Cash Flow Statement

Introduction to Cash Flow Statement, Objectives and Limitations

Objective

After going through this lesson, you shall be able to understand the following concepts.

- Meaning of Cash Flow Statement
- Objectives of Cash Flow Statement
- Uses of Cash Flow Statement
- Limitations of Cash Flow Statement
- Some Important Terms Used in Cash Flow Statement

Meaning of Cash Flow Statement

Every business organisation needs sufficient cash for smooth working of normal business operations. Some of the normal business activities are cash payments to suppliers, payments of rent, wages, salaries, interest, etc. Besides these there are various day-to-day expenses that a business organisation has to meet such as freight, commission, etc. On the other hand, a business organisation also receives cash in form of payments received from sale of goods and services, cash received from debtors, repayment of loan by outsiders, interest on loan given to other institutions, debentures of other organisations, etc. Thus, we can say that there exists a continuos flow of cash into the business and a simultaneous flow of cash out of the business. The flow of cash into in a business is termed as cash inflows and flow of cash from the business is termed as cash outflows.

Cash Flow Statement records the inflows and outflows of cash and cash equivalents during a particular period. This statement is prepared to know how the cash and cash equivalents are used in the business. All the Listed Companies are compulsorily required to prepare the Cash Flow Statement as per the Revised Accounting Standard- 3 (AS-3) along with their Financial Statements. According to the AS-3, Cash Flow Statement is bifurcated into three main heads.

I. Cash Flow from Operating Activities
II. Cash Flow from Investing Activities
III. Cash Flow from Financing Activities

Objectives of Cash Flow Statement

The important objectives for preparing Cash Flow Statement are as follows.

i. The foremost objective to prepare Cash Flow Statement is to ascertain gross inflows and outflows of cash and cash equivalents from various activities of a business.
ii. Secondly, this statement helps in analysing various reasons responsible for change in the balances of cash and cash equivalents during an accounting year.
iii. This statement also helps the accounting users (such as creditors and the investors) to analyse and interpret the financial vitality and solvency of a company.
iv. Lastly, it facilitates the financial managers to ascertain the requirement and availability of cash in the near future.

Uses or Advantages of Cash Flow Statement

The important advantages of Cash Flow Statement are enlisted below.

1. ***Short-term Financial Planning***- This statement is very advantageous for short-term financial planning. It helps in assessing and forecasting the sources and utilisation of cash and cash equivalents during a particular period.

2. ***Reasons for Change in Cash Position***- It is possible that sometimes a company may have surplus cash even in case of lower profits or deficiency of cash in spite of higher profits. In such a situation, Cash Flow Statement helps in analysing the reason for the such change in the balances of cash and cash equivalents.

3. ***Liquidity and Solvency Position***- Cash Flow Statement helps in determining and assessing the liquidity and solvency position of the firm.

4. ***Trend of Cash Receipts and Payments***- This statement enables analysing and studying the trends of cash receipts and payments from various activities of a company. This in turn, helps the management in drafting various policy measures and short-term plans.

5. ***Segregation of Cash Flows***- As this statement segregates the cash flows from the various activities *viz*. operating activities, investing activities and financing activities, so it becomes very easy to identify cash flows from each activities separately.

6. ***Dividend Decision***- The Cash Flow Statement also reveals the position of cash (cash balance) with an enterprise at the end of a particular period. This helps the enterprise to take decisions regarding the payment of dividend with reference to the availability of cash.

7. ***Comparative Study***- This statement enables to conduct a meaningful comparison of previous years' cash flows with the anticipated cash flows of the current year. This helps in putting various cost controlling measures and checks in case of deviation from the planned targets.

Limitations of Cash Flow Statement

After going through the advantages and uses of Cash Flow Statement, we know that this statement is an useful tool for analysing financial position, but it lacks on the following fronts.

1. ***Ignores Accrual Concept***- As the Cash Flow Statement is prepared on the cash basis, so it ignores accrual concept. That is, transactions are taken into consideration only when the settlement takes place. that This statement records the transactions only when settlement takes place.

2. ***Ignores Non-Cash Transactions***- Cash flow statement records only cash inflows and cash outflows. In other words, it does not records the non-cash transactions such as issue of bonus shares, conversion debenture into shares, etc. This fact limits this statement to reveal the true financial position of an enterprise.

3. ***Non-Substitute of Income Statement***- As stated in the above point that Cash Flow Statement considers on the cash transactions, however, Income Statements reveal both that is cash as well as non-cash transactions. Thus, Cash Flow Statement cannot be regarded as a substitute of Income Statements, thereby, does not represent the net income of a business.

4. ***Complementary in Nature***- Cash Flow Statement is complementary in nature in a sense that it has limited use in isolation without the financial statements. This is to say that it adds value to the financial statements but on its own, it is incomplete and fails to reveals the financial picture holistically.

5. ***Fails to Reveal True Liquidity Position***- The true and actual liquidity position of an organisation cannot be judged merely by the Cash Flow Statement. This is because this statement reveals only the cash position of a business, while ignoring the assets such as fixed assets and current assets. Think of a situation, where all the assets of a business are sold, then there will be high cash inflows (because of sale proceeds) and the Cash Flow Statement will indicate favourable conditions, but ironically this is not the situation!!

Some Important Terms Used in Cash Flow Statement

1. ***Cash***- It consists of cash in hand and demand deposits with banks.

2. ***Cash Equivalents***- These are short-term highly liquid investments that are easily convertible into cash and which are subject to an insignificant risk of change in value. In other words, cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or any other purpose. An investment held for short-term maturity say three months, can be regarded as cash equivalent. Some example of cash equivalents are treasury bills, commercial papers, etc.

3. ***Cash Flows***- Cash flows refer to the movement of cash in and out of the business. Cash flows can be either inflows or outflows of cash and cash equivalents. A cash inflow implies receipt of cash by the business and cash outflow implies the payment of cash by the business. Cash inflows result in increase in the total cash balance and cash outflows result in decrease in the total cash balance.

4. ***Operating Activities***- These activities are the main or principal revenue generating activities (such as sale and purchase of goods and services) of an organisation.

5. ***Investing Activities***- These activities basically involve sale and purchase of long-term investments and fixed assets. Long-term assets are the assets which are not meant for resale and are used for comparatively long period of time.

6. ***Financing Activities***- These are the activities which result due to changes in the composition and size of the capital structure and borrowings of an organisation.

Exercise

Read each of the following transaction carefully and sate with reason whether the transaction would (a) Increase, (b) Decrease or (c) No change in Cash and Cash Equivalents.

i. Cash Rs 20,000 deposited into bank
ii. Depreciation on Machinery Rs 5,000
iii. Treasury bill Rs 3,000 matured
iv. Payment of Rs 15,000 made to supplies of goods
v. Interest Rs 200 received on Investment
vi. Dividend Rs 3,000 declared and paid
vii. Profit of Rs 3,000 on sale of investment
viii. Loss on sale of Machinery Rs 1,600
ix. Bill Receivable Rs 1,200 honored at maturity
x. Debtors Rs 600 proved bad.

Solution

Transaction	Answer	Reason
i.	*No change*	Cash and Bank balance together are termed as cash equivalents. This transaction will not result in any change in the total balance of cash and cash equivalents
ii.	*No change*	Because depreciation is a non-cash transaction
iii.	*No change*	Treasury bills (T-bills) are considered as short-term investments with maturity of less than 3 months. Such investments are classified under cash and cash equivalents. At the time of maturity of T-bills, the balance of cash and cash equivalents increases (due to inflow of cash) and decrease (due to the maturity of T-bills) by the same amount, so the net effect is zero. Therefore, there is no change on the balance of cash and cash equivalents on the maturity of T-bills.
iv.	*Decrease*	Payment to the suppliers of goods will reduced the cash balance as supplier is paid in cash/cheque.
v.	*Increase*	Because interest is received in cash.
vi.	*Decrease*	Payment of dividend will result decrease in cash balance
vii.	*No change*	Profit on sale of investment is nominal account transaction while Cash and cash equivalents are treated as real account.
viii.	*No change*	Loss on sale affect the Profit and loss, does not affect the cash and cash equivalents.
ix.	*Increase*	This transaction will result in inflow of cash balance.
x.	*No change*	Bad debt is considered as non-cash transaction, so there would not be any change in the balance of cash and cash equivalents.

Classification of Cash Flows

Objective

After going through this lesson, you shall be able to understand the following concepts related to Cash Flow Statement.

- Cash Flow from Operating Activities
- Cash Flow from Investing Activities
- Cash Flow from Financing Activities

Introduction

In the previous lesson, we learnt that Cash Flow Statement records all the inflows and outflows of cash and cash equivalents during a accounting period for a business enterprises. We also know that with the help of this statement, the accounting users can assess how the cash and cash equivalents are used in the business. Accounting Standard-3 (AS-3) mandates the preparation of Cash Flow Statement along with the Financial Statements by all the Listed Companies for each accounting period. AS-3 specifies the classification of all types of cash inflows and outflows mainly under the following three types of activities.

I. Cash Flow from Operating Activities
II. Cash Flow from Investing Activities
III. Cash Flow from Financing Activities

Cash Flow from Operating Activities

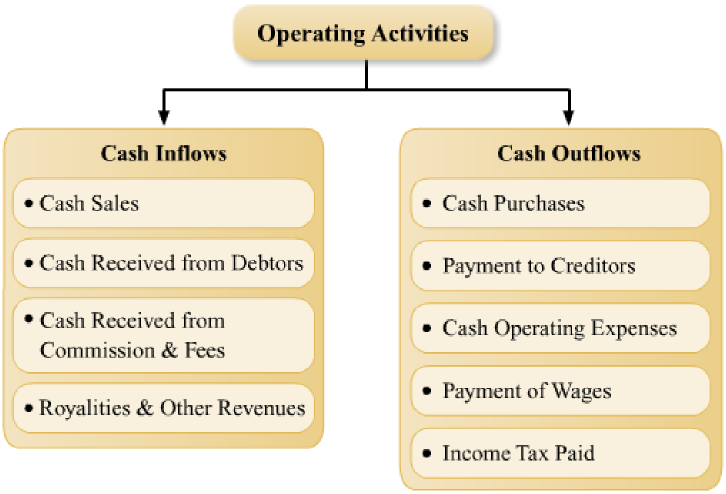
Operating activities are the core or principal revenue generating activities of an enterprise. The cash flows from the operating activities imply the inflows or outflows of cash and cash equivalents due to the core or principal revenue generating activities of an enterprise. The core revenue generating activities are the basic activities such as purchase of raw materials and sale of produced outputs. For example, the principal business activity of a furniture producing company is to purchase of woods, raw materials and sale of finished furniture. The following are the major cash inflows and cash outflows from operating activities of a business enterprise.

Cash Inflows from Operating Activities

a. Cash *receipts* from the sale of goods and rendering of services.
b. Cash *receipts* from royalties, commissions, fees and other revenues.
c. Cash *receipts* from the future contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.
d. Cash *receipts* from an insurance enterprise for premiums and claims, annuities and other policy benefits.
e. *Refunds* of income taxes (unless specifically mentioned to be identified with financing and investing activities).

Cash Outflows from Operating Activities

a. Cash *payments* to the suppliers of goods and services.
b. Cash *payments* to and on behalf of employees.
c. Cash *payments* to an insurance enterprise for premiums and claims, annuities and other policy benefits.
d. Cash *payments* of income taxes (unless specifically mentioned to be identified with financing and investing activities).
e. Cash *payments* relating to future contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.



Cash Flow from Investing Activities

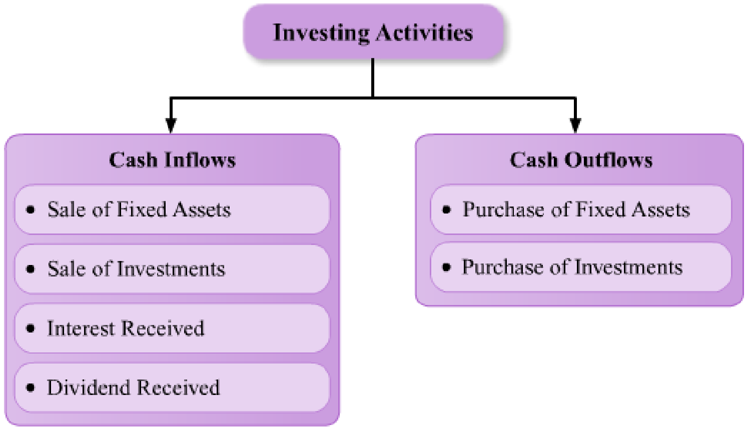
Investing activities are those activities that are related to the sales and purchases of long-term fixed assets such as land and building, plant and machinery, furniture, etc. Such fixed assets are not held for resale and are used for comparatively long period of time. The investing activities are the peripheral activities are not similar to the core business or operating activities. Investing activities also include any income arising from sale and purchase of investments in other companies (or assets) such as rent received from leasing fixed assets. As per the AS-3, the major cash inflows and outflows from investing activities are enlisted below.

