# UNIT 5: STATEMENT OF CHANGES IN FINANCIAL POSITION (CASH FLOW STATEMENT)

**Structure** **Page No.**



## 5.0 INTRODUCTION

In preceding unit, you learned that every business firm prepares two financial statements i.e. Profit & Loss Account or Income Statement Account and Balance Sheet or Position Statement. You are aware that the former reflects the state of a firm's assets and liabilities at the end of a specific year, whilst the latter talks about the firm's operations throughout a specific time period, such as a year. These financial statements are quite useful, but they do not show the sources and uses of monies over time. For example, a company that has made significant profits during the year may find it difficult to pay for day-to-day expenses. i.e. rent, interest, dividend, taxes etc as firm has not enough liquid funds and profits have been used in other assets. Therefore, in order to remove this defect, another statement with the help of Balance-sheet and Income Statement) which may identify the changes in assets, liabilities and the shareholders funds over a given period of time known as 'Statement of Changes in Financial Position (SCFP). This unit is an attempt to discuss the concepts relating to the preparation of Statement of Changes in Financial Position under different concepts.

A funds flow statement is generated to determine a company's periodic increase or decrease in working capital. The statement emphasises the sources and uses of working capital and exposes changes in the firm's financial structure between two balance-sheet dates.

It is also possible that, despite having adequate working capital as disclosed by the funds flow statement, the firm will be unable to fulfil its current liabilities as and when they become due. It could be due to stock building and an increase in trade receivables as a result of a slowdown in collections. In this case, another statement, the Cash Flow Statement, is created, which is more informative because it provides precise information about cash inflows and outflows. Thus, it is a vital financial tool for management since it aids in efficient cash management, discloses cash movement, aids in internal financial management, and reveals the success or failure of cash planning. In this unit, emphasis has been given on the various concepts that are used in the preparation of Funds Flow Statement and Cash Flow Statement.

## 5.1 OBJECTIVES

After completing this unit, you should be able to:

- Grasp the importance of preparing a Statement of Changes in Financial Position;
- Comprehend the concept of cash flowing through a corporation in a dynamic context.
- Understanding the sources and uses of working capital as well as cash during an accounting period from the financial statements;
- Understanding and interpreting changes in working capital and cash, determining the causes of these changesdiscuss the main parts of a statement of fund flow and cash flows and the information required to prepare the same and
- Prepare and use the funds flow statement and the cash flow statement as analytical tools.

## 5.2 STATEMENTS OF CHANGES IN FINANCIAL POSITIONS (SCFP)

The balance sheet and Profit & Loss account of a firm shows its financial position on a particular date and expressing the result of operations during the year respectively. Its use is limited for planning and analysis. Hence, these two financial statements provide useful financial information related to the operation of the firm. However, both these statements fail to provide the various reasons on the changes in assets, liabilities and owner's wealth during the year. The Financial Manager of any firm should know the funds flow of a balance sheet relating to its internal changes so there is a need to prepare another statement (apart from the Balance-sheet and Profit & Loss Account) which may identify the causes of changes in assets, liabilities and owner's funds over a given period. This statement is known as 'Statement of Changes in Financial Position (SCFP). Such a statement provides the basis for policy formulation by acting as financial reporting medium. Statement of Changes in Financial Position is a statement which is prepared to describe the changes in the financial position of a firm during a particular period. It identifies the sources and uses of funds during an accounting period. Now, the question that arises is as to 'what the term funds mean to'? It may be noted that there are several concepts of funds, out of which one concept use it in the narrow sense and include in the term 'funds' only cash and its equivalent and is used for expressing the liquidity of a business firm, while on the other hand, others use it in the broader sense, it represents the working capital (Current Assets - Current Liabilities) of a firm.

Accordingly, based on these two concepts of the term funds, the SCFP can be prepared viz.:

(i) SCFP - A Statement based on working capital/net current assets which is known as 'Funds Flow Statement'

The statement showing changes in financial position is also known as 'Funds Flow Statement', 'Management of Funds Statement' etc.

(ii) SCFP based on cash basis also known as 'Cash Flow Statement' and therefore, considers only receipts and payments of cash and transactions affecting the firm's cash position.

## 5.3 SCFP-(WORKING CAPITAL BASIS): FUNDS FLOW STATEMENT

A fund flow statement is a statement prepared to analyse the reasons for changes in the financial position of a company between two balance sheets. It portrays the inflow and outflow of funds i.e. sources of funds and applications of funds for a particular period.As discussed in the previous paragraphs, fund flow statement is one of the tools for analysing the financial position of a firm. It is a statement showing how funds are obtained and utilised for various business activities in a specific period is called 'funds flow statement.

According to Robert N Anthony; ***"****The funds flow statement describes the sources from which additional funds were derived and the use to which these sources were put****."***

***Roy A. Foulke defines funds flow statement as : " ****A statement of sources and application of funds is a technical device designed to analyse the changes in the financial condition of a business enterprise between two dates.***"**

Thus, funds flow statement is a statement showing the sources and uses of funds in a business firm during a certain period, generally an accounting period.

**Concept of 'Funds' and 'Flow'**

For clear understanding of funds flow analysis, the meaning of the terms 'Funds and 'Flow' should be clear in your mind. First, let us understand what is called funds ?

**Funds -** In the preparation of funds flow statement, the meaning of funds is very important. As discussed earlier, that the fund has a special meaning with reference to the preparation of funds flow statement. The term 'fund' has been used differently by the different financial experts. Some called cash as a narrow concept fund while others In the broadest meaning, the term "Fund" refers to working capital, that is, the excess of current assets over current liabilities. As a result, in this sense, the funds flow statement includes all transactions affecting current assets and current liabilities.

**Flow of Funds** - Flow of funds would take place when a business transaction causes a change in the amount of funds (working capital) that existed before the transaction. The flow of funds is recognized from the degree of change in the amount of working capital by a transaction; if it increases the amount of working, it is referred to as source of funds (inflow) whereas decrease in working capital indicates application of funds (outflow). If a transaction fails to cause a change in the amount of working capital, it does not amount to flow of funds.

## Check Your Progress 1

**1) What is statement of changes in financial position?**

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**2) Why a firm is required to prepare the statement of changes in financial position?**

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**3) What do you mean by 'Funds'?**

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**4) When any transaction is called a movement in funds?**

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**5. What are not fund items? Give examples.**

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## 5.4 CONSTRUCTION OF FUNDS FLOW STATEMENT

The construction of funds flow statement involves decisions regarding the following two important aspects -

(a) Sources of Information; and

(b) Preparing procedure.

**Sources of Information:** For the preparation of funds flow statement the following information are required -

- Two comparative balance sheets; one at the beginning and second at the end of the period;
- Summarised income statement comprising non-fund and non-operating items required for computing funds from operations
- Statement of retained earnings to identify hidden information and
- Supplementary information regarding change in the non-current accounts like Furniture, plant & machinery, Motor car, Buildings, Share capital, Debentures etc.

