


Financial Accounting
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Lecture – 17
Cash Flow Statement 4

Namaste. Welcome everybody we have been discussing about Cash Flow Statement. I hope you have gone through the given notes and understood what is a cash flow statement; please also have a look at cash flow statement for your own company. Today we will do second case on cash flow statement which will cover various aspects related to preparation of the statement, a small revision before that.

(Refer Slide Time: 00:52)


Cash Generated from Operations	
Retained Earning	XX
Dividend	XX
Net Profit After Tax	XX
Add: Provision for Tax	XX
Net Profit Before Tax	XX
Add: Non-cash Expenses	
Depreciation	XX
Amortisation (Goodwill w/o)	XX

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If you remember in the cash flow statement there are three sections, one is cash from operations cash flows from operations, second is cash flows from investing activities and third is cash flows from financing activity. In the first part we calculate the cash generated from day to day activities of the business and normally it is done using indirect method. So, we start with profit, then add back noncash items or non operating items, we make adjustment for some of the items which need to be deducted.

(Refer Slide Time: 01:39)

Adjust: Non-operating items	XX
Loss on sale of Asset/Investment	XX
Interest expenses	XX
Interest/ Dividend Income	(XX)
Profit on sale of Asset/ Investment	(XX)
Funds from Operations	XX




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3

So, in short we can say that the depreciation should be added or items like loss or interest expenses are added, while items like interest income or profit on sale of investments are reduced.

(Refer Slide Time: 02:04)

Adjust: Working Capital Items	XX
Decrease in Current Asset	XX
Increase in Current Liabilities	XX
Increase in Current Asset	(XX)
Decrease in Current Liabilities	(XX)
Cash generated from operation	XX
Income Tax Paid	(XX)
Cash flow from operating activities	XX



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4

That gives you funds from operations, then we also have to make adjustment for working capital items, we need to make adjustment for income tax that gives you cash flow from operating activities.

(Refer Slide Time: 02:18)




Cash Flow from Investing Activities	
Purchase of Assets / Investment	(XX)
Sale of Assets / Investment	XX
Interest / Dividend received	XX
Investment in joint venture	(XX)
Cash flows from investing activities	XX

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5

Next one is pretty simple all those items which are related to investment both inflows and outflows like purchase or sale of assets or interest received, they are all shown under the head investing activities.

(Refer Slide Time: 02:34)



Cash Flow from Financing Activities	
Issue of shares/ debentures for cash	XX
Redemption of Preference shares/ debentures	(XX)
Interest / Dividend paid	(XX)
Proceeds from borrowings	XX
Repayment of loan	(XX)
Cash flows from financing activities	XX

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6

Third one is financing activities, where we show all those items related to raising of funds by the business like issue of shares or issue of debentures or taking loan and the reverse of this, that is redemption of share or redemption of debenture or repayment of loan interest or dividend paid there on.

(Refer Slide Time: 03:00)

Cash Flow Statement

1. Cash Flow from Operating Activities	XX
2. Cash Flow from Investing Activities	XX
3. Cash Flow from Financing Activities	XX
Net Increase / decrease in cash (1+2+3)	XX
Cash & Cash Equivalents at the beginning	XX
Cash & Cash Equivalents at the end	XX

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So, these are the three headings, then we take the total of the three and that we match with the increase or decrease of cash during that particular period. We have already done one case now we will go for the second case.

(Refer Slide Time: 03:20)

Case 2.

Prepare cash flow statement from the following details of Keshav Ltd.

Profit and Loss A/c for the year ending 31 March 2020 is as follows

Sales	90000
Profit on sale of investment	2000
Revenue from Services	6000
Total	98000


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So, with this introduction now we prepare for the second case, it will be better if you take the printout of this particular case so, that you can actually solve as I am also solving it ok. Now look at the given data, we have been given profit and loss account for year 31st March 2020.

So, sales profit on sale of investment and revenue from services total is 98000.

(Refer Slide Time: 03:52)

Total	98000
Consumption of Materials	40000
Manufacturing Expenses	17000
Wages	1400
Depreciation	5000
General Expenses	3000
Discount on issue of debenture	3000
Tax	6000
Interim Dividend	5000
Profit Retained	17600

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Now, from these there are deductions like consumption of material, manufacturing expenses, wages, depreciation, general expenses, discount on issue of debentures, tax, interim dividend and we have got profit retained which is 17600. We have also been given 2 years figures of balance sheet for March 19 and March 2020.