Cash Inflows from Investing Activities

a. Cash *receipts* from sale/disposal of fixed assets (including intangible assets such as goodwill).
b. Cash *receipts* from sale/disposal of shares, warrants or debt instruments of other enterprises and interest from joint ventures (other than receipts from those instruments considered to be cash equivalents and are held for the trading purposes).
c. Cash *receipts* from repayment of advances and loans made to third parties (other than advances and loans made of financial enterprise)
d. Cash *receipts* from insurance company for any property involved in accident.
e. Any income arising from fixed assets or investments such as interest, dividends, rent received by leasing assets, etc. *In case of financial enterprises interest and dividend is treated as operating activities.*

Cash Outflows from Investing Activities

a. Cash *payments* to acquire shares, warrants, or debt instruments of other enterprises and interest in joint ventures (other than payments of those instruments considered to be cash equivalents and are held for the trading purposes).
b. Cash *payments* to acquire fixed assets (including intangible assets such as goodwill). These payments also include capitalised cost of research and development and self constructed fixed assets.
c. Cash loans *made/given* to the third parties (other than advances and loans made by financial enterprise).



Cash Flow from Financing Activities

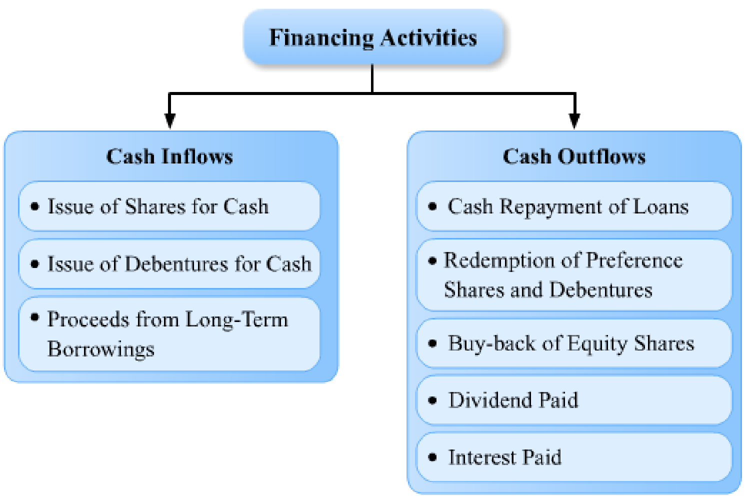
Financing activities are those activities that are related to capital or long term funds of an enterprise. These activities results in the change in the capital and borrowed funds.

Cash Inflows from Financing Activities

a. Cash proceeds from issue of shares and other similar instruments.
b. Cash proceeds from issue of debentures, loans, notes, bonds, and other short and long-term borrowings.

Cash Outflows from Financing Activities

a. Cash repayments of the amount borrowed in form of debentures, loans, notes bonds, and other short and long-term borrowings.
b. Buy-back of shares and debentures.
c. Interest paid on debentures, loans, and advances.
d. Dividend paid to the preference shareholders and equity shareholders.



Note:- An important point that should be understood before categorising various activities as operating, investing and financing is the *nature of the business enterprise.* For classification of activities, normally all business organisations are classified as financial or non-financial enterprises. The financial enterprises basically deal in lending and borrowing funds such as advancing loans, accepting deposits from the general public, etc. These enterprises are also termed as financial intermediaries such as banks, LIC, etc. The non-financial enterprises primarily deal in areas other finance. ***For the financial enterprises, the opertaing activities comprise of accepting deposits and forwarding loans, whereas, for the non-financial enterprises, such activities are considered as investing and financing activities.***

Example: Fill in the blanks. Name the type of activity and also state the appropriate reason.

S. No.	Transactions	Activity Name	Cash Flows	Reasons
1.	Dividend paid	______	______	Paid dividend to the shareholders
2.	Interest	______	Outflow	______
3.	Cash Sales	Operating	______	______
4.	Machinery	______	Inflow	______
5.	Shares	Investing	Inflow	______
6.	Income Tax	Operating	______	______
7.	Issue of Bonus Shares	______	No Cash flow	______
8.	Purchase of Goods	______	______	Expenditure incurred to generate revenue from operation
9.	Cash paid into bank	Cash and cash equivalents	______	______
10.	Debentures issued	______	______	Funds raised via issuing debentures

Solution

S. No.	Transactions	Activity Name	Cash Flows	Reasons
1.	Dividend paid	Financing Activity	Outflow	Paid dividend to the shareholders
2.	Interest	Financing Activity	Outflow	Claim of funds providers
3.	Cash Sales	Operating Activity	Inflow	Principal revenue
4.	Machinery	Investing Activity	Inflow	Sale of fixed assets
5.	Shares	Investing Activity	Inflow	Purchased of shares as investment
6.	Income Tax	Operating Activity	Outflows	Tax paid on income from main operations
7.	Issue of Bonus Shares	Cannot be considered as operating, investing and financing activity	No Cash flow	As bonus shares are issued without any consideration
8.	Purchase of Goods	Operating Activity	Outflow	Expenditure incurred to generate revenue from operation
9.	Cash paid into bank	Cash and cash equivalents	No flow	No change in cash equivalents
10.	Debentures	Financing Activity	Inflow	Funds raised via issuing debentures

Format and Steps to prepare Cash Flow Statement

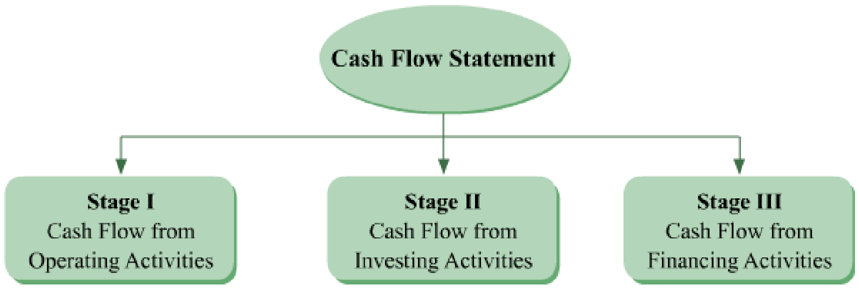
Objective

After going through this lesson, you shall be able to understand the following concepts.

- Steps to Prepare Cash Flow Statement
- Appendix- Some Important Terms and Definitions
- Format of Cash Flow Statement
- Extraordinary Items

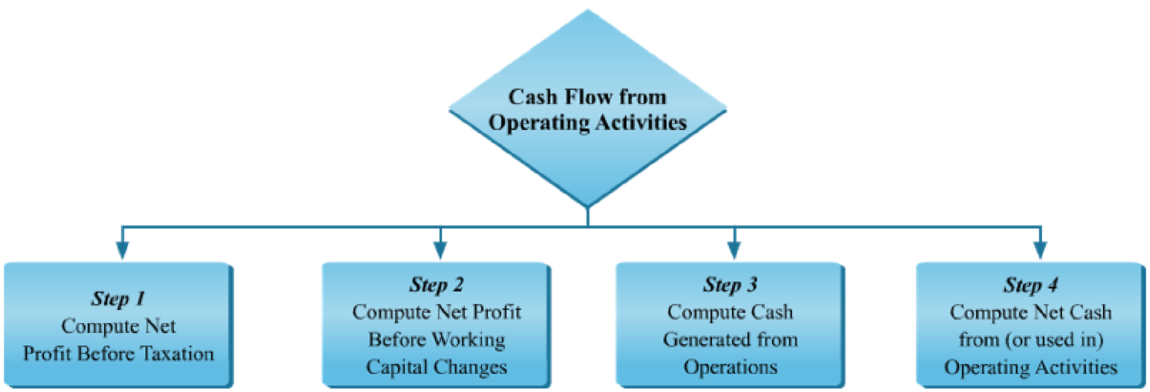
Steps to Prepare Cash Flow Statement

To prepare a Cash Flow Statement we need to follow the given below stages.



Stage I: Ascertain Cash Flow from Operating Activities

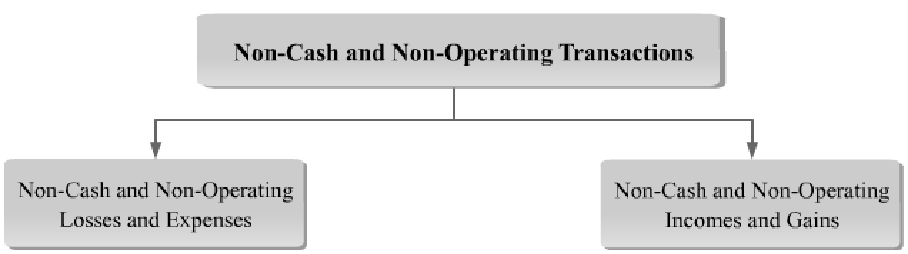
In the Stage I, we ascertain Cash Flow from Operating Activities by following the below given steps (Step 1, 2, 3 and 4).



Step 1*: *Compute Net Profit before Taxation- For this we begin with Net Profit or Net Loss. If the balance of Profit and Loss Account increases, then it is shown as Net Profit, else in case of decrease it is shown as negative figure (in brackets) as Net Loss. Next, we need to add the following items to the Net Profit.

a. *Transfer to Reserve*- The increase in the balance of Reserve from Previous Year to Current Year is added to the Net Profit.
b. *Proposed Dividend*- Proposed Dividend of the *Current year* is added to the Net Profit
c. *Interim Dividend*- Interim Dividend given in the adjustment (i.e. paid during the year) is added to the Net Profit.
d. *Provision for Taxation*- Provision for Tax *made during the year* is also added to the Net Profit.

Step 2: Compute Net Profit before Working Capital Changes- For this, we need to adjust the Net Profit before taxation (ascertained above) for the Non-Cash Transactions. These transactions do not involve any cash flows but as they affect net profit, so such items must be taken into consideration. The non-cash and non-operating transactions can be classified under two sub-headings as presented diagrammatically.



a. ***Non-Cash and Non-Operating Expenses and Losses***- These expenses and losses do not result in any cash outlays from the business. The following are the non-operating expenses and losses that are added to the Net Profit before Taxation.

Add: Non-Cash and Non-Operating Losses and Expenses

i. *Depreciation*- Amount of depreciation charged/provided during the year is added.
ii. *Preliminary Expenses and Discount on Issue of Shares and Debentures written-off*- The decrease in the balance of Preliminary Expenses and Discount on Issue of Shares and Debentures from previous year to current year is added.
iii. *Goodwill, Patents and Trade Marks Amortised (written-off)*- The decrease in the value of Goodwill, Patents and Trade Marks from previous year to current year is added.
iv. *Loss on Sale of Fixed Assets*
v. *Interest Paid*

b. ***Deduct: Non-Cash and Non-Operating Incomes and Gains*** from the Net Profit before Taxation
   i. *Interest Received*- Interest received by Financial Enterprises. (*see **APPENDIX**** below*)
   ii. *Dividend Received*- Dividend received by Financial Enterprises. (*see **APPENDIX**** below*)
   iii. *Rent Received*
   iv. *Profit on Sale of Fixed Assets*

Step 3*: *Compute Cash Generated From Operations- Now, to the Net Profit before Working Capital Changes (ascertained in Step: 2), we need to:

a. ***Add***: *Decrease in Current Assets*- (If Current Year's Balance < Previous Year's Balance)
b. ***Add***: *Increase in Current Liabilities*- (If Current Year's Balance > Previous Year's Balance)
c. ***Deduct***: *Increase in Current Assets*- (If Current Year's Balance > Previous Year's Balance)
d. ***Deduct***: *Decrease in Current Liabilities*- (If Current Year's Balance < Previous Year's Balance)

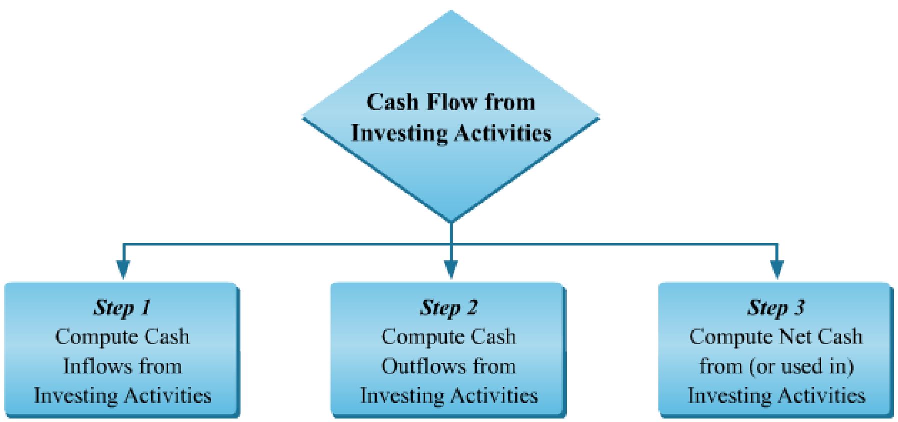
It should be noted that Provision for Doubtful debt is considered as a Current Liabilities.