**Preparing procedure -** Funds Flow Statement involves the following two statements, namely -

(a) Statement of Changes in Working Capital

(b) Statement of Flow of Funds/ Funds Flow Statement

### 5.4.1. Statement of Changes in Working Capital

A statement of changes in working capital is prepared by recording changes in current assets and current liabilities during the accounting period. Working capital during this period is bound to change due to an increase or decrease in the current assets and current liabilities.The statement of changes in working capital compares the number of current accounts - current assets and current liabilities - between the two balance sheet dates and illustrates the impact on working capital.

While preparing the statement of changes in working capital, the following rules are important in relation to this statement -

1. (i) Increase in a current assets items - increases in working capital;

   (ii) Decrease in a current assets items - decreases in working capital;

   (iii) Increase in a current liability items - decreases in working capital; and

   (iv) Decrease in a current liability items - increases in working capital.

In short, current assets have direct relation with working capital and current liabilities have inverse relation with working capital.

***1.*** The difference of total current assets and total current liabilities of a year is its net working capital at the end of the current year is more than the working capital at the end of previous year, the excess is called as 'Increase in Working Capital'. On the other hand, if previous year's working capital is more than the current year's working capital, the excess is called as 'Decrease in Working Capital'. ***Increase in Working Capital is shown as application of funds and Decrease in Working Capital as source of funds in the Funds Flow Statement.***

***The format of Statement of changes in working capital is given below -***

***Statement of changes in working capital***

| Items | Ist year (Rs) | IInd Year (Rs) | Effect on Working Capital (Rs) | |
|---|---|---|---|---|
| | | | Increase(+) | Decrease(-) |
| **A. <u>Current Assets:</u>** | | | | |
| Trade debtors | | | | |
| Inventory | | | | |
| Cash | | | | |
| Bills Receivables | | | | |
| Prepaid Expenses | | | | |
| ***Total Current Asset(A)*** | | | | |
| B. Current Liabilities: | | | | |
| Trade creditors | | | | |
| Bills Payable | | | | |
| Outstanding expenses | | | | |
| **Total Current Liabilities (B)** | | | | |
| Working Capital (A-B) | | | | |
| Increase in working capital | | | | |
| | | | | |

*The changes in current accounts, i.e. current assets and current liabilities are to be computed by comparing the figures for such accounts in the current period with that of the previous period. The amount of change so computed for each item of the current accounts along with its impact on the amount of working capital is to be recorded in the statement of changes in working capital.*

***In the following example 2.1 the particulars regarding the changes in current assets and current liabilities of 2020 and 2021 of Radha Electronics Ltd are given -***

| Liabilities | 31st Dec. 2020 (Rs) | 31st Dec. 2021 (Rs) | Assets | 31st Dec. 2020 (Rs) | 31st Dec. 2021 (Rs) |
|---|---|---|---|---|---|
| Share capital | 12,00,000 | 15,00,000 | Building | 10,00,000 | 12,50,000 |
| Sundry Creditors | 3,70,000 | 2,50,000 | Machinery | 7,50,000 | 9,00,000 |
| Bill payable | 1,50,000 | 1,70,000 | Patents rights | 70,000 | 95,000 |
| Profit & Loss A/c | 6,00,000 | 6,90,000 | Cash | 1,70,000 | 2,30,000 |
| | | | Sundry debtors | 3,30,000 | 1,35,000 |

| | | | | | |
|---|---|---|---|---|---|
| | 23,20,000 | 26,10,000 | | 23,20,000 | 26,10,000 |

Additional Information:

Depreciation of Rs 2,00,000 and Rs 2,50,000 have been charged on Building and Machinery respectively in 2021.

Prepare (a) Statement of changes in working capital; and (b) Funds flow statement.

**Solution -**

**Radha Electronics Ltd**

**Statement of Changes in Working Capital**

| Items | 2020 (Rs) | 2021 (Rs) | Effect on Working Capital (Rs) | |
|---|---|---|---|---|
| | | | Increase(+) | Decrease(-) |
| A. Current Assets: | | | | |
| Cash | 1,70,000 | 2,30,000 | 60,000 | |
| Sundry debtors | 3,30,000 | 1,35,000 | | 1,95,000 |
| Total Current Asset(A) | 5,00,000 | 3,65,000 | | |
| B. Current Liabilities: | | | | |
| Sundry creditors | 3,70,000 | 2,50,000 | 1,20,000 | |
| Bills payable | 1,50,000 | 1,70,000 | | 20,000 |
| Total Current Liabilities(B) | 5,20,000 | 4,20,000 | | |
| Working Capital (A-B) | (20,000) | (55,000) | | |
| Decrease in working capital | (35,000) | - | 35,000 | |
| | (55,000) | (55,000) | 2,15,000 | 2,15,000 |

## 5.4.2. Statement of Flow of Funds/ Funds Flow Statement

Funds flow statement is a financial document that analyses a company's balance sheet of two years to validate the movements of funds from the previous financial year to the current year. It compares the sources of inflow and outflow of funds during the concerned accounting period and analyses how it affects the working capital of an organisation. For the preparation of statement of sources and application of funds, we should be clear about the terms 'Sources and Application'.

**Sources (Inflow)** refers to a situation when a transaction increases the amount of funds (working capital), and

**Application** (**Outflow**) means a transaction that result in the reduction of funds.

As discussed already, such an increase or decrease in the fund may take place when current and non-current items are changed simultaneously as a result of a transaction. The increase in the funds (source) is recorded as a debit. Therefore, credits represent sources of fund and debits represent application of fund. For a better understanding of these terms, the important sources and uses of funds are summarised below -

## Sources of Funds -

(i) Issues Debentures and Debentures

(ii) Long term loans

(iii) Funds from Operations Activities/ Operational profits*

(iv) Income from investment I.e. dividend, interest received

(v) Sale of fixed assets (actual amount realised)

**Application of Funds** -

(i) Redemption of Preference shares

(ii) Redemption of Debentures

(iii) Purchase of investments

(iv) Purchase of fixed assets

(v) Operational losses*

(vi) Payment of long-term loans

(vii) Payment of taxes/dividend

Thus, from above discussion, we may conclude that -

(a) Decrease in non-current assets = Sources of funds

(b) Increase in non-current liabilities = Sources of funds

(c) Increase in non-current assets = Application of funds

(d) Decrease in non-current liabilities = Application of funds

The Dual-aspect concept of accounting suggests that the total of sources of funds must reconcile with the total application of funds. This principle is similar to that of the Balance-sheet where total assets equal total liabilities. Therefore,

(a) Sources of Funds = Application of Funds

(b) Increase in Liabilities + Decrease in Assets = Decrease in Liabilities + Increase in Assets.

