

A Detailed study of contemporary AS3 –Cash Flow Statement

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Abstract

Information about the cash flow of an enterprise is useful in providing users of financial statements with basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilize these cash flows. The standard deals with the provision of information about the changes in cash and cash equivalents of an enterprise by means of a cash flow statements which classifies cash flows during the period from operating, investing and financing activities. This paper deals in cash flow statements and their practical relevance with respect to economic decisions that are taken by users require in evaluation of the ability of an enterprise to generate cash and cash equivalents are the timing and certainty of their generation.

Keywords: Cash Flow Statement, Operating, Investing, Financing Activities

1. Introduction

1.1 Scope

An enterprise should purpose a cash flow statement and should present it for each period for which financial statements are presented.

Users of an enterprise's financial statements are interested in how the enterprise generates and uses cash and cash equivalents.

This is the cash regardless of the nature of the enterprises activities and irrespective of whether cash can be viewed as the product of the enterprise, as may be the case with a financial enterprise.

Enterprise need cash for essentially the same reasons, however different their principal revenue-producing activities might be. They need cash to conduct their operations, and to provide returns to their investors.

2. Benefits

A cash flow statements, when used in conjunction with the other financial statements, provides information that enables used to evaluate the changes in net assets of an enterprise, its financial structure and its ability to affect the amounts and finings of cash flows in order to changing circumstances and opportunities.

It also enhances the comparability of the reporting of operating performance by different enterprises because it aliments the effects of using different accounting treatments for the same transactions and events.

Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents and comparing the present value of the future cash flows of different enterprises.

Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows.

It also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.

3. Definition

Cash: Comprises cash on hand and demand deposit with banks

Cash & Cash Equivalent: Our short term, highly liquid investments that are readily convertible in to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows: Are inflows and outflows of cash and cash equivalents.

Financing Activities: Are activities that result in changes in the size and composition of the owner's capital and borrowings of the enterprise.

Investing Activities: Are the acquisition and disposal of long-term assets & other investments not included in cash equivalents.

Operating Activities: Are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

4. Cash and Cash Equivalents

- a. Cash equivalents are hold for the purpose of meeting short-term cash commitments rather than for investment or other purposes.
- b. For an investment to qualify as a cash equivalent, it must be ruddily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Also it should have a short maturity, of say, 3 months or less from the date of acquisition.
- c. Investment in shares are excluded from cash equivalents unless they are, in substance, cash equivalents; for example shortly before their specified redemption date (provided there is only an insignificant risk of failure of the company to repay the amount at maturity).
- d. Cash flows exclude movement between items that constitute cash or cash equivalents because these components are part of the cash management of an enterprise rather than part of its of wating investing and financing activities.

5. Presentation of a cash flow statement

- a. The cash flow statement should report cash flows during the period classified by operating, investing and financing activities.
- b. An enterprise presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business.
- c. Classification by activities provides information that allows users to assess the impact of these activities on the financial position of the enterprise and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.
- d. A single transaction may include cash flows that are classified differently. For eg:- when the installment paid in respect of a fixed asset acquired on different payment basis includes both interest and loan, the interest element is classified under financing activities and the loan element is classified under investing activities.

6. Operating Activities

- a. The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows to maintain the operating capability of the enterprise, pay dividends, repay loans and make new investments without recourse to external sources of financing.
- b. Information about the specific components to historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.
- c. Cash flows from operating activities are primarily derived from the principal revenue – producing activities of the enterprise.
- d. They generally result from the transactions and other events that enter in to the determination of net profit or loss.

7. Examples of Cash Flow

7.1. Operating Activities

- Cash receipts from the sale of goods and the rendering of services.
- Cash receipts from royalties, fees, commissions and other revenue.
- Cash payment to suppliers for goods and services.
- Cash payment to and on behalf of employees.
- Cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits.
- Cash payment on refunds of income taxes unless they can be specifically identified with financing and investing activities and
- Cash receipt and payment relating to futures contracts, forward contracts, option contracts and swap contracts when the contracts are help for dealing or trading purposes.

Some transaction, such as the sale of an item of plant, may give rise to a gain or loss which is included in the determination of net profit or loss, however, the cash flows relating t such transaction are cash flows from investing activities.

7.2. Investing Activities

The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditure have been made for unsources invented to generate future income and cash flows.

7.3. Examples

- Cash payment to acquire fixed assets (including intangibles). The payment include those relating to capitalized research and development costs and self-constrernated fixed assets.
- Cash receipts from disposal of fixed assets
- Cash payment to acquire shawls, warrants or debt instruments of other enterprises and interest in joint ventures (other than those which are hold for dealing or trading purposes)
- Cash advances and loans made to third parties (other than advances and loans made by a financial enterprise)
- Cash receipts from future contract, forward contracts
- Cash payment for futures contracts and forward contracts.

8. Financing Activities

The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise.

Examples of Cash Flows from Financing Activities:

- Cash proceeds from issuing shows or other similar instruments.
- Cash proceeds from issuing debentures, loans notes, bonds, and other short or long-term borrowings.
- Cash repayments of amounts borrowed.