Step 4*: *Compute Net Cash from (or used in) Operating Activities- Lastly, we need to consider Income Tax and Extra-ordinary Items. In order to get Net Cash from Operating Activities, we need to:

a. ***Deduct***: Income Tax paid
b. ***Add***:Income Tax Refund
c. ***Add***: Extraordinary Items that lead to cash inflows to the business due to operating items.
d. ***Deduct***: Extraordinary Items that lead to cash outflows from the business due to operating items.

Stage II: Ascertain Cash Flow from Investing Activities

In the Stage II, we ascertain Cash Flow from Investing Activities by following the below given steps (Steps 1, 2 and 3).



Step 1*: *Compute Cash Inflows from Investing Activities- It is ascertained by adding the following items.

a. *Proceeds from Sale of Fixed Assets and Investments*- If the current year's balance of fixed assets and investments is *less than* its previous year's balance, then the difference is regarded as Sale of Fixed Assets and Investments.

b. *Interest Received, Dividend Received and Rent Received*- Interest and Dividend received by the Non-Financial Enterprise. (*see* ***APPENDIX**** *below*)
c. *Extraordinary Items* that lead to cash *inflows* due to investing activities. For example- insurance claim received on account of loss of fixed assets due to natural calamities.

Step 2*: *Compute Cash Outflows from Investing Activities- It is ascertained by adding the following items.

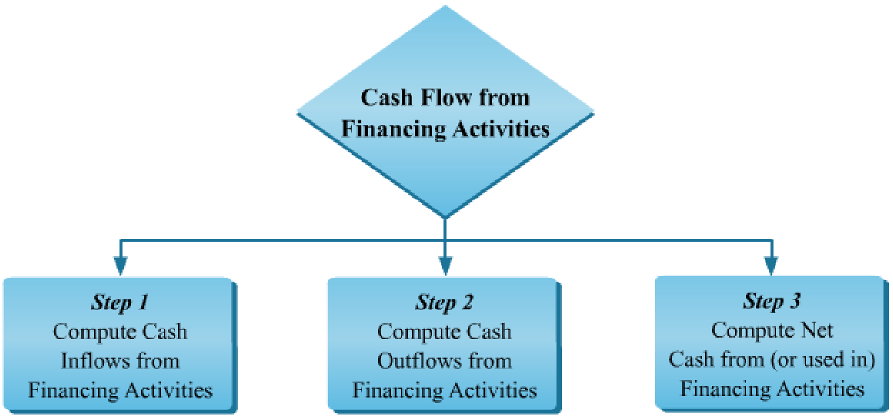
a. *Purchase of Fixed Assets and Investments*- If the current year's balance of fixed assets and investments is *more than* its previous year's balance, then the difference is regarded as Purchase of Fixed Assets and Investments.
b. *Purchase of Goodwill*- If the current year's value of goodwill increases from its previous year's value, then it is considered as Purchase of Goodwill.
c. *Extraordinary Items* that lead to cash *outflows* due to investing activities. For example- expenses incurred to repair building that was condemned or ceased by the government on safety grounds.

Step 3: ***Compute Net Cash from (or used in) Investing Activities***- It is ascertained with the help of the following formula.

Net Cash from (or used in) Investing Activities = Cash Inflows from Investing Activities – Cash Outflows from Investing Activities

Stage III: Ascertain Cash Flow from Financing Activities

In the Stage III, we ascertain Cash Flow from Financing Activities by following the below given steps (Steps 1, 2 and 3).



Step 1*: *Compute Cash Inflows from Financing Activities

a. *Proceeds from Issue of Shares and Debentures*- If the current year's amount of shares and debentures is *more than* its previous year's amount, then is regarded as Issue of Shares and Debentures.
b. *Proceeds from Other Long-term Borrowings (i.e. Loans Borrowed)*- If the balance of long-term borrowings increases from previous year to current year, then it is considered as Proceeds from Long-term Borrowings.
c. *Increase in Bank Overdraft*- Results in inflow of cash, treated as short-term borrowing.
d. *Extraordinary Items* that lead to cash *inflows* due to financing activities. For example-

Step 2*: *Compute Cash Outflows from Financing Activities

a. *Redemption of Preference Shares and Debentures*- If the current year's amount of preference shares and debentures is *less than* its previous year's amount, then is regarded as Redemption of Preference Shares and Debentures.
b. *Repayment of Loan*- If there is a decrease in the amount of loan from previous year to current year, then it is considered as Repayment of Loan.
c. *Interest Paid*- Interest Paid by Non-Financial Enterprise. (*see* ***APPENDIX**** *below*)
d. *Final Dividend Paid*- Final Dividend paid by both Financial and Non-Financial Enterprise. (*see* ***APPENDIX**** *below*)
e. *Interim Dividend Paid*- Interim Dividend paid by both Financial and Non-Financial Enterprise. (*see* ***APPENDIX**** *below*)
f. *Extraordinary Items* that lead to cash *outflows* due to financing activities. For example- payment made for Buy-back of Shares.
g. *Decrease in Bank Overdraft*- Results in outflow of cash, treated as payment of short-term borrowing.

Step 3: ***Compute Net Cash from (or used in) Financing Activities***- It is ascertained with the help of the following formula.

Net Cash from (or used in) Financing Activities = Cash Inflows from Financing Activities – Cash Outflows from Financing Activities

APPENDIX

Classification of Interest and Dividend Paid and Received- ***On the Basis of Nature of Business Enterprise***

Enterprises can be classified on the basis of nature of business as- Financial Enterprise and Non-Financial Enterprise. The financial enterprises basically deal in lending and borrowing funds such as advancing loans, accepting deposits from the general public, etc. These enterprises are also termed as financial intermediaries such as banks, LIC, etc. The non-financial enterprises primarily deal in areas other than finance. For the financial enterprises, the operating activities comprise of accepting deposits and forwarding loans, whereas, for the non-financial enterprises, such activities are considered as investing activities.

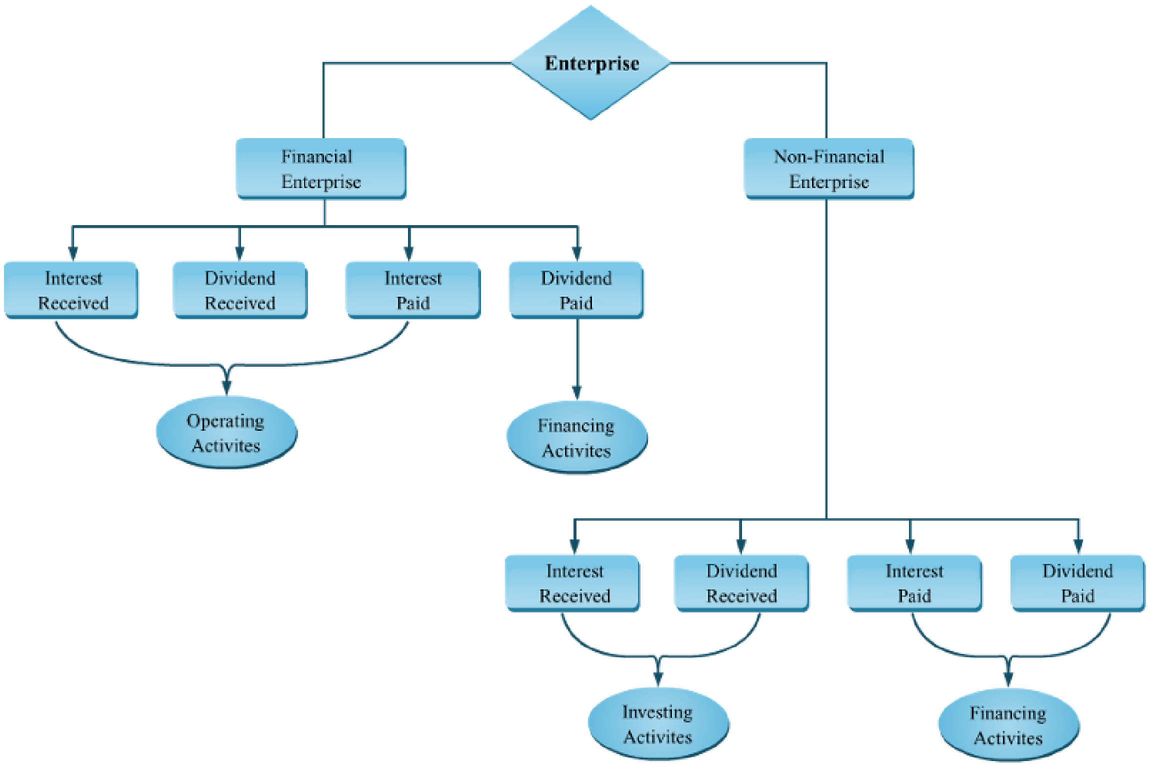
In the similar manner, the treatment of interest and dividend (paid or received) depends on the nature of the business enterprises. *For all the non-financial enterprises, interest paid and dividend paid are classified as Cash Outflows from Financing Activities and interest received and dividend received are classified as Cash Inflows from Investing Activities. For all the financial enterprises, interest received, dividend received are considered as Cash Inflows from Operating Activities and interest paid is considered as Cash Outflows from Operating Activities, while, dividend paid is considered as Cash Outflows from Financing Activities.* This is because the core (main) business activity of a financial enterprise is to lend and borrow funds. An important point that could make this explanation easy to understand is that dividend paid is always considered as Cash Outflows from Financing Activities whether it is for financial or non-financial enterprises.

Note- It should be noted that if nothing is mentioned in the question regarding the nature of business, then the enterprise is regarded as Non-Financial Enterprise.

Treatment of Interest and Dividend Paid and Received

Interest		
Nature of Enterprise	**Interest *Paid***	**Interest *Received***
Financial Enterprise	Operating Activity	Operating Activity
Non-Financial Enterprise	Financing Activity	Investing Activity
Dividend		
Nature of Enterprise	**Dividend *Paid***	**Dividend *Received***
Financial Enterprise	Financing Activity	Operating Activity
Non-Financial Enterprise	Financing Activity	Investing Activity

The tabulated information is presented diagrammatically below.