**Format of Funds Flow Statement**

There is no standard form prescribed for the presentation of funds flow statement. Different formats are used for the purpose depending upon the objective of analysis. However, the commonly used format is 'T form' or account form where sources are shown on the left side and application of funds on the right side of the statement.

Transactions that lead to an increase in working capital appear under the head of Sources like sale of furniture, issue of debentures etc. On the other hand, the Transactions that lead to a decrease in working capital appear under the head of Application / Uses of Funds like purchase of land and building, redemption of debentures etc. The transactions that do not affect working capital, are not shown in funds flow statement like purchase of building for consideration other than cash, e.g. by issuing of shares, issue of bonus shares etc.

The format of 'Funds Flow Statement' is shown below -

## Funds Flow Statement

| Sources of Funds | Amount Rs | Application of Funds | Amount Rs. |
|---|---|---|---|
| **1.** Issue of Shares | -- | Redemption of Debentures | --- |
| **2.** Issue of Debentures | -- | Repayment of long term loans | -- |
| **3.** Long term loans raised | -- | Purchase of fixed assets | --- |
| **4.** Funds from Operations* | -- | Funds lost in Operations* | --- |
| **5.** Sale of fixed Assets | -- | Sale of Investments | --- |
| **6.** Non-trading receipts e.g. dividends, interest | --- | Non-trading payments dividend, interest etc | --- |
| 7. Other receipts e.g donations | | | |
| Decrease in Working Capital (as per schedule of changes in Working capital) | --- | Increase in Working Capital (as per schedule of changes in Working capital) | --- |
| Total | ----- | Total | ---- |

## 5.4.3. *Funds from Operations (Funds lost in Operations)/Operational Profits (Operational Loss)

It refers to the operational profit or loss of firm which are considered as sources and application of funds respectively. Net Profit or Loss of Profit & Loss Account can not be considered as funds from operations without making certain adjustments. Certain item (non-funds and non-trading) are added back and certain other items (non trading) are subtracted from this net profit of loss to arrive the funds from operations. The procedure for adjusting profit and loss account, in order to arrive funds from operations is an under -

| Particulars | Rs. | Rs. |
|---|---|---|
| Net Profit as per Profit and Loss Account | | xxx |
| Add - (i) Goodwill, Patent, Trade mark written off | 000 | |
| (iii) Depreciation charged for the year | 000 | |
| (iv) Preliminary Expenses written off | 000 | |
| (v) Discount on issue of shares/debentures written off | 000 | |
| (vi) Premium on redemption of debentures/sharer written off | 000 | |
| (vii) Loss on sale of fixed assets | 000 | |
| (viii) Provision for Income tax | 000 | |
| (ix) Proposed dividend (current year) | 000 | |
| (x) Capital Expenditure | 000 | |
| (xi) Any other items e.g. transfer to sinking funds | 000 | xxx |
| | | Xxxx |
| Less - Non-fund items and Non-trading items (already Credited in Profit & Loss Account) | | |
| (i) Gain on sale /revaluation of fixed assets | 000 | |
| (ii) Dividend received on investment | 000 | |
| (iii) Excess Provisions written back | 000 | |
| (iv) Any other items | 000 | xxxx |
| **Funds from Operations (Funds lost in Operations)** | | **XXX** |

Now, in the above example of 2.1, we will construct the Funds Flow Statement -

**Radha Electronics Ltd.**
**Funds Flow Statement**

| Sources | Amount (Rs) | Applications | Amount (Rs) |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Issue of Shares<br>Funds from operations[1]<br>Decrease in working capital | 3,00,000<br>5,40,000<br><br>35,000 | Purchase of Building[2]<br>Purchase of Machinery[3]<br>Purchase of patents | <br>4,50,000<br><br>4,00,000<br>25,000 |
| | 8,75,000 | | 8,75,000 |

**Working Notes:**

1. **Calculation of funds from operation**:

| | (Rs) | (Rs) |
|---|---|---|
| Net Profit for the year (6,90,000 - 6,00,000) | | 90,000 |
| Add: Depreciation | 2,00,000 | |
| Building | 2,50,000 | 4,50,000 |
| Machinery | | |
| **Funds from operation** | | **5,40,000** |

2. **Calculation of Building purchased during the year:**

**Building Account**

| Particulars | Rs | Particulars | Rs |
|---|---|---|---|
| To Balance b/d<br>To Cash- Purchase<br>(balancing figure) | 10,00,000<br>4,50,000 | By Depreciation<br>By Balance c/d | 2,00,000<br>12,50,000 |
| | 14,50,000 | | 14,50,000 |

3. **Calculation of Machinery purchase during the year:**

**Machinery Account**

| Particulars | Rs | Particulars | Rs |
|---|---|---|---|
| To Balance b/d<br>To Cash- Purchase<br>(balancing figure) | 7,50,000<br>4,00,000 | By Depreciation<br>By Balance c/d | 2,50,000<br>9,00,000 |
| | 11,50,000 | | 11,50,000 |

## 5.5 USES OR OBJECTS OF FUNDS FLOW ANALYSIS

The funds flow statement has been widely used by the financial users, financial analysts, the institutions granting loans and the financial managers. Under this technique, a funds flow statement is prepared to reflect the movement of funds between two balance-sheet dates. The purpose of this statement is to improve the understanding of the operation and activities of a firm for the reporting period. This statement indicates the effectiveness of the finance department in generating funds from numerous sources and successfully using them to generate profits without jeopardising the firm's financial health. Therefore, this statement is a great significance to all - management of the business, shareholders, bankers and creditors.

**Check Your Progress 2**

1) **Write main sources of funds in an organisation.**

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2) **List the 6 main short term and long-term uses of funds in an organisation.**

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**3) Define 'Funds from Operation'?**

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4. **Which of the following transaction is a source/application/no flow funds?**

(a) Provision for taxation

(b) Dividend Received

(c) Purchase of Machinery by issuing of shares

(d) Collection of cash from debtors

(e) Decrease in Working capital

(f) Net profit of the year

(g) Purchase of plant

(h) Redemption of debentures

**Ans - Source of funds - a, b, e, f**
**Application of funds - g, h**
**No flow of funds - c, d**

## 5.6 SCFP (CASH BASIS): CASH FLOW STATMENT

A cash flow statement is an important tool used to manage finances by tracking the cash flow for an organization. This statement is one of the three key reports (with the income statement and the balance sheet) that help in determining a company's performance. While the proportion of aggregate investment in total assets held in the form of cash is quite small, often between 1% and 5%, its efficient management is crucial to the solvency of the business firm since cash is the focal point of fund flow in a business. It's also known as the 'life blood' of a company because of its significance. As a result, one of the most important jobs of management is to oversee and monitor the firm's cash position in order to ensure that sufficient cash is available to meet the firm's needs. Management uses another document called the "Statement of Changes in Financial Position based on Cash - i.e. Cash Flow Statement" to efficiently discharge this requirement. The purpose of such a statement is to track the cash inflows and outflows that occur as a result of various business activities.