(Refer Slide Time: 04:23)

Balance Sheet of Keshav Ltd		
	2019	2020
Liabilities		
Share Capital	50000	50000
General Reserve	10000	10000
Profit and Loss A/c	8000	25600
Debentures	10000	27000
Creditors	16000	10000
Differed Tax Liability	7000	12000
	101000	134600

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(Refer Slide Time: 04:29)

	2019	2020
Assets		
Land	40000	40000
Equipment	21000	55600
Investment Long Term	5000	3000
Sundry Debtors	15000	14300
Bank	5000	6700
Goodwill	15000	15000
	101000	134600



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20

So, again you can see certain items of liabilities and certain items of assets. Now using this information you are required to prepare cash flow statement ok. So, how shall we go about? You all know that if there is a change in the balance sheet between the 2 years that should be considered as most likely item of impact on cash. So, let us start with balance sheet, take every item of balance sheet and we will mark it as inflow or outflow and also as either as O, I or F if we feel that some moment has happened.

So, let us start with share capital share; capital you can see there is no moment, general reserve again no moment for profit and loss account we do see increased from 8000 to 25600. Now, this change is more slightly to have some impact on cash flow.

(Refer Slide Time: 05:46)

Cash Flow statement				
	2019	2020	change	OIF
Liabilities				
Share Capital	50000	50000	0	
General Reserve	10000	15000	0	
Profit and Loss A/c	8000	20600	17600	O
Debentures	10000	27000	17000	F
Creditors	16000	10000	-6000	CACL
Differed Tax Liability	7000	12000	5000	O
	101000	134600	33600	

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Now, it is what type of item? I will just take you to the solution. So, normally make five columns like this particular than 2 years figures change and OIF. Now, is there a change here in case of cash flow? Yes now we want to mark it as O,I or F. Now you all know that the change in the profit and loss account is due to the profit accumulated during the year and it is mainly the operating related item. So, we have marked it as O; now this is our working, this does not mean exact amount will go in cash flow statement, but to start with we are going to mark every change. We will also have a look at P and L items and then after considering both we will go for preparation of cash flow.

Now, the next one is debentures; you can see debentures there is a increase from 10000 to 27000. So, it is what type of item? You know that debenture is for raising of funds and from 10000 it has increased to 27. So, 17000 increase; that means, new debentures are issued. So, we will consider it as a what type of item? O or I or F, it is a F type of item that is financing item.

Next one is creditors. Creditors you can see 16 to 10. So, it is a fall of 6000. Now it is what type of item? Is it operating, investing or financing or none of the above? Actually only three categories so, none of the above does not exists, but it is not investment, it is not finance also and this is a item which is related to normal activities of the business. So, we will mark it as O particularly it is a working capital item ok. So, you can see here 16 to 10. So, minus 6 and this is I have marked it as CA or CL; that means, I know it is a

current liability, but I have marked it as CACL because it is something to do with current assets and liabilities; actually how to treat it we will go in the next step.

Next is differ tax liability it is gone up from 7 to 12. So, plus 5000 and taxation is a operating item. So, I have marked it as O. Are you clear? So, like this for every item in balance sheet assigned O, I or F or CACL; CACL is a part of O actually now this will help us for preparation of cash flow let us go to assets.

(Refer Slide Time: 08:44)

Cash Flow statement				
	2019	2020	Change	OIF
Assets				
Land	40000	40000	0	
Equipments	21000	55600	34600	I
Investment Long Term	5000	3000	-2000	I
Sundry Debtors	15000	14300	-700	CACL
Bank	5000	6700	1700	C
Goodwill	15000	15000	0	
	101000	134600	33600	

Now, in assets again there are changes. So, land there is no change equipment it has gone up from 21 to 55600. Now, it is what type of item? Is it F? Is it? I? I think the answer is yes we have made investment in the equipment new equipments have been purchased. So, write the change here and mark that change as I item ok 34600 I. Next is investment long term you can see investment has gone down from 5000 to 3000. So, minus 2000 it is investment so; obviously, it is a investing item; so, I category of item: sundry debtors. Sundry debtors you can see has gone down from 15000 to 14300.

So, it is minus 700, what type of item it is? You know it is a current asset. So, it is marked as CACL, next one is bank. Bank has gone up from 5000 to 6700. So, 1700 what type of item it is? O, I or F I think many would have marked it as O because it is a current asset or you can mark it as CACL, but in reality it is not be caution because bank balance is a part of your cash balance. So, we are making a cash flow statement any change in the cash balance is not to be shown in the cash flow.

We will take it in the last part of cash flow statement as a reconciliation ok. So, what I have done is for convenience, you can see here sundry debtors are marked as CACL and bank is marked as C; C means cash. So, it is cash and cash equivalent kind of item goodwill there is no change so 0. I hope you are getting, once again I am taking you to balance sheet liabilities, have a look at all the items you will realize that normally in the liability side there are F type of items or O type of items.