Format of Cash Flow Statement

Particulars		Rs
I. Cash Flow from Operating Activities		
Net Profit as per Profit and Loss A/c or Difference between Closing Balance and Opening Balance of Profit and Loss A/c		…
Add: Transfer to reserve		…
Proposed dividend for current year		…
Interim dividend paid during the year		…
Provision for tax made during the current year		…
Extraordinary item, if any, debited to the Profit and Loss A/c		…
Less: Extraordinary item, if any, credited to the Profit and Loss A/c		(…)
Refund of tax credited to Profit and Loss A/c		(…)
(A) Net Profit before Taxation and Extraordinary Items		…
Adjustment for Non-cash and Non-operating Items		
(B) *Add:* **Items to be Added**		
— Depreciation	…	
— Preliminary Expenses/Discount on Issue of Shares and Debentures written off	…	
— Goodwill, Patents and Trade Marks Amortised	…	

— Interest on Borrowings and Debentures	…	
— Loss on Sale of Fixed Assets	…	
(C) *Less:* **Items to be Deducted**		
— Interest Income	…	
— Dividend Income	…	
— Rental Income	…	
— Profit on Sale of Fixed Assets	…	
(D) Operating Profit before Working Capital Changes (A + B – C)		…
(E) *Add:* **Decrease in Current Assets and Increase in Current Liabilities**		
Detail:		
— Decrease in Stock/Inventories	…	
— Decrease in Debtors/Bills Receivables	…	
— Decrease in Accrued Incomes	…	
— Decrease in Prepaid Expenses	…	
— Increase in Creditors/Bills Payables	…	
— Increase in Outstanding Expenses	…	
— Increase in Advance Incomes	…	
— Increase in Provision for Doubtful Debts	…	…
(F) *Less:* **Increase in Current Assets and Decrease in Current Liabilities**		
Details:		
Increase in Stock/Inventories	…	
Increase in Debtors/Bills Receivables	…	
Increase in Accrued Incomes	…	
Increase in Prepaid Expenses	…	
Decrease in Creditors/Bills Payables	(…)	
Decrease in Outstanding Expenses	(…)	
Decrease in Advance Incomes	(…)	
Decrease in Provision for Doubtful Debts	(…)	(…)
(G) Cash Generated from Operations (D + E – F)		…
(H) *Less:* Income Tax Paid (Net of Tax Refund received)		(…)
(I) Cash Flow before Extraordinary Items		
Extraordinary Items (+/–)		…
(J) Net Cash from (or used in) Operating Activities		…
II. Cash Flow from Investing Activities		
Proceeds from Sale of Fixed Assets	…	
Proceeds from Sale of Investments	…	
Interest and Dividend received (For Non-financial Companies only)	…	
Rent Income	…	
Purchase of Fixed Assets	(…)	
Purchase of Investments	(…)	
Purchase of Intangible Assets like Goodwill	(…)	
Extraordinary Items (+/–)	(…)	
Net Cash from (or used in) Investing Activities		…

III. Cash Flow from Financing Activities		
Proceeds from Issue of Shares and Debentures	…	
Proceeds from Other Long-term Borrowings	…	
Increase in Bank Overdraft	…	
Final Dividend Paid	(…)	
Interim Dividend Paid	(…)	
Interest on Debentures and Loans Paid	(…)	
Repayment of Loans	(…)	
Redemption of Debentures/Preference Shares	(…)	
Decrease in Bank Overdraft	(…)	
Extraordinary Items (+/–)	(…)	
Net Cash from (or used in) Financing Activities		…
IV. Net Increase/Decrease in Cash and Cash Equivalents (I + II + III)		…
V. *Add:* Cash and Cash Equivalents in the beginning of the year		
Cash in Hand	…	
Cash at Bank	…	
Short-term Deposits	…	
Marketable Securities	…	…
VI. Cash and Cash Equivalents at the end of the year		…
Cash in Hand	…	
Cash at Bank	…	
Short-term Deposits	…	
Marketable Securities	…	…
		…

Extraordinary Items- These are the incomes or expenses that emerge from the unusual and infrequent events which are not normal to a business. The two important characteristics of extraordinary items are- ***unusual in nature*** (outside to the normal nature of a business) and ***non-recurring*** (i.e. not expected to occur frequently). Some of the examples of cash flows from extraordinary items are insurance claim received due to loss by fire, bad debts recovered, winning of a lottery, earthquake relief fund, compensation/claim received due to winning of a law suit, etc. Such items can be either classified as operating, investing or financing activities based on the nature of items on which cash flows occurred. For example,

- Extraordinary items should be classified as cash flows from operating activities in case of compensation received for the loss to operations due to natural calamities such as floods, earthquake, fire, etc.
- Extraordinary items should be classified as cash flows from investing activities in case of loss of *fixed assets* due to natural calamities, change in government policies, etc. For example, loss to Blue-Line (private) transporters when Delhi government mandated the use of CNG bus instead of diesel or petrol buses. Similarly, when a building or plant is condemned by the government authorities on safety grounds, then this loss is considered as investing activities.
- Extraordinary items should be classified as cash flows from financing activities in case of payment made for buy-back of equity shares.

Proposed Dividend and Interim Dividend

Objective

After going through this lesson, you shall be able to understand the following concepts in a Cash Flow Statement.

- Adjustments based on Net Profit
- Treatment of Proposed Dividend
- Treatment of Interim Dividend

Adjustments based on Net Profit

We know that the Cash Flow Statement opens with the first item as Net Profit (or Loss) as per the Statement of Profit and Loss. This is the net profit that is earned during the year and is before adjusting tax and extraordinary items. The year-wise net profits are given to us in the question. From this, we compute the net profit earned (or net loss incurred) during the year by deducting the previous year's profit from the current year's profit. Algebraically, this is presented as:

Net Profit (Loss) for the Year = Current Year's Profit (Loss) – Previous Year's Profit (Loss)

The following are the different cases of Net Profit that may you may counter while solving the numerical questions of Cash Flow Statement.

Different Cases of Net Profit

Case 1- When the Current Year's Profit is more than the Previous Year's Profit

Particulars	2012	2013
Statement of Profit and Loss	50,000	1,00,000

Treatment

Cash Flow Statement

Particulars	Amount (Rs)
Net Profit as per the Statement of Profit and Loss (1,00,000 – 50,000)	50,000

In this case, we simply deduct 50,000 from 1,00,000 and show the difference of Rs 50,000 as Net Profit earned during the year in Cash Flow Statement.
Net Profit (or Net Loss) = 1,00,000 – 50,000 = 50,000

Case 2- When the Current Year's Year is less than Previous Year's Profit

Particulars	2012	2013
Statement of Profit and Loss	1,25,000	50,000

Treatment

Cash Flow Statement

Particulars	Amount (Rs)
Net Loss as per the Statement of Profit and Loss (50,000 – 1,25,000)	(75,000)

Net Profit (or Net Loss) = 50,000 – 1,25,000 = – 75,000
In this case, the negative balance (shown in the brackets) of 75,000 is Net Loss.

Case 3- When there is Profit for the Current Year and Loss for the Previous Year

Particulars	2012	2013
Statement of Profit and Loss	(20,000)	80,000

Treatment

Cash Flow Statement

Particulars	Amount (Rs)
Net Profit as per the Statement of Profit and Loss {80,000 – (20,000)}	1,00,000

In this case also, the Net Profit (or Net Loss) is ascertained similarly as a difference of the Current and Previous Year's Balance. That is,
Net Profit (or Net Loss) = 80,000 – (20,000) = 80,000 + 20,000 = Rs 1,00,000

Case 4- When there is Loss in the Current Year and Profit for the Previous Year

Particulars	2012	2013
Statement of Profit and Loss	60,000	(80,000)

Treatment

Cash Flow Statement

Particulars	Amount (Rs)
Net Loss as per the Statement of Profit and Loss {(80,000) – 60,000}	(1,40,000)

Net Profit (or Net Loss) = (80,000) – 60,000 = – 80,000 – 60,000 = – 1,40,000

Case 5- When Loss exists in both the Years (Current as well as Previous Year) and Current Year's Loss is <u>More</u> than Previous Year's Loss

Particulars	2012	2013
Statement of Profit and Loss	(30,000)	(70,000)

Treatment

Cash Flow Statement

Particulars	Amount (Rs)
Net Loss as per the Statement of Profit and Loss {(70,000) – (30,000)}	(40,000)

Net Profit (or Net Loss) = {(70,000) – (30,000)} = {–70,000 + 30,000} = – 40,000

Case 6- When Loss exists in both the Years (Current as well as Previous Year) and Current Year's Loss is <u>Less</u> than Previous Year's Loss

Particulars	2012	2013
Statement of Profit and Loss	(1,10,000)	(90,000)

Treatment

Cash Flow Statement

Particulars	Amount (Rs)
Net Profit as per the Statement of Profit and Loss {(90,000) – (1,10,000)}	20,000

Net Profit (or Net Loss) = {(90,000) – (1,10,000)}= {– 90,000 + 1,10,000} = 20,000

Case 7- When Current Year depicts Profit and Previous Year's balance is NIL

Particulars	2012	2013
Statement of Profit and Loss		35,000

Treatment

Cash Flow Statement

Particulars	Amount (Rs)

Net Profit as per the Statement of Profit and Loss (35,000 – Nil)	35,000

Net Profit (or Net Loss) = 35,000 – Nil = 35,000

Case 8- When Current Year depicts Loss and Previous Year's balance is NIL

Particulars	2012	2013
Statement of Profit and Loss		(75,000)

Treatment

Cash Flow Statement

Particulars	Amount (Rs)
Net Loss as per the Statement of Profit and Loss {(75,000) – Nil}	(75,000)

Net Profit (or Net Loss) = (75,000) – Nil = – 75,000 – Nil = – 75,000

Case 9- When Previous Year depicts Profit and Current Year's balance is NIL

Particulars	2012	2013
Statement of Profit and Loss	28,000	

Treatment

Cash Flow Statement

Particulars	Amount (Rs)
Net Loss as per the Statement of Profit and Loss (Nil – 28,000)	(28,000)

Net Profit (or Net Loss) = Nil – 28,000 = – 28,000

Case 10- When Previous Year depicts Loss and Current Year's balance is NIL

Particulars	2012	2013
Statement of Profit and Loss	(32,000)	

Treatment

Cash Flow Statement

Particulars	Amount (Rs)
Net Profit as per the Statement of Profit and Loss {Nil – (32,000)}	32,000

Net Profit (or Net Loss) = Nil – (32,000) = Nil + 32,000 = 32,000

Case 11- When there is no information about Profit/Loss is provided instead Reserves and Surplus appears in the given information

Particulars	2012	2013

Reserves and Surplus	25,000	73,000

Treatment
In this case, as we can see that no Profit and Loss balances are provided. In fact, we have been provided with the balance of Reserves and Surplus. Therefore, here, we regard the increase (or decrease) in these balances as profit earned (or loss incurred) during the year.

Cash Flow Statement

Particulars	Amount (Rs)
Net Profit as per the Statement of Profit and Loss (73,000 – 25,000)	48,000

Net Profit (or Net Loss) = 73,000 – 25,000 = 48,000

Example: Find out the missing figure under different cases given below.

Cases	Profits for 2012	Profits for 2013	Net Profit (or Net Loss) as per the Statement of Profit and Loss
I	20,000	60,000	?
II	40,000	?	30,000
III	?	1,02,250	8,750
IV	?	(20,000)	70,000
V	40,000	?	(20,000)
VI	(7,250)	(1,650)	?
VII	?	(30,000)	(70,000)
VIII	(9,450)	?	(8,200)
IX	(20,000)	50,000	?
X	?	1,95,800	76,200

Solution

Cases	Profits for 2012	Profits for 2013	Net Profit (or Net Loss) as per the Statement of Profit and Loss
I	20,000	60,000	40,000
II	40,000	70,000	30,000
III	93,500	1,02,250	8,750
IV	(90,000)	(20,000)	70,000
V	40,000	20,000	(20,000)
VI	(7,250)	(1,650)	5,600
VII	40,000	(30,000)	(70,000)
VIII	(9,450)	(17,650)	(8,200)
IX	(20,000)	50,000	70,000
X	1,19,600	1,95,800	76,200

Proposed Dividend

After paying-off all the taxes at the end of an accounting year, the Board of Directors of a company may intend to distribute a part of its profits (in form of dividend) among its shareholders. The dividend so declared by the Board of Directors in the Annual General Meeting is known as Proposed Dividend. It is declared in percentage terms on the face-value of the shares. For example, if a company declares proposed dividend at the rate of 10%, then a shareholder holding 20 shares of Rs 100 gets Rs 200 as proposed dividend (i.e. 10% of the face-value of the shares held by him). This is called 'proposed' because the company has only declared or proposed its intentions to pay such dividends and have not actually paid. The declared proposed dividend will be paid at the end of the following (or next) accounting period.

Treatment of Proposed Dividend

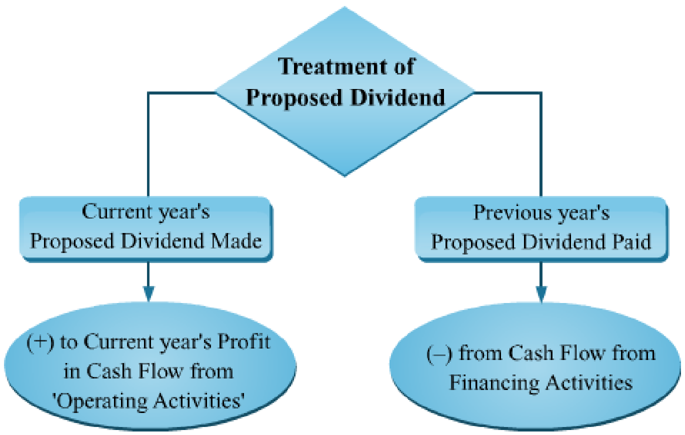
As a company declares proposed dividend at the end of an accounting period and pays it at the end of the following period, so such dividends are labelled as short-term liabilities (or Current Liabilities). For example, proposed dividend of Rs 25,000 declared on March 31, 2012 will be paid on March 31, 2013. Therefore, in the company's Balance Sheet prepared on March 31, 2012, proposed dividend of Rs 25,000 will be shown as Current Liabilities. From this discussion, we can distinguish between two important points.

