sale of fixed assets Less: **Non –operating & non-cash incomes** Profit on sale of fixed assets Profit on sale of investments Dividend and interest received on investments **Working capital (funds) from operations……….**	

Steps in preparing fund flow statement

1. Prepare Schedule of Changes in Working Capital
2. Compute funds from operations
3. Prepare fund flow statement.

Format of Fund Flow Statement	
Sources of Funds	Rs
Funds from Operations	
Sale of Fixed Assets	
Sale of Investments	
Income from investments	
Extra-ordinary receipts	
Issue of shares	
Issue of debentures	
Borrowings from Banks/ financial Institutions	
Receipt of public deposits from unsecured loans	
Decrease in working capital	
Total	
Applications of Funds	
Redemption of preference shares	
Redemption of debentures	
Purchase of investments	
Repayment of bank loans	
Payment of dividend	
Payment of tax	
Increase in working capital	
Total	

Schedule of Changes in working Capital

Particulars	Previous Year	Current Year	Increase	Decrease
1. Current Assets				
Inventory				
Debtors				
Cash/ bank				
Incomes receivable/accrued				
Loans And Advances				
Marketable securities				
Total				
2. Current Liabilities				
Creditors				
Outstanding Expenses				
Bank Overdraft				
Short term loans				
Proposed Dividends				
Provision for doubtful debts				
Total				
Increase/ Decrease in Working Capital				

Key Parameters to analyze fund flow statement

- Reasons of increase in carry of various items of inventory, which is disproportionate to percentage rise in sales, should be ascertained and explained. In case the increase in working capital gap is not commensurate with the increase in net sales, the position should be ascertained and explained.
- The projected funds flow would represent company's intentions about the use of funds. Any variance in actual and projections should be studied.
- It is often useful to prepare funds flow statement for shorter periods or over annual dates other than the fiscal year of the enterprise. This will ensure greater and stricter control over the use of funds and any wrong flow into areas unwanted can be detected much earlier.

Problem 1: Draft fund flow Statement on the basis of following details. Balance Sheets of Moonlight Ltd are given as under:

Liabilities	2001	2002	Assets	2001	2002
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Income Statement for 2002	Amt (Rs)
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Balance carried to B/S	**247,000**

Problem 2: From the data given below, prepare fund flow statement of Sunlight Ltd.

Liabilities	2006	2007	Assets	2006	2007
Share Capital	1,000,000	1,000,000	Land	100,000	100,000
Reserves & Surplus	117,500	260,000	Building	375000	450000
Loans	250,000	225,000	Less: Depreciation	60000	90000
Creditors	165,000	200,000		315000	360000
Outstanding expenses	17,500	22,500	Machinery	125000	200000
			Less: Depreciation	15000	37500
				110000	162500
			Long term investments	250000	150000
			Stock	160000	200000
			Debtors	390000	435000
			Cash	225000	300000
	1,550,000	**1,707,500**		**1,550,000**	**1,707,500**

1. Net Profit for the year 2007 is Rs 2,75,000. Machinery costing Rs 25,000 on which depreciation of Rs 5,000 has accumulated was sold at profit of Rs 10,000. Such profit being included in the net profit as given in point (a).
2. Investments costing Rs 1,00,000 were sold during the year for Rs 1,25,000. The same is included in net profit.
3. Cash dividend paid during the year is Rs 1,32,500.
4. Depreciation on machinery is Rs 27,500 and on building is Rs 30,000.