9. Other points

Reporting on cash flow from operating activities

An enterprise should report cash flows from operating activities using either.

- 1- The **direct method** where by major classes of gross cash receipts and gross cash payment are disclosed;

Or

- 2- The **indirect method** where by net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipt or payments, and items of income or expense associated with investing or financing cash flows.

1. Under the **Direct Method** information about major classes of gross cash receipt or cash payment may be obtained for;

- From the accounting records of the enterprise or
- By adjusting sales cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise) and other items in the statement of P/L for
 - (a) Changes during the period in inventories and operating receivables and payables.
 - (b) Other non-cash items
 - (c) Other items for which the cash effects are investing or financing cash flows.

2. Under the **indirect method** the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of.

- Changes during the period in inventories and operating receivable and payables
- Non-cash items such as depreciation, provisions deferred taxes, and unrealized foreign exchange gains and losses and
- All other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow operating activities may be presented under the indirect method by showing the operating revenues and expenses excluding non-cash items disclosed in the statement of P/L and the changes during the period in investors and operating receivables and payable.

10. Extraordinary Items

The cash flows associated with extraordinary item should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.

The cash flows associated with extraordinary items are disclosed separately as arising from operating, investing or financing activities in the cash flow statements, to enable users to understand their nature and effect on the present and future cash flows of the enterprise.

These disclosure are in addition to the separate disclosure of the nature and amount of extraordinary items required by Accounting Standard (AS) 5, net profit or loss for the period, prior period items and changes in Accounting policies.

11. Non-Cash Transaction

Investing and Financing: transaction that do not require the use of cash or cash equivalents should be excluded from a cash flow statement. Such transaction should be disclosed elsewhere in the financial statement in a way that provides all the relevant information about these investing and financing activities.

Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an enterprise. The exclusion of non-cash transaction from the cash flow statement is consistent with the objective of a cash flow statement as these do not involve cash flows in the current period.

Examples of non-cash transaction are:

- Acquisition of assets by assuming directly related liability
- Acquisition of an enterprise by means of issue of shares
- The conversion of debt to equity

12. Interest and Dividends

Cash flow from interest and dividends received and paid should each be disclosed separately.

Cash flow arising from interest paid and interest dividends received in the case of a financial enterprise should be classified as cash flows arising from operating activities.

In the case of other enterprise, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities.

Dividends paid should be classified as cash flows from financing activities.

Interest paid and interest and dividends received are usually classified as operating cash flows for a financial enterprise.

It is mainly appropriate that interest paid and interest and dividends received are classified as financing cash flows and investing cash flows respectively, because they are cost of obtaining financial resources or returns on investments.

13. Taxes on Income

Cash flows arising from taxes and income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

Taxes on income arise on transaction that give rise to cash flows that are classified as operating investing or financing activities in a cash flow statement.

While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transactions.

Therefore, taxes paid are usually classified as cash flows from operating activities. However when it is practicable to identify tax cash flows with an individual transaction that give rise to cash flows that are classified as investing or financing activities, the tax cash flow is classified investing or financing as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

14. Components of Cash and Cash Equivalent

An enterprise should disclose the components of cash and cash equivalent and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.

In view of the variety of cash management practices, an enterprise disclose the policy which it adopts in determining the composition of cash and cash equivalent.

The effect of any change in the policy for determining components of cash and cash equivalent is reported in accordance with (AS) 5, net profit or loss for the period, prior period items and changes in Accounting policies.

15. Other Disclosures

An enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it.

There are various circumstances in which cash and cash equivalent balances held by an enterprise are not available for use by it.

Examples include cash and cash equivalent balances held by a branch of the enterprise that operated in a country where exchange controls or other legal structure apply as a result of which the business balances are not available for the use of the enterprise.

Additional information may be relevant to the uses in understanding the financial position and liquidity of an enterprise. Disclosure of this information, together with a commentary by management is encouraged and may include:

- a) The amount of undrawn borrowing
- b) The aggregate amount of cash flows that represent increase in operating capacity separately from these cash flows that are required to maintain operating capacity.

16. Conclusions

1. A cash flow statement is a statement showing inflows (receipts) and out flows (payment) of cash during a particular period. It is a summary of sources and applications of cash during a particular span of time. It analyses the reasons for changes in balances of cash between the two balance sheet dates.
2. It includes only those items which affect cash. It is also called "statement of changes in financial position-cash basis" or a funds-flow statement-cash basis".
3. A cash – flow statement can be for the past or can be projected for a future period.

17. Suggestions

1. In cash of financial enterprise such as Bank or Mutual Fund company cash outflow and inflow arising from the purchase and sale of securities will be treated as flows from operating activities. This is because, purchase and sale of securities is a part of operating activities in cash of financial enterprises.
2. Interest paid and interest paid or received as well as dividend received will also be treated as cash flows from operating activities in case of financial enterprises.
3. (a) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds 50 corer. Turnover does not include 'other income'.
(b) All commercial industrial and business reporting enterprises having borrowing, including public deposit, in excess of 10 corer at any time during the accounting period.
(c) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

Such companies are however encouraged to comply with the standards.

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