Proposed Dividend Made (or Current Year's Proposed Dividend)- It implies the amount of dividend that the company intend to pay at the end of the following accounting period.

Proposed Dividend Paid (or Previous Year's Proposed Dividend)- It implies the amount of dividend that the company declared earlier is actually paid-off. In other words, it simply means that proposed dividend made is paid-out.

The proposed dividend made (or current year's proposed dividend) is shown under Cash Outflow from Financing Activity. That is, current year's proposed dividend is added to the profit of the current year to ascertain the Cash Flow from Operating Activities. On the other hand, proposed dividend paid (or previous year's proposed dividend) is subtracted from the Cash generated through Financing Activities.

The treatment of proposed dividend is explained diagrammatically below.



Let us understand the treatment of proposed dividend in the following given six cases.

***Case 1*: When Proposed Dividend is given in the Balance Sheet and *no* related adjustment is given.**

Example

Extracts of Balance Sheet			
Particulars	**Note No.**	**Previous Year**	**Current Year**
Current Liabilities Short-Term Provisions		6,000	8,000

NOTES TO ACCOUNTS

Particulars	**Previous Year**	**Current Year**
Short-Term Provisions (i) Proposed Dividend	*6,000	#8,000

Solution

Financing Activity	Operating Activity
* (–) Rs **6,000** as Dividend ***Paid***	# (+) Rs **8,000** as Proposed Dividend ***Made***

***Case 2*: When Proposed Dividend is given in the Balance Sheet only of the Previous Year and no related adjustment is given.**
Adjustment: NIL

Example

Extracts of Balance Sheet			
Particulars	**Note No.**	**Previous Year**	**Current Year**
Current Liabilities Short-Term Provisions		20,000	-

NOTES TO ACCOUNTS

Particulars	Previous Year	Current Year
Short-Term Provisions (i) Proposed Dividend	*20,000	-

Solution
In this case, the previous year's balance of Proposed Dividend will be treated as **Dividend Paid** and will be deducted from the Financing Activities as Rs 20,000.

***Case 3*: When Proposed Dividend is given in the Balance Sheet only of the Current Year and no related adjustment is given.**
Adjustment: NIL

Example

Extracts of Balance Sheet			
Particulars	**Note No.**	**Previous Year**	**Current Year**
Current Liabilities Short-Term Provisions		-	18,000

NOTES TO ACCOUNTS

Particulars	Previous Year	Current Year
Short-Term Provisions (i) Proposed Dividend	-	*18,000

Solution

In this case, the current year's balance of Proposed Dividend will be treated as **Dividend Made** and will be added to the Operating Activities as Rs 18,000.

***Case 4*: When Proposed Dividend is given only in the Adjustment as dividend paid, but *no* proposed dividend is appearing in the Balance Sheet.**

Example

Extracts of Balance Sheet			
Particulars	**Note No.**	**Previous Year**	**Current Year**
Current Liabilities Short-Term Provisions		-	-

Adjustment: Dividend of Rs 8,500 paid during the year 2010.

Solution

Financing Activity	Operating Activity
(–) Rs **8,500** as Dividend ***Paid***	(+) Rs **8,500** as Proposed Dividend ***Made***

***Case 5*: When Previous Year's and Current Year's Balances are given in the Balance Sheet along with Related Adjustment**

If adjustment related to proposed dividend is given along with the previous year's and current year's balances of Proposed Dividend, only then we need to prepare Proposed Dividend Account. To put in different words, even if adjustment related to proposed dividend is given and any of the two balances (previous year's, current year's or both) are missing, then also we have to prepare the Proposed Dividend Account. The format for the Proposed Dividend Account is given below.

Proposed Dividend Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Bank (*Balancing Figure-**Dividend Paid***)	**	Balance b/d (Previous Year's Balance)	
Balance c/d (Current Year's Balance)		Profit and Loss A/c (Balancing Figure- Dividend ***Made***)	##

In the adjustment, only one of them that is, either Dividend Paid or Dividend Made during the year is given. If any one of them is given, then the other will be the balancing figure. That is, if dividend made is given, then dividend paid (on the debit side) is the balancing figure. On the other hand, if dividend paid is given in the adjustment, then dividend made (on the credit side) is the balancing figure.

Treatment

***** Dividend Paid is deducted from the Financing Activity***
Dividend Made is added to the Net Profit in the Operating Activity

Example- When Dividend <u>Made</u> is given in the Adjustment

Extracts of Balance Sheet			
Particulars	**Note No.**	**Previous Year**	**Current Year**
Current Liabilities Short-Term Provisions		5,000	6,000

NOTES TO ACCOUNTS

Particulars	Previous Year	Current Year
Short-Term Provisions (i) Proposed Dividend	5,000	6,000

Adjustment: Dividend Rs 7,500 ***made*** during the year

Solution

Proposed Dividend Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Bank (*Balancing Figure-**Dividend Paid***)	*6,500	Balance b/d	5,000
Balance c/d	6,000	Profit and Loss A/c (***Made***)	#7,500
	12,500		12,500

Treatment

Financing Activity	Operating Activity
* (–) Rs **6,500** as Dividend ***Paid***	#(+) Rs **7,500** as Proposed Dividend ***Made***

Example- When Dividend Paid is given in the Adjustment

Extracts of Balance Sheet			
Particulars	**Note No.**	**Previous Year**	**Current Year**
Current Liabilities Short-Term Provisions		13,000	15,600

NOTES TO ACCOUNTS

Particulars	Previous Year	Current Year
Short-Term Provisions (i) Proposed Dividend	13,000	15,600

Adjustment: Dividend Rs 19,500 ***paid*** during the year.

Solution

Proposed Dividend Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Bank (***Paid***)	*19,500	Balance b/d	13,000
Balance c/d	15,600	Profit and Loss (*Balancing Figure-**Made***)	#22,100
	35,100		35,100

Treatment

Financing Activity	Operating Activity
* (–) Rs **19,500** as Dividend ***Paid***	# (+) Rs **22,100** as Proposed Dividend ***Made***

Example: How will you treat the dividend while preparing cash flow statement in the following cases:

Case 1

Extracts of Balance Sheet			
Particulars	**Note No.**	**2011**	**2012**
Current Liabilities Short-Term Provisions		8,000	6,000

NOTES TO ACCOUNTS

Particulars	2011	2012
Short-Term Provisions (i) Proposed Dividend	8,000	6,000

Additional Information- NIL

Case 2

Extracts of Balance Sheet			
Particulars	**Note No.**	**2011**	**2012**
Current Liabilities Short-Term Provisions		8,000	6,000

NOTES TO ACCOUNTS

Particulars	2011	2012
Short-Term Provisions (i) Proposed Dividend	8,000	6,000

Additional Information- Dividend paid during 2012 is Rs 7,500.

Case 3

Extracts of Balance Sheet			
Particulars	**Note No.**	**2011**	**2012**
Current Liabilities Short-Term Provisions		8,000	6,000

NOTES TO ACCOUNTS

Particulars	2011	2012
Short-Term Provisions (i) Proposed Dividend	8,000	6,000

Additional Information- During the year 2012 dividend was declared Rs 7,000.

Case 4

Extracts of Balance Sheet

Particulars	Note No.	2011	2012
Current Liabilities			
Other Current Liabilities	1	-	200
Short-Term Provisions	2	8,000	6,000

NOTES TO ACCOUNTS

Note 1

Particulars	2011	2012
Other Current Liabilities		
(i) Unclaimed Dividend	-	200

Note 2

Particulars	2011	2012
Short-Term Provisions		
(i) Proposed Dividend	8,000	6,000

Solution

Case 1

Operating Activities: Proposed dividend for 2012 Rs 6,000 is to be *added with* Net Profit.
Financing Activities: Proposed Dividend for 2011 Rs 8,000 is to be *deducted* as Dividend paid

Case 2

Proposed Dividend Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Bank A/c (***Dividend paid***)	7,500	Balance b/d	8,000
Balance c/d	6,000	Profit and Loss (*Balancing figure-* ***Made***)	5,500
	13,500		13,500

Operating Activities: Proposed Dividend Rs 5,500 is to *be added with* Net Profit.
Financing Activity: Amount paid as Dividend Rs 7,500 is to be *deducted.*

Case 3

Proposed Dividend Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Bank A/c (*Balancing figure-****Dividend paid***)	9,000	Balance b/d	8,000
Balance c/d	6,000	Profit and Loss A/c ***(Made***)	7,000
	15,000		15,000

Operating Activities: Proposed Dividend Rs 7,000 is to *be added with* Net Profit.
Financing Activities: Dividend paid Rs 9,000 is to be *deducted.*

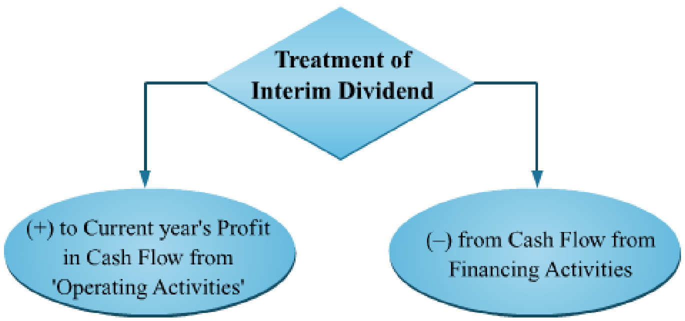
Case 4

Proposed Dividend of 2011	Rs 8,000
Less: Unclaimed Dividend	Rs (200)
Deducted from Financing Activities as Dividend paid	Rs 7,800*

Operating Activities: Proposed Dividend Rs 6,000 is to *be added with* Net Profit.
Financing Activities: Dividend paid Rs 7,800* is to be *deducted.*

Interim Dividend

A dividend that is declared and paid during the current year by a company before its Annual General Meeting is known as Interim Dividend. It implies that interim dividend by a company becomes due and paid during the current year only. As a result, interim dividend is added back to the profit of the current year so as to ascertain the Cash Flow from Operating Activities. It is also deducted from Cash Generated from the Financing Activities. The treatment of interim dividend in the Cash Flow Statement is shown diagrammatically below.



***Note*: It should be noted that unlike Proposed Dividend, Interim Dividend is always given in the adjustment and it is not affected by the adjustments on Proposed Dividend.**

Provision for Tax

Objective

After going through this lesson, you shall be able to understand the treatment of following items in a Cash Flow Statement.

- Taxes on Income and Gains
- Provision for Tax

Taxes on Income and Gains

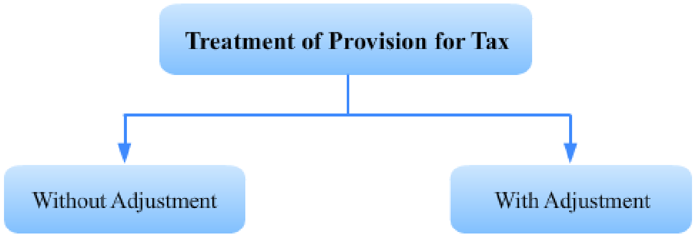
Companies are taxed on different financial variables such as income, profits, capital gains, dividends, etc. Some of the examples of taxes levied on the company's incomes and gains are income tax, profit tax (taxes on company's income and normal profits), capital gain tax (i.e. taxes on capital profits), dividend tax (i.e. taxes on the profit distributed as dividend), etc. As such taxes affect the balances of the cash and cash equivalents, so these are also shown in the Cash Flow Statement. As per the Accounting Standard-3 (AS-3), taxes paid on income (net of income tax refund received) is considered as a part of Cash Flow from *Operating Activities* unless it is specifically mentioned to be identified with investing or financing activities. This means that tax paid is shown as deduction from Cash Generated from Operations. According to the AS-3, the taxes should be classified as operating, financing or investing based on the financial items on which the taxes are paid.

a. Tax on Operating Profit- It is to be classified as Operating Cash Outflows.
b. Dividend Tax- The taxes levied on the amount of dividend is to be classified as financing activity. It is shown as deductions from Cash Flow from Financing Activities.
c. Capital Gain Tax- The taxes levied on the capital gains such as gain on sale of fixed assets (like land, building, etc.) is to be classified as investing activity. It is shown as deductions from Cash Flow from Investing Activities.

