SHERSHAH COLLEGE, SASARAM

MANAGEMENT ACCOUNTING

BBA PART II, PAPER X

CASH FLOW STATEMENT

(BY- MR. KUMAR MANGAL SINGH, SHERSHAH COLLEGE SASARAM)

Cash Flow Statement

● Meaning of Cash Flow and Cash Flow Statement:

- **Cash Flow:** A cash flow is the inflow (receipt) and the outflow (payment) of Cash and Cash equivalents, where cash and cash equivalents include Cash, Bank Balance, Marketable Securities, etc.(unless specified otherwise, Current Investments are considered as Marketable Securities).

- **Cash Flow Statement:** It is a statement that shows the inflows and the outflows of Cash and Cash Equivalents during the period. Inflows are those transactions that increase the Cash and Cash Equivalents and outflows are those transactions that decrease the Cash and Cash Equivalents. Such statement is prepared in accordance with the Accounting Standard-3 (Revised) on Cash Flow Statement. As per this accounting standard, cash flows are showed under the following 3 heads:

    1. Cash Flow from Operating Activities;
    2. Cash Flow from Investing Activities;
    3. Cash Flow from Financing Activities.

    1. **Cash Flow from Operating Activities:-** Activities related to core or principal revenue generating activities of an enterprise are called cash flow operating activities.

Cash Inflows:

i. from Cash Sales
ii. from Debtors
iii. as Commission and Royalty

Cash Outflows:

i. Cash Purchases

ii. Payment to creditors

iii. Payment of wages

2. **<u>Cash Flow from Investing Activities:-</u>** Activities related to sale and purchase of long-term fixed assets and investments are called cash flow investing activities.

Cash Inflows:

i. Proceeds from sale of Fixed Assets and Investments
ii. Interest and dividend received

Cash Outflows:

i. Purchase of long term fixed assets such as Land & Building, Plant & Machinery, Investments, etc.

3. **<u>Cash Flow from Financing Activities:-</u>** Activities related to capital or long term funds of an enterprise are known as cash flow from financing activities.

Cash Inflows:

i. Proceeds from Issue of Shares and Debentures for Cash
ii. Proceeds from Long-term Borrowings such as Bonds, Loans, etc.

Cash Outflows:

i. Repayment of Loans
ii. Redemption of Preference Shares and Debentures
iii. Buy-back of Equity Shares
iv. Payment of Dividend and Interest, etc.

Objectives of Cash Flow Statement

A Cash flow statement shows inflow and outflow of cash and cash equivalents from various activities of a company during a specific period. The primary objective of cash flow statement are determined:

1. To determine the sources of Cash and Cash Equivalents under operating, investing and financing activities of the enterprise.
2. To determine the applications of Cash and Cash Equivalents for operating, investing and financing activities of the enterprise.
3. To determine the net change in Cash and Cash Equivalents due to cash inflows and outflows for operating, investing and financing activities of the enterprise that take place between the two balance sheet dates.

Benefits of Cash Flow Statement

Cash flow statement provides the following benefits:

1. **To facilitate Short-term Planning:** It helps in planning investments and assessing the financial requirements of the enterprise based on information provided in the statement about the sources and applications of Cash and Cash Equivalents.
2. **To assess Liquidity and Solvency:** It helps in identifying the ability of the enterprise to meet its liabilities on time.
3. **To manage Cash Efficiently:** It provides information about the cash position by reflecting either a surplus of cash or a deficit of cash in the statement. This helps the enterprise to take decisions about the investment of surplus cash and the arrangement of deficit funds.
4. **To facilitate Comparative Study:** It facilitates the comparison of actual cash flows with the budgeted cash flows to identify whether the inflows and outflows of cash are moving as per the plan. Such comparison will also reflect deviations of the actual cash flows from the budgeted cash flows for which necessary actions are then taken by the enterprise.
5. **To justify Cash Position:** Cash flow statement is prepared to record all the cash inflows and outflows which result in the surplus or deficit of cash for an enterprise. Since, all the cash transactions are presented in the statement, it becomes easy to identify the items which increase or decrease the cash balances.
6. **To evaluate Management Decisions:** This statement classifies the cash transactions under 3 separate heads namely, operating, investing and financing. Such classification helps the users of the statement to evaluate whether the decisions taken by the management are appropriate from investing and financing point of view.

7. **To take dividend decisions:** In order to declare or approve the dividends, every enterprise should comply with the prescribed provisions e.g. depositing the amount of dividend in a separate bank, etc. Accordingly, to identify whether the enterprise has sufficient funds for such compliance cash flow statement is referred by the management. Also, it helps in deciding how much dividend the enterprise should pay during a particular year.

Limitations of Cash Flow Statement:

1. **Non-cash transactions are not shown:** It takes into consideration only cash inflows and cash outflows. Non-cash transactions are not considered for preparation of cash flow statement.
2. **Not a substitute for an Income Statement:** Cash flow statement cannot be used as a substitute for an Income Statement because Income Statement is prepared on accrual basis of accounting whereas cash flow statement is prepared on cash basis. Also, it is not possible to compute net profit or loss from the cash flow statement.
3. **Not a substitute for Balance Sheet:** Cash flow statement do not show the financial position of the enterprise and therefore, cannot be used as a substitute for Balance Sheet.
4. **Historical in Nature:** Cash flow statement is prepared based on the cash inflows and outflows that have already taken place during the year and hence, it is historical in nature.
5. **Assessment of Liquidity:** Cash flow statement takes into consideration all the transactions of cash and cash equivalents. This cash and cash equivalents is just one of the components in the current assets which determine the liquidity position of the enterprise. Therefore, cash flow statement alone cannot help in determining the liquidity position of the enterprise.
6. **Accuracy of Cash Flow Statement:** Since, the cash flow statement is prepared from the financial statements of an enterprise, accuracy of the same shall depend upon how accurately the financial statements of the enterprise are prepared.

Points to be noted:-

• **Transactions not regarded as Cash Flow:** These are the transactions that are mere movements in between the items of Cash and Cash Equivalents. This includes cash deposited in bank, cash withdrawn from the bank and purchase or sale of marketable securities.

• **Non-cash transactions:** These are the transactions in which the inflow or outflow of Cash or Cash Equivalent does not take place. Therefore, these non-cash transactions

are not considered while preparing the Cash Flow Statements. These transactions include depreciation, amortization, issue of bonus, etc.