A Cash Flow Statement is a financial statement that shows how the cash position has changed over time by identifying the main sources and uses of cash. A balance sheet, for example, Balance sheet indicates the cash balance as of a certain date is 31.03.2022 at Rs 75,00,000/ while the cash balance as per it previous year balance sheet as on 31.03.2021 was Rs 55,00,000/. The cash flow statement explains why there was an inflow of Rs 20,00,000 over the course of a year.

The main goal of cash flow analysis is to figure out what transactions caused the cash balance to fluctuate over time. In the hands of management, the cash flow statement is an important planning tool. This aids management in making strategies for immediate cash demands in the future. The following are some of its primary applications:

* Discloses the various sources of cash

* Discloses the various uses of cash;

* Helps in efficient cash management

* Discloses the success or failure of cash planning.

* Helps in internal financial management

## 5.7 COMPONENTS OF CASH FLOW STATEMENT

A cash flow statement is divided into 3 sections. Each head signifies the source from which a company can make money. A positive cash flow indicates cash inflows, whereas a negative cash flow indicates cash outflows**.**Cash Flow Statement is based on balance sheet, profit & loss account, profit & loss appropriation account and other given information. The council of Institute of Chartered Accountants of India (ICAI) issued on 3rd March, 1997 revised Accounting Standard 3 (Revised AS -3) superseding the AS -3 issued in June 1981This Accounting Standard is recommended for use by firms listed on a recognised stock market, as well as other commercial, industrial, and business entities in the public and private sectors with a turnover of more than Rs 50 crore in a financial year, in the early years. All of these businesses must prepare a cash flow statement in accordance with AS -3 (Revised) and display it as an important component of their financial statements for each period for which they are prepared.

The Cash flow statement should report cash flows during the period under analysis classified into the three broad components i.e., **Operating Activities, Investing Activities** and **Financing Activities.** A brief discussion of each of these components is given below:

(1) **Cash Flows from Operating Activities**: A business's major revenue-generating activities are its operating activities. The cash flows from this are often the outcome of transactions and other events that affect net profit or loss. The following are some examples of cash flows from operating activities:

(i) Cash inflows associated with sales and rendering of services;

(ii) Cash inflows from fees, commission, royalties and other revenues;

(iii) Cash outflows from operating expenses, such as payments to suppliers of goods or services, wages, interest, and taxes, and so on.

(iv) Change in current assets, e.g., Receivables, inventory, and changes in current liabilities, including accounts payable, salaries payable, interest due, and taxes payable, are all indicative of operating activity.

**(2) Cash Flows from Investing Activities**: The acquisition and sale of fixed assets such as land and buildings, plant and machinery, and the purchasing and selling of investments and other investments not included in cash equivalents are the cash flows from this activity. The acquisition of these assets results in a financial outflow, whereas their disposal results in a cash inflow. They show how much money has been spent on resources that are expected to create future income and cash flows..

**(3) Cash Flows from Financing Activities:** Financing activities include changes in the quantity and composition of owner's equity and preference capital, debentures, long-term loans, and other similar items. Cash inflow is implied by the issuance of equity, preference, and debenture capital, as well as the raising of long-term loans. On the other side, cash outflow is related with capital retirement, dividend payments to shareholders, debenture redemption, and long-term debt amortisation.

The net gain or reduction in cash flow for the company is computed by adding the findings from each section.

Securities and Exchange Board of India (SEBI) has prescribed format for cash flow statement for listed companies. You can follow the following format as per AS -3 for the preparing of Cash Flow Statement for a firm other than financial enterprise.

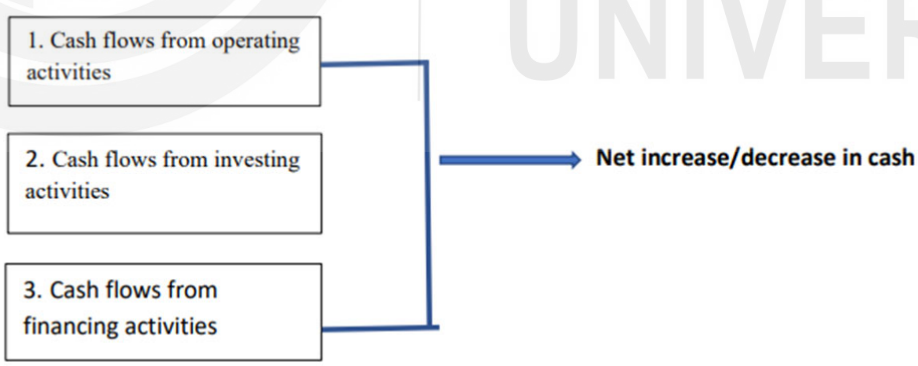
The format of the cash flows statement is given below:

| | | |
|---|---|---|
| *Cash Flows from Operations* | | |
| **Net Profit** | | **XXX** |
| *Add:* Any deducted non-cash item | | |
| Depreciation | XX | |
| Loss on disposal | XX | |
| Decrease in current assets | XX | |
| Increase in current liabilities | XX | XXX |
| *Less:* any added non-cash item | | |
| Gain on disposal | (XX) | |
| Increase in current assets | (XX) | |
| Decrease in current liabilities | (XX) | (XX) |
| **Net Cash flows from Operations** | | **XXX** |
| | | |
| *Cash Flows from Investment* | | |
| Proceeds from disposal of assets | | XXX |
| Dividend received | | XX |
| Purchase of assets | | (XX) |
| Net Cash flows from Investment | | XXX |
| | | |
| *Cash Flows from Financing* | | |
| Dividends paid | | (XX) |
| Issuance of stocks | | XXX |
| Increase in notes payables | | X |
| Increase in long term debt | | XX |
| Net Cash flows from Financing | | XXX |
| Increase in Cash and Marketable Securities | | XXX |
| Beginning Cash and Marketable securities | | XX |
| Ending Cash and Marketable securities | | XX |
| Change in Actual Cash Balance | | XXX |

Note: Listed companies in India must use the indirect method. But, the answer would be same whether the Cash Flow Statement is prepared by using the direct or indirect method.

**The summarised Cash Flow Statement is:**

**Net increase/decrease in cash**




## 5.8 DEFINITIONS OF CERTAIN TERMS AS PER AS -3

The following terms are used in AS -3(Revised) - Cash Flow Statement with the meanings specified -

**Cash -** It consists of cash in hand as well as demand deposits with banks. - It consists of cash on hand as well as demand deposits with banks.