However, students must note that if in case simply 'tax' is given in the question and no specification is mentioned such as whether the tax is on dividend or on capital gains, then the tax is classified as operating activity and is shown as deductions from the Cash Generated from Operations.

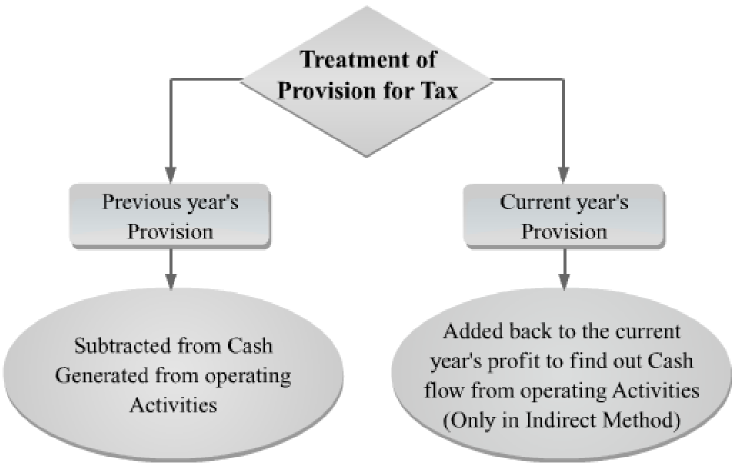
Provision for Tax

Provision for Tax appears on the liabilities side of the balance sheet. There can be two situations for the treatment of provision for tax.



Treatment of Provision for tax (*with No Adjustment*)

When there is no information on tax paid during the year, then the previous year's provision for tax is considered to have been paid during the current year, hence, it is subtracted from the Cash Flow from Operating Activities. On the other hand, current year's provision for tax is considered as tax provided for the current year, hence, is added to the current year's profit to find out the Cash Flow from Operating Activities. The treatment of provision for tax with no adjustment is explained diagrammatically below.



Example

Extracts of Balance Sheet

Particulars	**Note No.**	**Previous Year**	**Current Year**
Current Liabilities			
Short-Term Provisions		3,500	5,250

NOTES TO ACCOUNTS

Particulars	**Previous Year**	**Current Year**
Short-Term Provisions		
(i) Provision for Tax	3,500	5,250

Treatment

Operating Activity	**Operating Activity**
(–) Rs 3,500 as ***Tax Paid***	(+) Rs 5,250 as ***Tax Made***

***Example*: When only Previous Year's Provision for Taxation is given in the Balance Sheet.**

Extracts of Balance Sheet

Particulars	Note No.	Previous Year	Current Year
Current Liabilities			
Short-Term Provisions		4,500	-

NOTES TO ACCOUNTS

Particulars	Previous Year	Current Year
Short-Term Provisions		
(i) Provision for Tax	4,500	-

Solution In this case, the previous year's balance of Provision for Taxation (Rs 4,500) is regarded as ***Tax Paid***, thereby is deducted from Cash Flow from Operating Activities.

***Example*: When only Current Year's Provision for Taxation is given in the Balance Sheet.**

Extracts of Balance Sheet

Particulars	Note No.	Previous Year	Current Year
Current Liabilities			
Short-Term Provisions		-	5,000

NOTES TO ACCOUNTS

Particulars	Previous Year	Current Year
Short-Term Provisions		
(i) Provision for Tax	-	5,000

Solution In this case, the current year's balance of Provision for Taxation (Rs 5,000) is regarded as ***Tax Made***, thereby is added to the Net Profit as per the Profit and Loss Account.

***Example*: When Provision for Taxation is given only in the Profit and Loss Account.**

Extracts of Statement of Profit and Loss

Particulars	Note No.	Previous Year	Current Year
Tax Expenses:			
(i) Current Tax (Provision for Tax)			7,000

Solution In this case, Rs 7,000 is added to the Net Profit as per the Profit and Loss Account and the same amount of Rs 7,000 is deducted from Cash from Operations.

Treatment of Provision for tax (*with Adjustment*)

In case, the previous year's and current year's balances of provision for taxation is given (in Balance Sheet) along with related adjustment, then we need to prepare Provision for Taxation Account. This account is prepared to ascertain the *tax paid* or *tax made* during the year. The format of Provision for Tax Account is given below.

Provision for Taxation Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Bank (*Balancing Figure- **Tax Paid***)	**	Balance b/d (Previous Year's Balance)	
Balance c/d (Current Year's Balance)		Profit and Loss A/c (*Balancing Figure- **Tax Made***)	##

In the adjustment, only one of them that is, either Tax Paid or Tax Made during the year is given. If any one of them is given, then the other will be the balancing figure. That is, if tax made is given, then tax paid (on the debit side) is the balancing figure. On the other hand, if tax paid is given in the adjustment, then tax made (on the credit side) is the balancing figure.

Treatment

***** Tax Paid is deducted from the Operating Activity***

Tax Made is added to the Net Profit in the Operating Activity

Example:

Extracts of Balance Sheet

Particulars	**Note No.**	**Previous Year**	**Current Year**
Current Liabilities Short-Term Provisions		3,500	5,250

NOTES TO ACCOUNTS

Particulars	**Previous Year**	**Current Year**
Short-Term Provisions (i) Provision for Tax	3,500	5,250

Adjustment: Income tax of Rs 2,625 paid during the year.

Solution

Provision for Taxation Account

Dr. **Cr.**

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Bank (Tax Paid)**	2,625	Balance b/d (Previous Year's Balance)	3,500
Balance c/d (Current Year's Balance)	5,250	Profit and Loss (*Balancing Figure*- Tax Made) ##	4,375
	7,875		7,875

Treatment

Operating Activity	**Operating Activity**
(–) Rs **2,625** as Tax Paid	(+) Rs **4,375** as Tax Made

Exercise

How will you deal with the following cases while preparing Cash Flow Statement.

Case 1

Extracts of Balance Sheet

Particulars	**Note No.**	**2011**	**2012**
1. Shareholders' Funds Reserves and Surplus	1	20,000	35,000
2. Current Liabilities Short-Term Provisions	2	10,000	12,000

NOTES TO ACCOUNTS

Note 1

Particulars	**2011**	**2012**
Reserves and Surplus (i) Statement of Profit and Loss	20,000	35,000

Note 2

Particulars	2011	2012
Short-Term Provisions (i) Provision for Tax	10,000	12,000

Adjustment- NIL

Case 2

Extracts of Balance Sheet			
Particulars	**Note No.**	**2011**	**2012**
1. Shareholders' Funds			
Reserves and Surplus	1	20,000	35,000
2. Current Liabilities			
Short-Term Provisions	2	10,000	12,000

NOTES TO ACCOUNTS

Note 1

Particulars	2011	2012
Reserves and Surplus (i) Statement of Profit and Loss	20,000	35,000

Note 2

Particulars	2011	2012
Short-Term Provisions (i) Provision for Tax	10,000	12,000

Adjustment- Tax paid during 2012 Rs 10,500

Case 3

Extracts of Balance Sheet			
Particulars	**Note No.**	**2011**	**2012**
1. Shareholders' Funds			
Reserves and Surplus	1	20,000	35,000
2. Current Liabilities			
Short-Term Provisions	2	10,000	12,000

NOTES TO ACCOUNTS

Note 1

Particulars	2011	2012
Reserves and Surplus (i) Statement of Profit and Loss	20,000	35,000

Note 2

Particulars	2011	2012
Short-Term Provisions (i) Provision for Tax	10,000	12,000

Adjustment- Provision for tax made during 2012 Rs 15,000

Case 4

Extracts of Balance Sheet			
Particulars	**Note No.**	**2011**	**2012**
1. Shareholders' Funds			
Reserves and Surplus		20,000	35,000

NOTES TO ACCOUNTS

Particulars	2011	2012
Reserves and Surplus (i) Statement of Profit and Loss	20,000	35,000

Adjustment- Tax paid during the year Rs 10,000

Solution

Case 1

Cash Flow from Operating Activities

Particulars	Amount Rs
Profit during the year	15,000
Add: Provision for taxation	12,000
Less: Income tax paid	(10,000)
	17,000

Case 2

Cash Flow from Operating Activities

Particulars	Amount Rs
Profit during the year	15,000
Add: Provision for taxation	12,500
Less: Income tax paid	(10,500)
	17,000

Working Note

Provision for Taxation Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Bank A/c (**Tax paid**)	10,500	Balance b/d	10,000
Balance c/d	12,000	Profit and Loss A/c (*Balancing Figure- **Tax made***)	12,500
	22,500		22,500

Case 3

Cash Flow from Operating Activities

Particulars	Amount Rs
Profit during the year	15,000
Add: Provision for taxation	15,000
Less: Income tax paid	(13,000)
	17,000

Working Note

Provision for Taxation Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Bank (*Balancing figure- **Tax paid***)	13,000	Balance b/d	10,000
Balance c/d	12,000	Profit and Loss A/c ***(Tax made)***	15,000

	25,000		25,000

Case 4

Cash Flow from Operating Activities

Particulars	Amount Rs
Profit during the year	15,000
Add: Provision for taxation	10,000
Less: Income tax paid	(10,000)
	15,000

Fixed Assets Account and Provision for Depreciation Account

Objective

After going through this lesson, you shall be able to understand the following treatments of adjustments related to fixed assets.

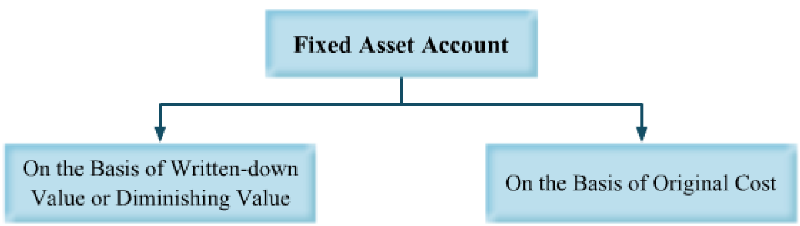
- Fixed Assets Account
- Provision for Depreciation Account (or Accumulated Provision for Depreciation)

Introduction

We know that the activities that are related to the sale and purchase of fixed assets or long-term investments are classified as Investing Activities. Up till now, we have compared the opening and closing balances of fixed assets to ascertain the amount of sale or purchase of fixed assets. That is, if the previous year's balance exceeds the current year's balance of fixed assets, then it is regarded as ***sale*** and is shown as Cash ***Inflow*** from Investing Activities. On the contrary, if the current year's balance exceeds the previous year's balance, then it is regarded as ***purchase*** and is shown as Cash ***Outflow*** from Investing Activities. However, there may be cases, where, besides the opening and the closing balances of the fixed assets, some additional information regarding depreciation and sale is also provided. Such additional information are provided outside of the given balance sheet in form of adjustments. In such cases (where adjustments are given), we need to prepare relevant accounts such as Fixed Assets Account, Accumulated Depreciation Account, etc. to ascertained the sale and purchase of fixed assets.

Preparation of Fixed Assets Account

In the balance sheet (given in the question), fixed assets may either be mentioned at *written-down value* or on *original cost*. Therefore, there are two probable situation for preparation of Fixed Assets Account. These are presented diagrammatically below.



I- When Fixed Assets are shown on their *Written-down Value* (or *Diminishing Value*)

When the company's balance sheet does not include Provision for Depreciation or Accumulated Depreciation (for both years), it implies that the fixed assets are shown at their written-down value i.e. after providing depreciation. In such a case, we need to prepare only one account- Fixed Assets Account; on the basis of their written-down value.

Steps to Prepare Fixed Assets Account (at Written-down Values)

***Step 1*:** The opening balance (previous year's balance) is shown on the debit side and the closing balance (current year's balance) is shown on the credit side of the Fixed Assets Account.

***Step 2*:** Next, the amount of depreciation charged during the year is shown on the credit side of the account.

Step 3: If fixed assets is sold during the year, then it is shown on the credit side of the account as Bank (Sale of Fixed Assets).

Step 4: In case of sale, if there exists profit (or loss) on sale, then it is debited (or credited) to the account.

Step 5: Then, finally, both the sides are totalled. If the total of credit side exceeds the total of the debit side, then the balancing figure is shown as Bank- Purchase of Fixed Assets, on the contrary, if the total of debit side exceeds the total of the credit side, then the balancing figure is shown as Bank- Sale of Fixed Assets.

The below given represents the format of Fixed Assets Account.