And normally in assets there will be I type of items because there will be investments like fixed assets or investments and there would be O type of items or CACL type of items are you getting? Now let us go back to P and L from profit or loss account have a look at those items which will have impact on cash flow. So, suppose sales is 90000 will it have impact on cash flow? So, we would have received 90000 is it O I or F type of received?

Again many of you would have marked it as O, but keep in mind that is a not the correct answer then what type of item it is? Is it I or f the answer is no because it is an normal day to day item and in the indirect method we do not show normal items related to operations I will just take you to the actual calculation.

(Refer Slide Time: 12:41)

Keshav Ltd. Profit and Loss A/c for the year ending 31 March 2020 Marking relevant items

Sales	90000	No adj	
Profit on sale of investment	2000	IO	+-
Revenue from Services	6000	No adj	
Total	98000		

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So, this is how I have made the format, first is sales very tricky item because many times peoples feel that sales means cash has come in keep in mind we do not follow a direct method. So, we are going to take profit and loss as a starting point and only we are going

to mark three category of items. Items like depreciation which are non-cash, items like profit on sale of investments which are related to not operation something else, that is non operating items and CACL type of items are you getting me? So, in the sales the first item sales I have written it has no adjustment.

The next is profit on sale of investments which is 2000. You all know that since this is a profit on sale of investment it is a investing flow. So, I have marked it as I it will have one impact on operating flow as well because we have already considered it in P and L account, we have already added it in profit. So, we will have to reduce it from profit that is why it is a marked as both I and O. Remember balance sheet items have only one impact P and L items are going to have two impacts because balance sheet is already balance P and L accounts are coming from outside in the cash flow statements.

So, they will have two impacts on cash flow. So, they have been marked as 2; either it will not have any impact no adjustment or it will have two impacts. So, I and O in I it is plus, plus means cash is coming in and in O it is minus. This is just a working note for our understanding, but it will ease our actual making of cash flow are you getting me? Next is revenue from services you know that any revenue earn is a day to day item it is just like sales is from sale of goods. They might have also provided some services, for which they have earned 6000 this is not a cash flow item so, I have marked it as no adjustment ok.

(Refer Slide Time: 15:10)

Total	98000		
Consumption of Materials	40000	NA	
Manufacturing Expenses	17000	NA	
Wages	1400	NA	
Depreciation	5000	O	+
General Expenses	8000	NA	
Discount on issue of debenture	3000	OF	+
Tax	6000	OO	+-
Interim Dividend	5000	FO	+-
Profit Retained	17600	O	+

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Let us go to the next one. So now, consumption of material 40000: where we need go OIF? I will request you to mark all the items; manufacturing, wages, depreciation, general expenses and so, on are you able to make up your mind? Even if it goes wrong no problem mark it and then we will go to the next step just mark whatever you feel.

So, consumption of raw material materials will go as a O item. Maybe few of you have made mistake it is not a O item it is a no adjustment item. So, ignore it put a dash or write no adjustment; manufacturing expenses again same thing it is a normal day to day item. So, no adjustment; wages no adjustment: depreciation again no adjustment? No it has. Because it is a non-cash item though it is reduced from P and [laughter], it is not involving any cash outflow. So, we will mark it as O it will also have some impact on the equipment or the machinery account. So, in O that is in the operating flows it is going to be added.

So, I have marked it as plus and in I that is in the machinery we will mark it as minus. So, depreciation OI plus and minus getting? This will be true for all non cash items they will be added in the cash flow statement. General expenses no adjustment; discount on issue of debentures will it involve any cash flow? Indirectly yes because when we issue debentures we should have got cash, but to the extent of discount we will not receive cash its a F type of item, it will also have impact on operating flows because it is one of our expenses, but it does not involve any cash ok.

So, I have marked it as OF getting it? In operations its plus and in F it will have minus. Tax 6000 I think most of you are judged it correct it is a O type of item, but this 6000 does not mean it is cash tax paid, this much of tax has been charged for the year do you will have to look at the balance sheet item and then finally, decide how much tax is paid ok. So, right now I have marked it as O, O because it will come two times in the operating flows and marked it as plus and minus.

Because again it comes two times, exact amount we will determine later on. Interim dividend do you remember what is interim dividend? Dividend represents the share of profit which is paid to the shareholders. If it is paid during the year it is called as interim dividend. Now interim dividend is a F type of item it is a financing outflow, but it will


have an impact on O because it is rooted through P and L. So, I have marked it as FO minus and plus.