**Cash Equivalents** - Cash equivalents are short-term highly liquid investments I.e. Government securities that may be converted into spendable cash resources without delay or loss in value.

**Cash Cycle -** It denotes the period of time when cash is locked up in operations.

**Cash Flows-** Change in the cash position of the firm I.e., shows inflows and outflows of cash and cash equivalents.

**Operating Activities -** These are the primary revenue-generating activities of any business, as well as any additional activity that are not investing or financing activities.

**Investing Activities -** These are the buying and selling of long-term assets and other investments that are not cash equivalents.

**Financing Activities -** These are those which are the result in changes in the size and composition of the owners' capital (including equity share capital, preference share capital in case of a company) and borrowings of the business firm.

**Check Your Progress 3**

1) **Define 'Cash Flow Statement'?**

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**Mention any four uses of Cash Flow Statement.**

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**What do you mean by cash and cash equivalent in view of the AS-3?**

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**4. What are the activities in which cash flows are classified as per AS 3?**

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**5) Differentiate between a cash flow and a fund flow statement.**

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## 5.9 CONSTRUCTION OF CASH FLOW STATEMENT

Most simply, cash flow statements tell the story of how much cash a company has coming in (inflows), and how much it has going out (outflows). A cash flow statement shows how much cash a business has on hand, and how that number is changing over time. A typical cash flow statement shows cash flow on a monthly basis over a 12 month period. Let's look at how to make a cash flow statement, which shows all cash inflows and outflows in terms of operating, investing, and financing operations. The net cash flow supplied by or utilised in each of a company firm's three major activities should then be highlighted. Make sure the sum of net cash flows from operating, investing, and financing activities equals the net increase or decrease in cash and cash equivalents indicated in the comparative balance sheets.

**Calculation of Cash Flow from Operating Activities -**

A business firm should calculate cash flows from operating activities using either -

(i) The Direct Method; or

(ii) The Indirect Method.

**Note - Direct and Indirect methods of preparing**

**Direct Method**

Major kinds of gross cash revenues and gross cash payments are disclosed using the direct approach. This is depicted in the diagram below –

**Cash Flows from Operating Activities -**

(i) ***Cash Receipts from Customers:***

- Net sales per the Income Statement
- (+) Opening Balance in Accounts Receivable
- (-) Closing Balance in Accounts Receivable
- Equals Cash Receipts from Customers

***(ii) Cash Payments for Inventory:***

- Inventory at the end of financial year
- (-) Closing Balance Inventory
- (+) Opening Balance in Accounts Payable to Vendors
- (-) Closing Balance in Accounts Payable to Vendors
- Equals Cash Payments for Inventory

***(iii) Cash Paid to Employees:***

- Salaries and Wages per the Income Statement
- (+) Opening Balance in Salaries and Wages Payable
- (-) Closing Balance in salaries and Wages Payable
- Equals Cash Paid to Employees

***(iv) Cash Paid for Operating Expenses:***

- Operating Expenses per the Income Statement
- (-) Depreciation Expenses
- (+) Increase or (-) Decrease in Prepaid Expenses
- (+) Decrease or (-) Increase in Accrued Expenses
- Equals Cash Paid for Operating Expenses

***(v) Taxes paid:***

- Tax Expense per the Income Statement
- (+) Opening Balance in Taxes Payable
- (-) Closing Balance in Taxes Payable
- Equals Taxes Paid

In this case, you would use the direct method to report the following in the cash flows from operating activities section of the cash flow statement:

(i) Cash Receipts from Customers

(ii) Cash Paid to Employees

(iii) Cash Payments for Inventory

(iv) Cash Paid for Operating Expenses

(v) Interest Paid

(vi) Taxes Paid

***Equals Net Cash provided by (used in) Operating Activities.***

Similar types of computations can be conducted on the balance sheet accounts to exclude the effects of accrual accounting and determine the cash flows to be reported in the investing and financing activities components of the cash flow statement.

**Indirect Method**

You prepare the cash flows from the operating activities section using the indirect method, beginning with net profit/income before income tax and extraordinary items from the profit & loss account / income statement, reverse out entries to income and expense accounts that do not involve a cash movement, and show the change in net working capital. Income earned but not yet received, amortization of prepaid expenses, accumulated expenses, and depreciation or amortization are examples of entries that effect net income but do not represent cash flows. This strategy entails examining your income and expense accounts, as well as your working capital. The indirect technique would be reflected in the following way on the cash flows from operating activities:

**Cash Flows from Operating Activities -**

| | Rs. |
|---|---|
| Net Profit/Income before income tax and extraordinary items | |
| As per profit & loss account/Income Statement | xxx |
| **Adjustments for**: | |
| Depreciation | |
| Dividend Income | |
| Interest Income | |
| Gain/Loss on sale of Fixed Assets/Investment | |
| ***Cash Flows from Operating Activities*** | |

Amortization of Intangible Assets

Foreign Exchange gain/loss

***Operating Profit before Working Capital Changes***

**Adjustments for changes in Working Capital -**

**Add - a.** Decrease in Current Assets (excluding cash and cash equivalents)

**b.** Increase in current liabilities

**Less** - **a.** Increase in Current Assets (excluding cash and cash equivalents)

**b.** Decrease in current liabilities

***Cash generated from operations***

***Less -*** Income Tax Paid (Net of Refunds)

Adjustment for Extraordinary items (Net of Tax)

**Net Cash From (Used in) Operation Activities**

**Note -** ***Listed Companies in India must use the Indirect method. Both the methods give same figure of cash from operating activities.***

There is no difference in calculating the cash flows from investing activities and financing activities and would be presented in the cash flow statement in the same way under the both method.

The Direct Method for preparing a cash flow statement is a simple activity that is left to the students to complete. We'll use an indirect way to examine the cash flow statement in this case, as shown in the figure below:

We use the above approach and procedure in preparing cash flow statement in Illustration 2.2.-

Varsha Ltd, provides you the following information for the year ended 31st March, 2022:

| | Rs. |
|---|---|
| (a) Cash and bank balances as on 31st March, 2022 | 20,00,000 |
| (b) Cash and bank balances as on 1st April, 2021 | 15,00,000 |
| (c) Net Profit before tax provision | 90,00,000 |
| (d) Income Tax paid | 12,75,000 |

| | |
|---|---|
| (e) Dividend paid | 25,50,500 |
| (f) Book value of Assets Sold | 55,500 |
| Loss on sale of assets | 12,000 |
| (g) Depreciation debited to Profit & Loss Account | 60,00,000 |
| (h) Capital grant received -amortised in Profit and Loss Account | 2,500 |
| (i) Increase in Working Capital (excluding cash and bank balance) | 1,68,22,500 |
| (j) Grant received for capital projects | 4,500 |
| (k) Purchase of Fixed Assets | 55,23,000 |
| (l) Expenditure on Construction Work | 1,04,22,000 |
| (m) Long Term Borrowings from financial institution | 1,39,66,500 |
| (n) Provision for Income Tax debited in Profit & Loss Account | 15,00,000 |
| (o) Interest expenses debited in Profit & Loss Account | 30,00,000 |
| (p) Interest actually paid 32,60,500 | |
| (q) Interest income credited to Profit & Loss Account | 7,50,000 |
| (r) Book Value of Investment sole | 83,29,500 |
| Profit on Sale of Investment | 30,000 |

You are required to prepare a Cash Flow Statement as per AS-3 (Revised).