Fixed Assets (at Written-down Values)

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Balance b/d (*Opening Balance*) Profit and Loss A/c (Profit on Sale of Fixed Assets) ♦♦ Bank (*Balancing Figure- Purchases of Fixed Assets*)##		Depreciation (*Charged during the year*) ♥ Profit and Loss A/c (Loss on Sale of *Fixed Asset*)♦ Bank- Sale of Fixed Assets ♣ Balance c/d (*Closing Balance*)	

Treatment

Investing Activity	Operating Activity
## (–) as Purchase of Fixed Assets ♣ (+) as Sale of Fixed Assets	♥ (+) as Depreciation charged during the year ♦♦ (–) as Profit on Sale of Fixed Assets ♦ (+) as Loss on Sale of Fixed Assets

***Case- 1*: When the balances (i.e. opening and closing balances) of Fixed Assets are given in the Balance Sheet and Depreciation charged during the year is given in the adjustment.

Example

Extracts of Balance Sheet

Particulars	Note No.	Previous Year	Current Year
Fixed Assets Tangible Assets		2,80,000	2,52,000

NOTES TO ACCOUNTS

Particulars	Previous Year	Current Year
Tangible Assets (i) Machinery (Net)	2,80,000	2,52,000

Adjustment- Depreciation of Rs 84,000 charged during the year.

Solution

Machinery Account (at Written-down Values)

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Balance b/d	2,80,000	Depreciation A/c	**84,000**
Bank A/c (*Balancing Figure- Purchases of Machinery*)	**56,000**	Balance c/d	2,52,000
	3,36,000		3,36,000

Treatment

Investing Activity	Operating Activity
(–) Rs **56,000** as Purchases of Machinery	(+) Rs **84,000** as Depreciation charged during the year

<u>Case- 2</u>*: When the balances (i.e. opening and closing balances) of Fixed Assets are given in the Balance Sheet and Depreciation charged during the year is given along with the information of ***sale of part of fixed assets in the adjustment.

Example

Extracts of Balance Sheet

Particulars	**Note No.**	**Previous Year**	**Current Year**
Fixed Assets Tangible Assets		3,00,000	2,70,000

NOTES TO ACCOUNTS

Particulars	**Previous Year**	**Current Year**
Tangible Assets (i) Machinery (Net)	3,00,000	2,70,000

Adjustments

i. Depreciation of Rs 90,000 charged during the year.
ii. A part of Machinery costing Rs 45,000 (accumulated depreciation Rs 6,000) was sold for Rs 34,500.

Solution

Machinery Account (at Written-down Values)

Dr. **Cr.**

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Balance b/d	3,00,000	Depreciation A/c	90,000
		Bank A/c (*Sale of Machinery*)	**34,500**
		Loss on Sale of Machinery (45,000 – 6,000 – 34,500)	**4,500**
Bank A/c (*Balancing Figure- Purchase of Machinery*)	**99,000**	Balance c/d	2,70,000
	3,99,000		3,99,000

Treatment

Investing Activity	Operating Activity
(–) Rs **99,000** as Purchase of Machinery (+) Rs **34,500** as Sale of Machinery	(+) Rs **90,000** as Depreciation charged during the year (+) Rs **4,500** as Loss on Sale of Machinery

II- When Fixed Assets are shown on their Original Cost

When the balance sheet of a company consists of *Provision for Depreciation* or *Accumulated Depreciation* (for both years), it implies that the fixed assets are shown on their original cost. In such a case, two separate accounts are required to be prepared *viz.* Fixed Assets Account and Provision for Depreciation Account. The Fixed Assets Account helps in ascertaining the amount of fixed assets purchased or sold during the year, while, the Provision for Depreciation Account helps in ascertaining the amount of depreciation charged during the year. The format of Fixed Asset Account and Provision for Depreciation Account is given below.

Fixed Assets (at Written-down Values)

Dr. **Cr.**

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Balance b/d (*Opening Balance*) Profit and Loss A/c (Profit on Sale of Fixed Assets) ♦♦ Bank (*Balancing Figure- Purchases of Fixed Assets*)ψ		Depreciation (***on part***) Profit and Loss A/c (Loss on Sale of *Fixed Asset*) ♦ Bank- Sale of Fixed Assets Balance c/d (*Closing Balance*) ♣	

Accumulated Depreciation Account (Provision for Depreciation Account)

Dr. **Cr.**

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Fixed Assets Account- (*Balancing figure- Depreciation on part*)* **(See Note)** Balance c/d (*Closing Balance*)		Balance b/d (*Opening balance*) Profit and Loss A/c (*Balancing figure- Depreciation charged during the year*) #	

*Note- Any one of these items may be given in the question, i.e. either depreciation on a part of fixed assets could be given or Depreciation charged during the year could be given. In case, the item # is given, then * have to be ascertained as balancing figure. On the contrary, if the item * is given, then # have to be ascertained as balancing figure.*

* Fixed Assets Account- (Balancing figure- Depreciation on part)- *The Balancing figure ascertained on the debit side of the Accumulated Depreciation Account is shown on the credit side of the Fixed Assets Account. This figure won't be shown anywhere else.*

Treatment

Investing Activity	**Operating Activity**
ψ (–) as Purchase of Fixed Assets	# (+) as Depreciation charged during the year
	♦♦ (–) as Profit on Sale of Fixed Assets
♣ (+) as Sale of Fixed Assets	♦ (+) as Loss on Sale of Fixed Assets

<u>Case- 1</u>*:** When the balances (opening and closing balances) of Fixed Assets and the balances (opening and closing balances) of Provision for Depreciation (or Accumulated Depreciation) are given in the Balance Sheet and ***<u>depreciation on a part of fixed assets sold</u> is given in the adjustment.

Extract of Balance Sheet

Particulars	**Note No.**	**Previous Year**	**Current Year**
Fixed Assets			
Tangible Assets		75,000	1,25,000

NOTES TO ACCOUNTS

Particulars	**Previous Year**	**Current Year**
Tangible Assets		
Fixed Assets (Cost)	1,05,000	1,75,000
Less: Accumulated Deprecation	(30,000)	(50,000)
	75,000	1,25,000

Adjustments

i. During the year machinery costing Rs 12,000(accumulated depreciation Rs 5,000) was sold for Rs 4,000.

Solution

Machinery Account (on cost)

Dr. Particulars	Amount Rs	Particulars	Cr. Amount Rs
Balance b/d	1,05,000	Depreciation A/c (on part) ♦ Bank A/c (*Sale of Machinery*)° Loss on Sale of Machinery *(12,000 – 5,000 – 4,000)	5,000 4,000 3,000
Cash (*Balancing Figure- Purchase of Machinery*) ♣	82,000	Balance c/d	1,75,000
	1,87,000		1,87,000

Accumulated Depreciation Account (Provision for Depreciation Account)

Dr. Particulars	Amount Rs	Particulars	Cr. Amount Rs
Machinery (*Depreciation. on part of machinery sold*) ♦	5,000	Balance b/d	30,000
Balance c/d	50,000	Profit and Loss A/c (*Balancing Figure- Dep. charged during the year*) ◊	25,000
	55,000		55,000

Treatment

Investing Activity	Operating Activity
♣ (–) Rs **82,000** as Purchase of Machinery	◊ (+) Rs **25,000** as Depreciation charged during the year
° (+) Rs **4**,000 as Sale of Machinery	* (+) Rs **3,000** as Loss on Sale of Machinery

<u>Case- 2</u>*: When the balances (i.e. opening and closing balances) of Fixed Assets and the balances (i.e. opening and closing balances) of Provision for Depreciation (Accumulated Depreciation) are given in the Balance Sheet and ***<u>depreciation charged during the year is also given along with information regarding sale of part of machinery</u> in the adjustment.

Example

Extracts of Balance Sheet

Particulars	Note No.	Previous Year	Current Year
Fixed Assets Tangible Assets		90,000	1,05,000

NOTES TO ACCOUNTS

Particulars	Previous Year	Current Year
Tangible Assets		
Machinery (Cost)	1,00,000	1,40,000
Less: Accumulated Deprecation	(10,000)	(35,000)
	90,000	1,05,000

Adjustments
i. Depreciation charged during the year is Rs 27,500.
ii. During the year, a part of machinery costing Rs 7,500 was sold for Rs 2,000.
Solution

Machinery Account (on cost)

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Balance b/d	1,00,000	Depreciation A/c (on part) ♦	**2,500**
		Bank A/c (*Sale of Machinery*)°	**2,000**
		Loss on Sale of Machinery * (7,500 – 2,500 – 2,000)	**3,000**
Cash (*Balancing Figure-Purchase of Machinery*) ♣	**47,500**	Balance c/d	1,40,000
	1,47,500		1,47,500

Accumulated Depreciation Account (Provision for Depreciation Account)

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Fixed Assets (*Balancing Figure - Dep. on part of machinery sold*) ♦	**2,500**	Balance b/d	10,000
Balance c/d	35,000	Profit and Loss A/c (*Depreciation charged during the year*) ◊	**27,500**
	37,500		37,500

Treatment

Investing Activity	Operating Activity
♣ (–) Rs **47,500** as Purchase of Machinery	◊ (+) Rs **27,500** as Depreciation charged during the year
° (+) Rs **2,000** as Sale of Machinery	* (+) Rs **3,000** as Loss on Sale of Machinery

Example

Extracts of Balance Sheet

Particulars	Note No.	Previous Year	Current Year
Fixed Assets			
Tangible Assets		2,00,000	3,20,000

NOTES TO ACCOUNTS

Particulars	Previous Year	Current Year
Tangible Assets		
Fixed Assets (Cost)	2,80,000	4,20,000

Less: Accumulated Deprecation	(80,000)	(1,00,000)
	2,00,000	3,20,000

Adjustments
i. Depreciation charged during the year is Rs 25,000.
ii. During the year, a part of machinery costing Rs 8,000 was sold for Rs 12,000.
Solution

Fixed Assets Account (on cost)

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Balance b/d	2,80,000	Depreciation A/c (on part) ♦	5,000
Profit on Sale of Machinery *(8,000 – 5,000 – 12,000)	9,000	Bank A/c (*Sale of Machinery*)°	12,000
Cash (*Balancing Figure- Purchase of Machinery*) ♣	1,48,000	Balance c/d	4,20,000
	4,37,000		4,37,000

Accumulated Depreciation Account (Provision for Depreciation Account)

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Fixed Assets (*Balancing Figure -Dep. on part of machinery sold*) ♦	5,000	Balance b/d	80,000
Balance c/d	1,00,000	Profit and Loss A/c (*Depreciation charged during the year*) ◊	25,000
	1,05,000		1,05,000

Treatment

Investing Activity	Operating Activity
♣ (–) Rs **1,48,000** as Purchase of Machinery ° (+) Rs **1**2,000 as Sale of Machinery	◊ (+) Rs **25,000** as Depreciation charged during the year * (–) Rs **9,000** as Profit on Sale of Machinery

When Opening and Closing Balances of Provision for Depreciation Account are given in the Adjustments

As we know that when the opening and closing balances of Fixed Assets appear in the Balance Sheet (without any balances of Provision for Depreciation or Accumulated Depreciation Account), then it implies that the fixed assets are appearing at their written-down values. Also, we know that in this regard, only one account i.e. Fixed Assets Account is prepared. But sometimes, it may happen that the opening and the closing balances of Provision for Depreciation or Accumulated Depreciation Account are given to us in the adjustments.

In such cases, you should note that we have to prepare two separate accounts namely- Fixed Assets Account and Provision for Depreciation Account. An important thing to be noted here is that in this case, the opening and the closing balances of the Fixed Assets Account is shown after adding the opening and closing balances of the Provision for Depreciation to it. This is because the Fixed Assets Account is always prepared considering the original cost; and as the balances of fixed assets given in the Balance Sheet is net of the provision for depreciation balances, so we need to add these balances (of provision for depreciation account) to the balances of the fixed assets while preparing the Fixed Assets Account. Let's understand this point with the help of the following example.

Example

Extracts of Balance Sheet

Particulars	Note No.	Previous Year	Current Year
Fixed Assets Tangible Assets		4,00,000	5,00,000

NOTES TO ACCOUNTS

Particulars	Previous Year	Current Year
Tangible Assets (i) Machinery	4,00,000	5,00,000

Adjustment- Provision for depreciation amounted to Rs 40,000 and Rs 1,40,000 for the previous year and current year respectively. A part of Machinery costing Rs 60,000 (accumulated depreciation Rs 8,000) was sold for Rs 46,000.