Minus because it is an outflow in financing we will add it in O. So, I have written it as plus last item profit retained again it is O, because it comes from day to day activities and we will mark it as plus. If you remember the second effect of profit written is there in the balance sheet. So, now, we have marked all items of P and L we have also marked all items of balance sheet. I hope you have understood it is very important for you to properly understand all these items.

Once this is clear making of cash flow statement is really very simple. Are you getting all the items? I will request you to practice a lot. Take 2 years balance sheet for any company, calculate the cash flow statement and check it with their actual cash flow statement ok. So, now, look at the answer now actual answer is very simple if you have really understood all these items, you can easily write down the final answer.

(Refer Slide Time: 20:12)

Cash Flow statement	
Retained Earning	17600
Interim Dividend Paid	5000
Net Profit After Tax	22600
Taxes Provided	6000
Net Profit Before Tax	28600
Depreciation	5000
Discount on issue of Debentures	3000
Profit on sale of investment	(2000)
Funds From operation	34600

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Now, this is in front of you in final short, but I request you to properly solve it yourself. Now, I will try to explain every item it start you know there is a particular format. So, we are starting with retained earnings 17600 from where we did you got this item? Actually it came from 2 sources: first it was given in P and L it also I had a some impact on balance sheet. Because balance sheet we had transferred the balance of P and L which is a increase of 17600 it is only one item, but it comes at two places ok. So, here retain

earnings it is a inflow see if it is a outflow you should write in bracket if it is a inflow; that means, a positive figure.

So, retained earnings 17600 to that add interim dividend paid. Now you know here we had written interim dividend 5000 as F and O. So, it is a financing item we are also going to add it for calculation of P and L. So, remember it is paid actually it is a outflow, but in P and L we add it because right now we are not showing it as a outflow, we are calculating it using it for calculation of profit. So, 17600 plus 5000 I get NPAT or Net Profit After Tax which is 22600 then tax provided.

See in P and L we had got 6000 OO of which the first effect is this the tax was reduced from profit and loss account we will add it back, we are going to take this item again, but we will look at it later on. Right now just add a back the tax we will get net profit before tax, which is 28600. Please try to solve with me so, that you also get the practice. Next is depreciation you know here in P and L we add a item of 5000 O plus. So, we are this is a non cash expense.

So, we will add back 5000 same way there was a item discount on issue of debenture in P and L we had marked it as OF in any case this 3000 is to be added in O. So, discount on issue of debenture is added. See this is only one effect the second effect we will see later on the effect related to operating activities we are looking right now. Next is profit on sale of investments. If you remember in P and L we had added these 2000 to calculate the profit now, we are going to reverse it.

So, we will reduce 2000 because it is a negative figure we will write in bracket are you getting? So, NPBT 28600 add 5000 add 3000 minus 2000. So, we are getting 34600 this is called as funds from operations. This is the money which we have generated from our operations or from our normal business that is why we have started with profit, we have removed non operating type of items now which items are yet to be shown in operating activities. Do you remember?

Items which we are related to CA or CL or related to working capital they are yet to be treated. So, we start with funds from operations, then make adjustment for debtor and creditor there are only two adjustments let us go to balance sheet to have a look at it. So, you know that in the liabilities there was a item creditors. From 16000 it has reduced to 10000 minus 6000. So, I hope you understand that we have paid 6000 getting it? That is

why the creditors balance have come down we are going to reduce it from the cash flow as minus 6000 getting it?

(Refer Slide Time: 24:54)

Funds From operation	34600
Decrease in Sundry Debtors	700
Increase in Sundry Creditors	(6000)
Cash generated from operation BT	29300
Income Tax Paid (6-5)	(1000)
Net Cash flow from operating activities	28300
Cash Flow from Investing Activities	
Sale of Investment (2000+2000)	4000
Purchases of Equipment	(39600)

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But for debtors it is exactly opposite; in the assets the debtors have gone down now debtors are going down means, these are the balances with customers they have paid us we have got more money that is why their balance has gone down. So, this minus 7000 is going to be plus in the cash flow statement getting it? I know its slightly tricky keep in mind that it will be exactly opposite for debtors and creditors.

For creditor it is minus 6 for debtor there the figure was minus so, we converted into plus or you can also remember it this way that whatever is a direction of movement in a current liability same will be for cash ok. So, current liability went down. So, cash also went down, but for a debtor which is a current asset it competes with cash. So, debtors have gone down so, cash has gone up ok. So, it is a plus 700. So, at this stage we get cash generated from operations which is 29300.

So, we will stop here, we will continue the same assignment or the same case in the next session. Namaste.