**Solution -**

## <u>VARSHA LTD.</u>

## CASH FLOW STATEMENT as per AS-3 (Revised)

## For the year ended 31st March, 2022

| | Rs. | Rs. |
|---|---|---|
| **I. Cash Flows from Operating Activities** | | |
| Net Profit before tax as per Profit & Loss Account | 90,00,000 | |
| Add - Non -Cash expenses - | | |
| Depreciation | 60,00,000 | |
| Loss on sale of assets | 12,000 | |

| | | |
|---|---|---|
| Interest Expenses | 30,00,000 | |
| | 90,12,000 | |
| Less - Non- Cash income - | | |
| Amortization of capital grant received | (2,500) | |
| Profit on sale of investments | (30,000) | |
| Interest income from investments | (7,50,000) | |
| **Operating profit before changes in working capital** | 1,72,29,500 | |
| Less - Increase in Working Capital | (1,68,22,500) | |
| **Cash from Operations** | 4,07,000 | |
| Less - Income Tax Paid | (12,75,000) | |
| **Net Cash Outflows in Operating Activities** | | (8,68,000) |
| **II. Cash Flows from Investing Activities** | | |
| Sale of Assets ( Rs 55,500 -12,000) | 43,500 | |
| Sale of Investments (Rs 83,29,500 + 30,000) | 83,59,500 | |
| Interest income from investments | 7,50,000 | |
| Purchase of Fixed Assets | (55,23,000) | |
| Expenses on Construction Work | (1,04,22,000) | |
| **Net Cash Outflows in Investing Activities** | | (67,92,000) |
| **III. Cash Flows from Financing Activities** | | |
| Dividend paid | (25,50,500) | |
| Grants for Capital Projects | 4,500 | |
| Long-term borrowings | 1,39,66,500 | |
| Interest paid | (32,60,500) | |
| **Net Cash Inflows from Financing Activities** | | 81,60,000 |
| **IV. Net Increase in Cash and Cash Equivalents** | | **5,00,000** |
| **V. Cash and Bank balance as on 01.04.2021** | | **15,00,000** |
| **VI. Cash and Bank balance as on 31.03.2022** | | **20,00,000** |

## 5.10 IND AS 7 STATEMENT OF CASH FLOWS

According to the Cash flows from investment activities roadmap for implementation of Ind AS provided under the Enterprises (Indian Accounting Standards) Rules, 2015, released by the Ministry of Corporate Affairs, the Indian Accounting Standard is applicable to a certain class of companies (MCA). The IND AS was published on the 16th of February, 2015, and was updated on the 17th of March, 2017 and the 30th of March, 2019.

### Key Requirements of Ind AS 7

Except in restricted cases where cash flows are offset and reported on a net basis, the statement of cash flows must disclose cash flows categorized by operating, investing, and financing activities, as well as cash and cash equivalent components at the beginning and end of the reporting period.

**Applicability –**

The cash flow statement applies to all businesses, and no form of entity is excluded from preparing and presenting one. However, according to existing AS, this statement is not required for small and medium businesses.

### Scope –

For each period for which financial statements are prepared, a business must compile a statement of cash flows in line with this standard's requirements and exhibit it as an integrated part of its financial statements.

## 5.11 COMPARISON: STATEMENT OF CASH FLOW (AS - 3) WITH CONVERGED IND AS-7 AND WITH IAS 7

There are no significant differences between existing accounting standard (AS 3) and converged accounting standard (Ind AS 7). AS-3 exempts certain companies from preparation of a cash flow statement, that is, firm which is not listed, / have not accepted deposits exceeding Rs 10 crore, which are not engaged in banking and insurance activities and have annual turnover not exceeding Rs 50 crore are not required to prepare cash flow statement. No such exemption has been mentioned in the Ind AS 7. Accordingly, all companies covered by Ind AS will be required to prepare and present a cash flow statement.

**COMPARISON: STATEMENT OF CASH FLOW (AS - 3) WITH IAS -7,** In the case of non-financial organisations, IAS 7 allows the interest paid and interest and dividends received to be classified as operating cash flows. AS -3 does not allow for this and instead mandates that these items be classed as finance and investment activity, respectively.

The dividend paid might be classified as an operating activity under IAS 7. AS 3 demands, however, that it be classed solely as a part of financing activity.

## 5.12 USES OR OBJECTS OF CASH FLOW ANALYSIS

A Cash flow statement is a vital tool of financial analysis, essential for short-term financial planning. The major uses of cash flow statement are as follows -

A. It is useful to the management for evaluating the current cash position;

B. It is helpful in determining the short-term solvency and debt repayment capacity of the firm.

C. It assists management in evaluating historical cash cycle behaviour and regulating future cash uses.

D. It helps to know the cash generation through normal business operations and other financial sources during the period under review.

E. It helps to know the ways through which cash outflow has taken place in the business.

F. It helps in the formation of policies concerning dividend, expansion of business, acquisition of assets etc.

G. It is useful for outsiders also such as lenders, bankers, creditors and investors.

**Check Your Progress 4**

1) What are the major non-cash items in the preparation of cash flow statement?

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2) List the major classification of cash flows as per AS -3 (Revised).

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3) Distinguish between AS -3 Cash Flow Statement and IAS 7 -Statement of Cash Flows.

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4) How will you calculate cash flows from Operating Activities as per direct and indirect method of AS 3?

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5) The following transactions have been extracted from the records of M/S Sangeeta Automobiles Ltd, calculate the resulting cash flow and state the nature of cash flows e.g. Operating, Investing and Financing -

(a) Paid Rs 10,00,000 to acquire shares in IRCTC Ltd and received a dividend of Rs 1,00,000 after acquisition of shares.

(b) Sold furniture of which original cost of Rs 6,00,000 with an accumulated depreciation of Rs 4,20,000 for Rs 80,000 only.

(c) Acquired Building for Rs 45,00,000 paying 1/3$^{rd}$ down and executing a bond for the balance amount.