Solution

Machinery Account (On Cost)

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Balance b/d (4,00,000 + 40,000)	4,40,000	Depreciation A/c (on part)#	**8,000**
		Bank- Sale of Machinery♦	**46,000**
		Loss on Sale of Machinery* (60,000 – 8,000 – 46,000)	**6,000**
Bank (*Balancing Figure- Purchase of Machinery*) ◊	**2,60,000**	Balance c/d (5,00,000 + 1,40,000)	6,40,000
	7,00,000		7,00,000

Note- In this case, the Provision for Depreciation is given outside the Balance Sheet, which implies that the Machinery balances given in the Balance Sheet are net of the provision for depreciation amount. In other words, we can say that the Machinery balances are given to us at Written-down values. As a result, we have added the provision for depreciation amounts to the opening and the closing figures of the Machinery amounts in the Machinery Account. The opening Machinery balance becomes Rs 4,40,000 (i.e. 4,00,000 + 40,000) and the closing Machinery balance becomes Rs 6,40,000 (i.e. 5,00,000 + 1,40,000).

Accumulated Depreciation Account (Provision for Depreciation Account)

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
Fixed Assets (Dep. on part of Fixed Assets)#	**8,000**	Balance b/d	40,000
Balance c/d	1,40,000	Profit and Loss A/c (*Balancing figure- Depreciation charged during the year*)°	**1,08,000**
	1,48,000		1,48,000

Treatment

Investing Activity	Operating Activity
◊ (–) Rs **2,60,000** as Purchase of Machinery ♦(+) Rs **46,000** as Sale of Machinery	°(+) Rs **1,08,000** as Depreciation charged during the year * (+) Rs **6,000** as Loss on Sale of Machinery

IMPOTANT NOTE*: *An easy way to spot-out which one of the above methods is to used is to analyse the following two conditions.

1. *Whether (Net) or (On Cost) is mentioned with the balances of the Fixed Assets in the Balance Sheet. If Net is mentioned, then it implies that Fixed Assets are shown at their Written-down Values that means only one account that is Fixed Assets Account is to be prepared. On the other hand, if on Cost is mentioned, then it implies that Fixed Assets are shown at their original costs and two accounts are to be prepared.*

2. *If nothing is mentioned with the balances of the Fixed Assets, then we need to simply see whether the opening and closing balances of Provision for Depreciation (Accumulated Depreciation) are mentioned either in the Balance Sheet or in the Adjustments. If yes, then we need to prepare two accounts.*

3. *If the opening and the closing balances of the Fixed Assets are given in the Balance Sheet, but no balances are appearing in the Balance Sheet for Provision for Depreciation (instead given in the adjustments), then as we know, we need to prepare two accounts. But in this case, the opening and the closing balances of the Fixed Assets are shown after adding the opening and closing balances of provision for depreciation to that of the Fixed Assets Account.*

4. *On the other hand, if the opening and the closing balances of the Fixed Assets are given along with the balances of Provision for Depreciation in the Balance Sheet, then also we need to prepare two accounts. But in this case, we need not to add the balances of the provision for depreciation to that of the Fixed Assets Account (as we did in the 3rd point above).*

Interest on Long-term Borrowings and Debentures

Objective

After going through this lesson, you shall be understand the following adjustments related to the Cash Flow Statement.

- Interest on Debentures (or Long-term Loans)
- Discount on Issue of Debentures

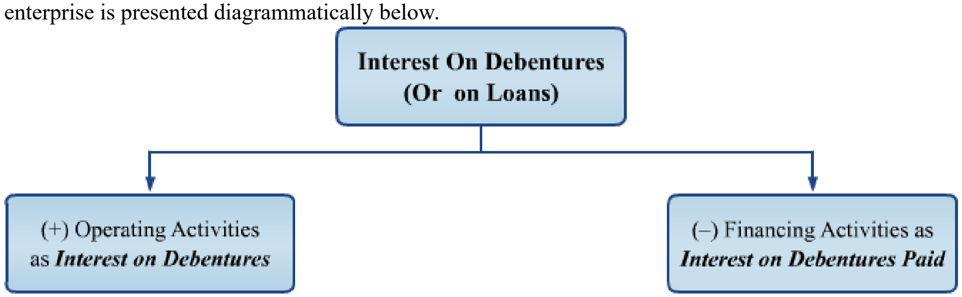
Introduction

As we all known that payments of interest on debentures and on any long-term loans are obligations for an enterprise that it has to discharge at any costs. In this lesson we will learn the treatment of interest on long-term loans and debentures in the preparation of Cash Flow Statement. But before proceeding further, let us recapitulate a few concepts related to the interest payments.

- Interest payments by the financial enterprises is considered as cash flow from operating activities as well as cash flow from financing activities.
- For the non-financial enterprises, interest paid is considered only as cash outflow from financing activity (and not as an operating activity).
- But, for the ***financial enterprises***, interest paid is added to the net profit in the operating activities and is deducted in the financing activities.

Interest on Debentures (or Long-term Loans)

In case, nothing specific is mentioned regarding the nature of the business enterprise, we assumed it to be as non-financial enterprise. Accordingly, the treatment of interest on debentures in case of non-financial enterprise is presented diagrammatically below.



The calculation of interest on debentures and its treatment is explained below with the help of the following cases.

***Case 1*: When rate of interest on debentures (or on Loans) is *not* mentioned**
Additional Information: NIL
In this case, as no rate of interest is mentioned, so no interest shall be provided on debentures (or on loans)

***Case 2*: When rate of interest is mentioned on debentures (or on Loans) and there is *no change* in the balance of debentures from the previous year.**
Additional Information: NIL
In this case, interest on debentures (or on loans) can be calculated either on the opening or closing balances of debentures (as there is no change in the two balances).

Example

Extracts of Balance Sheet
as on March 31

Particulars	Note No.	2011	2012
Non-Current Liabilities			
Long-Term Borrowings		1,00,000	1,00,000

NOTES TO ACCOUNTS

Particulars	2011	2012
Long-Term Borrowings		
(i) 12% Debentures	1,00,000	1,00,000

Additional Information: NIL
Calculation of Interest on Debentures

$$\text{Interest} = 1,00,000 \times \frac{12}{100} = \text{Rs } 12,000$$

Treatment

Operating Activity	Financing Activity
(+) Rs 12,000 added to Net Profit	(–) Rs 12,000 as Interest Paid

***Case 3*: When rate of interest is mentioned on debentures (or on Loans) and there is an *increase* in the balance of debenture from the previous year.**
Additional Information: Date of issue of debentures is *not mentioned*
Interest on debentures (or on loans) is calculated on the balance of the previous year and the interest so calculated is added to Operating Activities and deducted from the Financing Activities.

Example

Extracts of Balance Sheet
as on March 31

Particulars	Note No.	2011	2012
Non-Current Liabilities			
Long-Term Borrowings		1,00,000	1,50,000

NOTES TO ACCOUNTS

Particulars	2011	2012
Long-Term Borrowings		
(i) 12% Debentures	1,00,000	1,50,000

Additional Information: NIL

Calculation of Interest on Debentures

$$\text{Interest} = 1,00,000 \times \frac{12}{100} = \text{Rs } 12,000$$

Treatment

Operating Activity	Financing Activity
(+) Rs 12,000 added to Net Profit	(–) Rs 12,000 as Interest Paid

***Case 4*: When rate of interest is mentioned on debentures (or on Loans) and there is *<u>decrease</u>* in the balance of debenture from the previous year.**

Additional information: Date of redemption of debentures is *not mentioned*

Interest on debentures (or on loans) is calculated on the balance of the previous year and the interest so calculated is added to Operating Activities and deducted from the Financing Activities.

Example

Extracts of Balance Sheet
as on March 31

Particulars	**Note No.**	**2011**	**2012**
Non-Current Liabilities Long-Term Borrowings		1,00,000	70,000

NOTES TO ACCOUNTS

Particulars	**2011**	**2012**
Long-Term Borrowings (i) 12% Debentures	1,00,000	70,000

Additional Information: NIL

Calculation of Interest on Debentures

$$\text{Interest} = 1,00,000 \times \frac{12}{100} = \text{Rs } 12,000$$

Treatment

Operating Activity	Financing Activity
(+) Rs 12,000 added to Net Profit	(–) Rs 12,000 as Interest Paid

***Case 5*: When rate of interest on debentures (loan) is mentioned and there is an increase in the balance of debentures from the previous year**

Additional Information: Date of issue of debentures (raising loan) *is mentioned*.

Example

Extracts of Balance Sheet
as on March 31

Particulars	**Note No.**	**2011**	**2012**
Non-Current Liabilities Long-Term Borrowings		1,00,000	1,20,000

NOTES TO ACCOUNTS

Particulars	2011	2012
Long-Term Borrowings (i) 12% Debentures	1,00,000	1,20,000

Additional Information: Debentures of Rs 20,000 were issued on July 01, 2011.

Calculation of Interest on Debentures

Interest from April 01 to July 01, 2011	$=1,00,000\times\frac{12}{100}\times\frac{3}{12}$	= 3,000
Interest from July 01, 2011 to March 31, 2012	$=1,20,000\times\frac{12}{100}\times\frac{9}{12}$	= 10,800
Total Interest on Debentures		13,800

Treatment

Operating Activity	Financing Activity
(+) Rs 13,800 added to Net Profit	(–) Rs 13,800 as Interest Paid

***Case 6*: When rate of interest on debentures (loan) is mentioned and there is a decrease in the balance of debentures from the previous year**

Additional Information: Date of redemption of debentures (or repayment of loan) *is mentioned*.

Example

Extracts of Balance Sheet
as on March 31

Particulars	Note No.	2011	2012
Non-Current Liabilities Long-Term Borrowings		1,00,000	60,000

NOTES TO ACCOUNTS

Particulars	2011	2012
Long-Term Borrowings (i) 12% Debentures	1,00,000	60,000

Additional Information: Debentures were redeemed on Oct. 01, 2011.

Calculation of Interest on Debentures

Interest from April 01 to Sep 30, 2011	$=1,00,000\times\frac{12}{100}\times\frac{6}{12}$	= 6,000
Interest from Oct 01, 2011 to March 31, 2012	$=60,000\times\frac{12}{100}\times\frac{6}{12}$	= 3,600
Total Interest on Debentures		9,600

Treatment

Operating Activity	Financing Activity
(+) Rs 9,600 added to Net Profit	(–) Rs 9,600 as Interest Paid

***Case 7*: When rate of interest on debentures (loan) is mentioned and interest on debentures is outstanding in the current year.**

Example

Extracts of Balance Sheet

Particulars	Note No.	2011	2012
Non-Current Liabilities Long-Term Borrowings	1	1,00,000	1,00,000

Current Liabilities Other Current Liabilities	2	-	2,000

NOTES TO ACCOUNTS

Note 1

Particulars	2011	2012
Long-Term Borrowings (i) 12% Debentures	1,00,000	1,00,000

Note2

Particulars	2011	2012
Other Current Liabilities (i) Interest Outstanding on Debentures	-	2,000

Calculation of Interest on Debentures

Interest for the year 2012	$=1,00,000\times\frac{12}{100}$	= 12,000
Less: Interest Outstanding		(2,000)
Interest paid on Debentures		10,000

Treatment

Operating Activity	Financing Activity
(+) Rs 12,000 added to Net Profit	(–) Rs 10,000 as Interest Paid

***Case 8*: When rate of interest on debentures (or on loans) is mentioned and interest on debentures is outstanding for the previous year.**

Example

Extracts of Balance Sheet
as on March 31

Particulars	Note No.	2011	2012
Non-Current Liabilities Long-Term Borrowings	1	1,00,000	1,00,000
Current Liabilities Other Current Liabilities	2	2,000	-

NOTES TO ACCOUNTS

Note 1

Particulars	2011	2012
Long-Term Borrowings (i) 12% Debentures	1,00,000	1,00,000

Note2

Particulars	2011	2012
Other Current Liabilities (i) Interest Outstanding on Debentures	2,000	-

Calculation of Interest on Debentures

Interest for the year 2012	$=1,00,000\times\frac{12}{100}$	= 12,000
Add: Interest outstanding		2,000
Total Interest paid on Debentures		14,000

Treatment

Operating Activity	Financing Activity
(+) Rs 12,000 added to Net Profit	(–) Rs 14,000 as Interest Paid

Discount on Issue of Debentures

Discount allowed by a company on the issue of debentures is written-off during its life through its Statement of Profit and Loss. On account of the issue of new debentures, the amount of discount so allowed may increase. Any amount of discount allowed on issue of debentures is adjusted towards proceeds from such issue. The adjusted amount or the net proceeds is shown as Cash Flow from Financing Activities. On the other hand, the amount of discount written-off during the year is added back to the current year's profit to calculate the Cash Flow from Operating Activities.