Ans :

| (a) **Cash Flows from Investing Activities** | **Rs.** |
|---|---|
| Purchase of shares | ( 10,00,000 ) |
| Dividend Received on Shares | 1,00,000 |

| (b) **Cash Flows from Investing Activities** | |
|---|---|
| Sale of Furniture | 80,000 |
| **(c) Cash Flows from Investing Activities** | |
| Purchase of Building ( 1/3 of Rs 45,00,000) | ( 15,00,000 ) |

## PRACTICAL ASSIGNMENT

**Select any company which you like from the listed in any stock exchange, examine the cash flow statements for the last three years. What inferences can you draw from them?**

## 5.13 SUMMARY

We attempted to illustrate the concept of money flow analysis and to discuss the reasons for changes in working capital between two dates in this unit. We began by tracing the various sources of funds, such as the issue of shares, debentures or loans, and the sale of fixed assets and investments, as well as the various possible applications of funds, such as the redemption of preference shares, debentures, repayment of bank loans, purchase of fixed assets and investments, and payment of taxes and dividends. The entire procedure discloses the regions where money is spent and the sources from which it is collected. Finally, we learnt how to do a money flow analysis using publicly available accounting information.

In the next part of this unit, you learnt that cash is the key resource to any business decisions so the study of cash flow statement has become necessary to know the details of cash flow position between two dates in the organisation. Cash Flows can be classified into three activities e.g. Cash flows from Operating Activities, Cash

flows from investing activities and Cash flows from financing activities. An attempt has also been made to distinguish between the Cash Flow Statement as per the AS 3 and Ind AS 7 wherein there is no significant difference between existing AS and converged IND AS 7 except that the cash flow statement will be mandatory to all companies which are covered by the Ind AS. Cash flow statement in its actual and forecast form is used for various management decisions. But presently, it is also reported to the various external users of accounting information.

## 5.14 KEY WORDS

**Cash -** it includes cash, demand deposits and cash equivalents.

**Cash Balance:** It includes both cash in hand and cash at bank. It also includes both opening and closing balances.

**Cash Equivalents:** Cash equivalents are short-term highly liquid investments I.e. Government securities that may be converted into spendable cash resources without delay or loss in value.

**Cash Cycle** measures the amount of time that cash is tied up in operations.

**Cash Flow:** Variation in the firm's cash situation.

**Fund:** Fund means working capital.

**Fund Flow:** Flow of funds means changes occurred two different time periods.

**Funds from Operations:** The variation in working capital as a result of operations.

Inflow of funds in the form of revenue vs outflow of funds in the form of expenses is the difference.

**Sources of funds:** We use these sources of working capital to fund additional projects. Sources include operations, exceptional earnings, fixed asset sales, new long-term borrowings, fresh capital issuance, and the decrease of existing working capital.

**Statement of Changes in Working Capital:** Keeping track of the changes in current assets and liabilities throughout time.

**Use of Funds:** The use of additional working capital, also known as application of funds, includes amounts lost in operations (operating loss), acquisition of fixed assets, working capital used to retire long-term debts, dividend payments, and amounts used to expand working capital.

**Working Capital:** The current asset-to-current liability ratio is the difference between current assets and current liabilities.

## 5.15 SELF-ASSESSMENT QUESTIONS/EXERCISES

1) What exactly is working capital, and what factors influence the amount of working capital in a business?

2) "Current assets to an extent are financed by current liabilities" Explain.

3) "Operations provide funds" Comment.

4) Differentiate between "Schedule of Changes in Working Capital" and "Fund

Flow Statement.

5) Is a huge balance in Retained Earnings an indication of a significant cash balance?

6) "Net Profit of a business cannot pay dividend". Comment.

9) Prepare a schedule of changes in working capital with imaginary figures.

10) What is Cash Flow Statement? What are the advantages of preparing such a statement?

11) Discuss in brief the major classification of cash flows as per AS -3 (Revised)

12) With reference to AS -3, explain the distinction between direct and indirect ways of reporting cash flows from operating activities.

13) Write short Notes -

(a) Operating Activities

(b) Investing Activities

(c) Financing Activities

14) In what way the preparation of cash flow statement as per the existing AS-3 is different with the converged IND AS-7?

15) Explain briefly the steps to be followed in preparing a fund flow statement.

16.

The comparative balance sheet of M/s Anshul Ltd. as on 31st March, 2021 and 2022 were as follows:

| Items | 31st March | |
|---|---|---|
| | 2021 (Rs) | 2022 (Rs) |
| **Assets:** | | |
| Land and buildings | 1,02,000 | 1,10,000 |
| Plant and machinery | 56,000 | 44,000 |
| Sundry debtors | 32,000 | 24,000 |
| Inventory | 70,000 | 61,000 |
| Bills receivables | 23,000 | 17,000 |
| Cash and bank balance | 40,000 | 47,000 |
| Total | 3,23,000 | 3,03,000 |

| Items | 31st March | |
|---|---|---|
| | 2021 (Rs) | 2022 (Rs) |
| **Liabilities:** | | |
| Share capital | 1,40,000 | 1,30,000 |
| Debentures | 38,400 | 28,600 |
| Reserves | 97,900 | 1,02,550 |
| Provision for taxation | 2,700 | 2,850 |
| Proposed dividend | 24,000 | 18,000 |
| Bills payable | 10,000 | 10,000 |
| Sundry creditors | 10,000 | 11,000 |
| Total | **3,23,000** | **3,03,000** |

Prepare a schedule of changes in working capital.

17. The Balance Sheets of Self Reliance Ltd, Aligarh are as under -

**Balance Sheet of Self Reliance Ltd.**

| Liabilities | 31st Dec. 2020 | 31st Dec. 2021 | Assets | 31st Dec. 2020 | 31st Dec. 2021 |
|---|---|---|---|---|---|
| Share capital | 2,00,000 | 2,30,000 | Plant &Machinery | 1,90,000 | 2,10,000 |
| Trade Creditors | 80,000 | 1,00,000 | Building | 1,05,000 | 1,37,000 |
| Bank loan | 40,000 | 25,000 | Inventory | 20,000 | 27,000 |
| Mortgage | - | 25,000 | Sundry debtors | 40,000 | 55,000 |
| Profit & Loss A/c | 65,000 | 83,000 | Cash | 30,000 | 34,000 |
| | 3,85,000 | 4,63,000 | | 3,85,000 | 4,63,000 |

Prepare from the above comparative balance sheet:

(a) A schedule of change in working capital; and
(b) Funds flow statement.

18. From the following information from Mitali electronic Ltd; you are required to prepare cash flow statement as per AS-3 for the year ended 31st March 2022.

| **LIABILITIES (Rs)** | **2021 (Rs)** | **2022** |
|---|---|---|
| Capital | 5000000 | 5000000 |
| Retained earnings | 2650000 | 3690000 |
| Debentures | 0 | 900000 |
| Current Liabilities: | | |
| Bank loan | 330000 | 270000 |
| Divided payable | 150000 | 300000 |
| Creditors | 150000 | 300000 |
| Liabilities for expenses | 880000 | 820000 |
| | 91,60,000 | 1,12,80,000 |
| **ASSETS** | | |
| Current assets: | | |
| Cash | 1520000 | 1820000 |
| Prepaid expenses | 90000 | 120000 |

| | | |
|---|---|---|
| Inventories | 1180000 | 1500000 |
| Marketable securities | 2010000 | 1920000 |
| Debtors | 2390000 | 2830000 |
| Less: Provision | -150000 | -190000 |
| Plant and machinery | 2730000 | 4070000 |
| Less: Depreciation provision | -610000 | -790000 |
| | 91,60,000 | 1,12,80,000 |

Additional Information:

1. Net Profit for the year ended 31st March 2022 is Rs 22,40,000.
2. Mitali Electronics Ltd. Declared dividend (amount to be ascertained) for the year 2021-2022.

19. From the following balance sheets and additional information, prepare a Cash Flow Statement of Raj Woods Limited -

| Liabilities | 31st March 2021 | 31st March 2022 | Assets | 31st March 2021 | 31st March 2022 |
|---|---|---|---|---|---|
| Share capital | 14,80,000 | 14,90,000 | Plant &Machinery | 8,00,000 | 8,60,000 |
| Trade Creditors | 3,60,000 | 4,10,000 | Building | 5,00,000 | 5,50,000 |
| Bank loan | 3,00,000 | 4,50,000 | Land | 2,00,000 | 3,00,000 |
| | | | Inventory | 2,50,000 | 2,20,000 |
| | | | Sundry debtors | 3,50,000 | 3,84,000 |
| | | | Cash | 40,000 | 36,000 |
| | 21,40,000 | 23,50,000 | | 21,40,000 | 23,50,000 |

Additional Information -

(a) Provision for depreciation on Plant & Machinery as on 31st March, 2021 was Rs. 2,70,000 and on 31st March, 2022 - Rs 3,60,000.

(b) A machine costing Rs 80,000, accumulated depreciation Rs 20,000 was sold during the year for Rs 30,000.

(c) Dividend for the year 2021 was paid of Rs 2,40,000 in 2021-22.

## 5.16 ANSWERS TO SELF ASSESSMETN QUESTIONS

16.

M/s Anshul Ltd.

**Schedule of Changes in Working Capital**

| Items | 2021 (Rs) | 2022 (Rs) | Effect on Working Capital (Rs) | |
|---|---|---|---|---|
| | | | Increase(+) (Rs) | Decrease(-) (Rs) |
| A. Current Assets: | | | | |
| Sundry debtors | 32,000 | 24,000 | | 8,000 |
| Inventory | 70,000 | 61,000 | | 9,000 |
| Bills receivables | 23,000 | 17,000 | | 6,000 |
| Cash and Bank balance | 40,000 | 47,000 | 7,000 | |
| Total Current Asset(A) | | | | |
| | 1,65,000 | 1,49,000 | | |
| B. Current Liabilities: | | | | |
| Provision for taxation* | | | | 150 |
| Proposed dividend* | | | 6,000 | |
| Bills payable | 2,700 | 2,850 | | |
| Sundry creditors | 24,000 | 18,000 | | 1,000 |
| | 10,000 | 10,000 | | |
| Total Current Liabilities(B) | 10,000 | 11,000 | | |
| Working Capital (A-B) | 46,700 | 41,850 | | |
| | 1,18,300 | 1,07,150 | | |
| Decrease in working capital | | 11,150 | | |
| | | | 11,150 | |
| | 1,18,300 | 1,18,300 | 24,150 | 24,150 |

***Both the items are treated as current items.**

**17.**

**Self Reliance Ltd.**

**Statement of Changes in Working Capital**

| Items | 2020 (Rs) | 2021 (Rs) | Effect on Working Capital (Rs) | |
|---|---|---|---|---|
| | | | Increase(+) | Decrease(-) |
| **A.Current Assets**: | | | | |
| Trade debtors | 40,000 | 55,000 | 15,000 | |
| Inventory | 20,000 | 27,000 | 7,000 | |
| Cash | 30,000 | 34,000 | 4,000 | |
| Total Current Asset(A) | 1,65,000 | 1,49,000 | | |
| **B. Current Liabilities:** | | | | |
| Trade creditors | 80,000 | 1,00,000 | | 20,000 |
| Total Current Liabilities(B) | 80,000 | 80,000 | | |
| Working Capital (A-B) | 10,000 | 16,000 | | |
| **Increase in working capital** | 6,000 | | | 6,000 |
| | 16,000 | 16,000 | 26,000 | 26,000 |

## Working Note:

The increase in working capital is ascertained by subtracting working capital of 2020 from the working capital of 2021. The working capital for 2020 and 2021 is calculated as under:

Working capital as on 31$^{st}$ December, 2020:

= Total Current Assets – Total Current Liabilities
(as on 31$^{st}$ Dec.,2020) (as on 31$^{st}$ Dec., 2020)

=Rs 90,000- Rs 80,000 = Rs 10,000

Working capital as on 31$^{st}$ December, 2021:

= Total Current Assets – Total Current Liabilities
(as on 31$^{st}$ Dec., 2021) (as on 31$^{st}$ Dec., 2021)

=Rs 1, 16,000- Rs 1, 00,000 = Rs 16,000

Therefore, increase in working capital = Working capital as on 31$^{st}$ Dec., 2021- Working capital as on 31$^{st}$ Dec., 2020

=Rs16, 000 – Rs 10,000 = Rs 6,000

## Funds Flow Statement

| Sources | Amount (Rs) | Applications | Amount (Rs) |
|---|---|---|---|
| Share capital (2,30,000- 2,00,000)<br>Mortgage<br>Profits/Funds from operation (83,000 – 65,000) | 30,000<br><br>25,000<br>18,000 | Plant and machinery (2,10,000 – 1,90,000)<br>Building (1,37,000 – 1,05,000)<br>Bank Loan (40,000 – 25,000)<br>Increase in working capital | 20,000<br><br>32,000<br><br>15,000<br><br>6,000 |
| | 73,000 | | 73,000 |
| | | | |

*Note: In the above question, working accounts and notes have not been prepared as there is no adjustment item.*

*18.*

| | |
|---|---|
| Net cash inflow from operating activities | Rs 19,60,000 |
| Net cash inflow from investing activities | Rs (13,40,000) |
| Net cash inflow from financing activities | - |
| Total net increase in cash flow | Rs 6,20,000 |

19.

| | |
|---|---|
| Cash Generated from Operations | Rs 3,90,000 |
| Net cash inflow from operating activities | Rs 4,36,000 |
| Net cash inflow from investing activities | Rs (3,50,000) |
| Net cash inflow from financing activities | (90,000) |
| Total net increase in cash flow | Rs (4,000) |

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